DRAFT - December XX, 2008

TO: President-Elect Obama

SUBJECT: Update on Economic Policy Work

The following memo is background for our meeting on Tuesday. It includes a discussion of our work in several areas: the Economic Recovery Act, reforms & budget savings, the medium-term budget outlook & options, and financial issues including housing, autos, TARP, and financial regulation. Portions of the memo were contributed by your CEA, OMB and Treasury designees. The memo is also informed by extensive discussions with your DPC designees, the energy team, the health team, and others inside and outside the transition.

I. THE ECONOMIC RECOVERY ACT

We have undertaken a large-scale effort to develop an American Economic Recovery Plan that helps jolt the economy out of its short-term weakness, provide relief to those hurt by the recession, and begin to make investments that will benefit America for years and decades to come. In addition to our internal policy development process we have consulted extensively at the staff and member level on the Hill, with different groups through the Office of Public Liaison (e.g., the leadership of all the major Hispanic organizations, the AARP, progressive groups, and other meeting planned for the future) and the Intergovernmental Affairs (several governors, mayors, the National Governors Association and others), and with outside economists and policymakers.

A very large package is required to address the rapidly deteriorating economic situation, but there are serious challenges in constructing a package on a scale that is far larger than previous countercyclical efforts. While the most effective stimulus is government investment, it is difficult to identify feasible spending projects on the scale that is needed to stabilize the macroeconomy. Moreover, there is a tension between the need to spend the money quickly and the desire to spend the money wisely. To get the package to the requisite size, and also to address other problems, we recommend combining it with substantial state fiscal relief and tax cuts for individuals and businesses.

A. Economic Outlook (Christina Romer)

The economic outlook is grim and deteriorating rapidly. Forecasts now expect output to contract at a 6.0 percent annual rate in 2008-Q4 (the government will release these data on January 30th), which would be the worst contraction since the early 1980s. In the absence of fiscal stimulus, most forecasts indicate continued deep contraction in the first half of 2009. Growth is not expected to turn positive until late 2009. Figure 1 shows forecasted output growth without fiscal stimulus from Macroeconomic Advisers and the Federal Reserve, both updated 12/11/08.

Most analysts are predicting that in the absence of stimulus, unemployment will peak at around 9.5 percent. Consistent with the trend over the last two recessions, unemployment is expected to return only very gradually to its normal pre-recession level, remaining above 8 percent through the end of 2011. Figure 2 shows forecasts of the unemployment rate in the absence of stimulus.

Forecasts have become decidedly more pessimistic in recent days. Macroeconomic Advisers reported the largest negative forecast revision in its history on December 8th, and on the 11th they revised down their forecast of growth in the current quarter by another percentage point (to -6.6 percent). The driving factors for the negative revisions were the extremely negative employment report from last week and the trade deficit and unemployment claims report from this week. They suggest that the pace of job loss is accelerating from the 533,000 jobs lost in November, which already was the highest rate in 34 years.

The fundamental factors driving the deterioration of both the current economy and forecasts of future performance are continued financial market disruptions, housing and asset price declines, extremely pessimistic expectations, and accelerating decline in the rest of the world.

B. Effects of Fiscal Stimulus (Christina Romer)

Changes in government purchases and taxes have important effects on output and hence on employment and unemployment. The effects of fiscal stimulus, however, vary with the type of fiscal action:

Research suggests that an increase in government purchases of 1 percent of GDP increases real GDP relative to what it otherwise would have been by approximately 1.5 percent after two years.

A permanent tax cut of 1 percent of GDP increases GDP by 0.4 percent after one year and 0.8 percent after two years. The smaller effect is due in large part to the fact that a significant fraction of a tax cut is typically saved, while spending, by definition, is spent.

A temporary tax cut has even smaller effects because consumers typically save a larger fraction of transitory gains.

When money is sent to the states, they use some of it to maintain spending, some to avoid tax increases, and some to supplement rainy day funds. Although there is less research on this topic, it is not unreasonable to assume that a permanent increase in transfers to the states of 1 percent of GDP therefore increases GDP by about 1 percent after two years.

This difference in effects suggests a useful way of measuring the effective stimulus. Transfers to the states have roughly two-thirds the impact of an increase in government purchases, and tax cuts (which usually have an important temporary component) have slightly less than half the impact. One can therefore define the effective stimulus of a package of fiscal changes by weighting government spending by 1, transfers to the states by 0.7, and tax cuts by 0.4. This measure shows what a package would be equivalent to as a change in government purchases (which then have a multiplier effect of approximately 1.5). Table 1 provides an example:

C. Needed Size of Fiscal Stimulus (Christina Romer)

How much effective fiscal stimulus would be desirable depends on the goals of policy:

Eliminating the output gap by 2011-Q1: about $1.7 trillion of legislated stimulus required. An ambitious goal would be to eliminate the output gap by 2011-Q1, returning the economy to full employment by that date. Current projections suggest that this gap will be roughly 5 percent. To eliminate this gap completely, the effective fiscal stimulus needs to be roughly $960 billion. To achieve that magnitude of effective stimulus using a feasible combination of spending, taxes, and transfers to states and localities would require a package costing about $1.8 trillion over two years.

Close more than half of the output gap by 2011-Q1: about $900 billion of legislated stimulus. Under this intermediate option $900 billion in legislated stimulus would generate about $600 billion in effective stimulus, bringing the unemployment rate down to about 6.5 percent and the output gap to around 2 percent.

Creating 2.5 million jobs (relative to the no-stimulus baseline): $500 billion of legislated stimulus. A more modest goal would be to create 2.5 million jobs (relative to the no-stimulus baseline) by 2011-Q1. This would require an effective fiscal stimulus of $400 billion, which could be achieved by passing a reasonable $500 billion package.

Effective Fiscal Stimulus and Outcomes in 2011Q1

Actual Stimulus	GDP Gap	Jobs Created	Unemployment Rate
$1.7 trillion	0.0%	6.00 million	5.1%
$900 billion	1.9	3.75 million	6.6
$500 billion	3.0	2.50 million	7.5

D. The Core Package

We have undertaken an effort, together with the policy teams, your OMB designees, and OMB career staff, to identify as much spending and targeted tax cuts as could be undertaken effectively in five priority areas: energy, infrastructure, health, education, protecting the vulnerable, and other critical priorities. The short-run economic imperative was to identify as many campaign promises or high priority items that would spend out quickly and be inherently temporary. The long-run economic imperative, which coincides with the message imperative, is to identify items that would be transformative, making a lasting contribution to the American economy. In all of these cases we had to balance various tensions, including incorporating serious reforms versus fast passage and implementation, and making the disparate components of the package coherent.

The spending and targeted tax cuts we identified represent the "core package" that we recommend as part of any of economic recover options. This package totals about $260 billion, with 75 percent of the money spending out over the first two years. We will continue to refine this package to make sure it meets our goals and reflects your input and priorities. But the overall contours, and especially the size, are unlikely to change very much. The overall package is shown in Table X. More details in all of these areas are provided in the Appendix, including discussions of critical reforms to accompany these proposals (e.g., a use-it-or-lose-it rule for infrastructure subsidies).

Table X. The Core of the Economic Recovery Act

Putting America on the Path to Energy Independence	Cost ($billions)
Jumpstarting a SmartGrid	$14
Launching New National Efficiency Effort	$20
Spurring Wave of Next-Generation Clean Technologies	$13
Tax Incentives for Green Investments & Purchases	[$15]
Subtotal	$62
Restoring and Strengthening American Infrastructure	
Immediate Investments to Repair our Roads and Bridges	$20
Creating New Infrastructure Bank	$10
Safeguarding Drinking Water and Wastewater Systems	$5
Modernizing Federal Buildings and Lands	$8
Modernizing Airports and Air Traffic Control	$1
Providing New, Clean Transportation Options	$5.5
Increasing Availability of Affordable Public Housing	$5
Restoring U.S. Leadership on Broadband Access	$6
Subtotal	$60.5
Transforming Healthcare and Protecting Families	
Shifting to Paperless Health System Through Health IT	$2
Comparative Effectiveness, Prevention, Research	$3
Other:† Protecting Vulnerable Populations and Pandemic Preparedness	$4.5
Subtotal	$9.5

Supporting the Success of our Children and Young AdultsModernizing Thousands of Schools$7Making Necessary Investments to Support Student Achievement$0.5Stopping Teacher Layoffs and Improving Teacher Training$4.2Preventing a 25 percent Cut in Pell Grants and Short-term Increases$13.6Supporting Proven Job Training Programs$1Increasing Short-term Childcare and Early Childhood Funds$3.7American Opportunity Tax Credit$20Subtotal$50Protecting the Most VulnerableExtending Unemployment Insurance$29.5Modernizing Unemployment Insurance$7Temporarily Increasing Food Stamps$11Protecting WIC, TANF and other programs from shortfalls$5Temporarily Increasing SSI Benefits$3.4Increasing the EITC & Childcare$10Subtotal$58Other Priorities Being ConsideredHire 7,000 Cops$1.4Homeland Security Interoperable Communications Networks$10Jumpstart Social Entrepreneurship$2International Assistance $5Short-term Scientific Research Grants$3Improve Federal Census$1Subtotal$22.4TOTAL$262

E. Sources of Additional Stimulus

Of the about $260 billion of the core package, about $250 billion would spend out over the next two years, with the majority of that spending coming in the second year. This entire total would represent highly effective fiscal stimulus, either because it is direct government purchases or because it is transfer payments to low-income households (e.g., food stamps) that will likely spend the money.

This total, however, falls well short of what economists believe is needed for the economy, both in total and especially in 2009. We are trying to identify additional spending items that would constitute highly effective stimulus, would jumpstart campaign promises, and would have a lasting impact. But we are not optimistic that we can identify much more than the current total.

As a result, to achieve our macroeconomic objectives - minimally the 2.5 million job goal - will require other sources of stimulus including state fiscal relief, tax cuts for individuals or tax cuts for businesses. All three of these areas, however, raise tradeoffs because they are not as economically effective as stimulus, generally do not represent a down payment on a campaign promise, and do not have a lasting impact on the economy beyond protecting against a deep recession. These issues are discussed below.

State Fiscal Relief

State deficits alone are projected to total $200 to $250 billion over the next 2-1/2 years, excluding local government deficits. Under the balanced budget rules that apply in every state (except Vermont), states are undertaking large reductions in spending and several states, including California, are actively considering tax increases. These steps would not only be macroeconomically contractionary, but would also damage health and education systems.

The 2003 fiscal stimulus included $20 billion in state fiscal relief, half of it delivered by temporarily raising the federal matching rate for Medicaid (FMAP) and half of it in block grants distributed proportionately to state populations [?]. The need for both aggregate fiscal stimulus and also state fiscal relief is considerably larger today and the economy team would recommend $150 billion to $200 billion over two years for this purpose. We would recommend including as much of this as possible in FMAP ñ around $85 billion ñ and the remainder in the form of a general block grant or a block grant under another label, like preventing cuts to teachers and cops.

This, however, raises a few challenges. First, state fiscal relief is likely to be unpopular with some, especially Republicans, who view it as letting states off the hook for their profligacy. Second, this is a significant sum of money (potentially more than the combined energy and infrastructure portions of the proposal) that does not make a contribution to fulfilling a major campaign promise or have a lasting impact. Third, this form of stimulus is about 30 percent less effective than direct spending.

Individual Tax Cuts

The core package includes several targeted tax cuts that you proposed in the campaign (e.g., for college, the EITC and childcare), but additional tax cuts are required to achieve the degree of fiscal stimulus we are seeking:

Making Work Pay ($70 billion annually). This is a core campaign commitment to cut taxes for 95 percent of workers and their families, providing a $1,000 refundable tax cut to a middle-class working couple. Tax cuts are generally less than half as effective as government spending in terms of stimulus, but the funds may enter the economy more quickly. And if individuals perceive the tax cut to be permanent, they are more likely spend the funds rather than save them, thereby increasing the stimulative effect You could help increase this perception by, for example, promising to propose to make it permanent in your budget submission.

Temporarily cutting sales taxes ($100 to $250 billion over two years). Several economists have proposed providing grants to states that would require them to cut their sales taxes. Arguably this is the most economically stimulative form of tax cuts because it encourages households to spend now rather than later to take advantage of the temporarily lower taxes. Also it has the least risk of becoming permanent and hurting the long-run fiscal situation. It does, however, raise administrative complications because it would require 50 states to pass laws and may be perceived by the public as a short-sighted remedy to the serious challenges we face.

Business Tax Cuts

Finally, the package could include business tax cuts that go beyond the targeted business tax cuts (e.g., incentives for renewables) already included in the core package. Here are some of the options we have considered:

Extending small business expensing for two years ($2 billion over two years and $0.1 billion over ten years). The stimulus that passed in 2008 temporarily raised the amount small businesses could expense (i.e., deduct immediately) to $250,000 through the end of 2008. In the campaign you proposed to extend this temporarily higher limit through the end of 2010. Treasury estimates that would cost $2 billion over two years. Note that much of that money would be recouped in the following years because the small businesses that took the expensing would lose their future depreciation allowances, resulting in them paying higher taxes in future years (although still lower taxes overall). We recommend including this proposal in your package.

Extending 50 percent bonus depreciation for two years ($144 billion over two years and $28 billion over ten years). The 2008 stimulus bill also allowed all businesses to deduct 50 percent of their investments in 2008, a provision that was included largely at the insistence of Republicans. You could extend this for two years. That would have a large up-front cost but most of the money would be recouped in future years as firms shift from smaller annual savings from depreciation deductions to larger upfront deductions from the bonus depreciation. The economic evidence that this will increase investment is weak and economists generally consider the experience with it in 2002-04 and 2008 relatively disappointing. But it is administratively simple and has commanded strong Republican support in the past.

Establishing 100 percent bonus depreciation for one year ($XX billion over two years and $XX billion over ten years). An alternative, supported by several Republicans today, would be to allow firms to expense all of their investments in 2009. The goal would be to encourage firms to shift substantial investments into this year, although it would also result in weaker investment in at least the beginning of 2010. The downside of this proposal is that it represents a higher cost for a genre of proposal that may not be highly effective. The upside is that it would garner significantly more Republican support.

Extending Net Operating Losses ($33 billion over two years and $6 billion over ten years). Currently firms are allowed to get a de factor refund for tax losses (or for tax benefits like bonus depreciation) up to the amount of taxes they have paid in the previous two years. In addition they can carry these losses forward for 18 [?] years. With the very weak economy, however, many firms have losses and moreover cannot borrow money to sustain themselves until they can monetize these losses against future taxes. As a result, this proposal would extend the carryback period from two years to five years. This proposal would also enhance the potential stimulus to investment that comes from bonus depreciation. It is strongly supported by Republicans and we recommend you include it in the package.

Extending Making Work Pay to the Employer Side ($70 billion annually). Finally, Making Work Pay is implemented as a tax credit against an employees share of the Social Security payroll tax. You could temporarily, for one or two years, extend this same tax credit to employers. This would give them an incentive to hire new employees, improve their cash flow, and some of the benefits would also be passed on to workers in the form of higher wages. This could provide an incentive for hiring and message optics specifically around jobs. The downsides are that it could raise some administrative issues and that Republicans would not perceive it to be a business tax cut.

F. Combining These Elements into Three Illustrative Plans

Here are three illustrative packages based on the proposals outlined above:

Illustrative Plan #1: This would supplement the core package with $85 billion in state fiscal relief (delivered via FMAP), one year of Making Work Pay, and a set of business investment incentives. The total cost would be $520 billion and it would fall slightly short of your 2.5 million jobs goal.

Illustrative Plan #2: This would take Illustrative Plan #1 while adding an additional $90 billion of state fiscal relief in the form of a block grant (bringing the total state fiscal relief to $175 billion) and adding a second year of Making Work Pay. The total package would be $680 billion and it would create 3 million jobs but still leave the unemployment rate above 7 percent.

Illustrative Plan #3: This plan would build on the previous two by bringing total state fiscal relief up to $200 billion and adding a New Jobs Tax Credit. The net result would be 3.5 million jobs and an unemployment rate just below 7 percent, and cost X.

Table X. Three Illustrative Plans

	#1	#2	#3
Energy	62	62	62
Infrastructure	60	60	60
Health care (incl $85b FMAP)	95	95	95
Education	50	50	50
Protecting the Vulnerable	58	58	58
Other Priorities	22	22	22
State Block Grant	53	103	114
Making Work Pay	70 (one year)	140 (two years)	140 (two years)
Business Investment Incentives	50	50	50
New Jobs Tax Credit	-	-	140
TOTAL	$520	$640	$780
Memo			
Jobs Created by 2011-Q1	[2.3 million]	[3 million]	[3.5 million]
Unemployment Rate in 2011-Q1	[7.6%]	[7.2%]	[6.9%]

G. Key Questions and Considerations

In the meeting with you on Tuesday we will discuss these illustrative packages and frame some of the key questions:

How to tradeoff the politics around the optics of the package against the economic desire for more stimulus?

How to tradeoff the desire for reform vs. the desire for quick passage and implementation?

How many Republican proposals should be included in the outset?

How much do we want to start with an ideal plan vs. having a strategy to get from our starting point to a final plan?

Are there any useful guideposts in developing the plan (e.g, 50 percent tax cuts and 50 percent spending increases) that we should consider?

II REFORMS & BUDGET SAVINGS (Peter Orszag)

In the first few months of your Administration, we will submit or sign an $800 billion economic recovery package, a more than $100 billion Iraq/Afghanistan supplemental, potentially a request for $350 billion from the second half of TARP, and a $410XX billion continuing resolution omnibus appropriations bill for the FY 2009 budget. This could come as a considerable sticker shock to the American public and the American political system, potentially reducing your ability to pass your agenda and undermining economic confidence at a critical time.

You will likely submit an economic and budget blueprint to Congress in the second half of February which details your overall budget framework and given the budgetary pressures created by the actions above, a key focus of this blueprint will be the major choices you are making to put America on a fiscally sustainable course.

This section of the memo discusses some ideas that could potentially be developed or released before the February budget blueprint to convey that you take fiscal discipline seriously and are not just focused on big spending and big tax cutting items. A key factor to consider will involve ensuring that these proposals do not just seem quantitatively small compared to all the new spending and some would argue miss the source of the long-run deficit.

A. Proposals focused on waste, inefficiency and budget process

Attacking waste and inefficiency within government programs is not only an important symbolic step but also can help to create more confidence in government overall despite the relatively small savings from this approach. While the full line-by-line review of the government you have proposed will take time and could be reflected in the FY 2011 budget, there are a number of immediate ways to make a downpayment on this pledge:

Releasing a Top Ten cuts/eliminations list. In advance of the budget release, we could release a Top 10 cuts and/or program eliminations list that would demonstrate that we are focused on finding cost savings and eliminating waste throughout the Federal budget. Potential candidates include:

Subsidies to large farmers, like the uncapped agricultural commodity payments.
"Reading First," a program you identified for termination during the campaign.

Contracts that have come in late and over budget
Duplicative programs such as HUD "economic development" programs

Establishing a unit to examine waste, fraud, and abuse ñ and require cabinet officers to report back on the steps they are taking to address these problems. This new unit, potentially placed at OMB, would investigate and expose wasteful spending by examining internal documents and conducting interviews of officials. The unit would also issue reports on the degree to which agencies followed the recommendations contained in IG and GAO reports, an idea supported by Congressman Waxman. You could announce the creation of this unit with an immediate order to your Cabinet officials to report on outstanding IG and GAO reports about their agencies.

Convening a "War on Waste" summit. You could meet with top government watchdogs responsible for targeting waste and inefficiency within federal programs with a directive to provide their top recommendations on what to either cut or eliminate within 30 days. This proposal has been supported by Senator McCaskill.

Endorsing a Corporate Subsidy Reform Commission. You could endorse a proposal similar to the one suggested by Senator McCain establishing a commission with BRAC-like powers to review inequitable Federal corporate subsidies and make recommendations for the termination, modification, or retention of such subsidies. Senator Kerry and the CATO Institute have endorsed the concept, arguing that a BRAC-like process is the only way to remove the entrenched interests supporting various subsidies. Congressional leadership would likely oppose, given reluctance to establish procedures that bypass the traditional Committee process, and rank and file members would be concerned about protecting their ìsubsidizedî interests. There is also potential that some of the programs that you have advocated would be construed as subsidies.

Executive Pay Freeze. You could issue a government-wide directive that would institute a pay freeze for Executive branch employees while the economy remains in recession. This could be a quick demonstration of your awareness of the struggles of working Americans, though it could also highlight the relatively high salaries of federal executives.

Earmark Reform. Phil and the ethics team are working on a set of measures, likely via Executive Order, to tackle earmarks by both defining and publicizing how we will manage them in the administration, and using this effort as leverage with the Congress.

Entitlement Commission. Whatever specific policy steps we endorse could be supplemented with a process for other entitlement changes. Several proposals exist to establish bipartisan commissions to study entitlement reform, most notably the Bipartisan Task Force for Responsible Fiscal Action proposed by Senators Conrad and Gregg.

The Conrad-Gregg bill would establish a 16-member bipartisan task force to make recommendations on how to substantially improve the long-term fiscal balance. The recommendations would be fast-tracked in both houses, with final passage requiring a three-fifths vote. The proposal has been endorsed by House Majority Leader Hoyer, former GAO Comptroller General David Walker, Leon Panetta, and AARP CEO Bill Novelli. It has been opposed by Speaker Pelosi, Senators Reid and

Baucus, and various chairs in House as unnecessary and unlikely to produce the results intended.

Alternatively, Representatives Tanner and Castle, and Senators Hagel and Webb have called for a bipartisan, 8-member Social Security and Medicare commission. The commission would submit a final report within one year and ideally Congressional hearings would review the commission's recommendations. The Tanner commission does not bypass normal Congressional procedures, and is less controversial but viewed as not having much potential impact.

B. Proposals focused on reducing health spending

Although reducing waste and inefficiency within government programs is an important component of an overall fiscal discipline package, the key to our fiscal future is entitlement spending. As we have already discussed with you, we believe it would be helpful to get out early in January with a "downpayment" on health care cost savings totaling about $225 billion over ten years. These proposals include:

Medicare Advantage Competitive Bidding: ~$160 billion
Mandatory Adoption of Health Information Technology: ~$10 billion
Part D Income-Related Premium: ~$8 billion
Medicare Accountable Health Organization: ~$6 billion
Reduce Medicare Payments for Hospitals with High Readmission Rates: ~$5 billion
Expand Hospital Incentive Quality Demonstration: ~$3 billion
Reduce Medicare Payments to Physicians Who Do Not Meet Flu Vaccine Benchmarks: ~$2 billion
Establish Prior Authorization for Imaging: ~$1 billion
Increase Medicaid Brand-Name Drug Rebate to 22.1 Percent: ~$5 billion
Family Planning in Medicaid: <$1 billion

In addition to these "scoreable" avings, we would also announce our support for a substantial comparative effectiveness effort, a Federal health board, pilot projects to evaluate the best changes in incentives for doctors and hospitals to increase efficiency, and a prevention agenda. These steps may not immediately score, but we believe would ultimately improve the efficiency of the health system substantially.

III. THE MEDIUM-TERM BUDGET OUTLOOK & ISSUES (Peter Orszag)

As you know, the budget outlook over the next ten years has deteriorated considerably. Even without any new proposals, the budget deficit averages about 5 percent of GDP over the coming decade -- an unsustainable course that is particularly troubling given the even larger deficits, driven primarily by rising health care costs, that are projected to occur thereafter.

The net impact of the campaign's proposals is to expand the budget deficit over the next ten years, so the budget path including all those proposals is even more ominous for the medium term. For both substantive and political reasons (given the concerns of Senator Conrad and the Blue Dogs), it will therefore be necessary to do some combination of scaling back on campaign promises and making new choices to raise revenues or reduce spending. The following analysis proposes that you set a provisional budget goal to guide our internal efforts to develop specific options for a sustainable medium-term fiscal outlook. Based on your guidance we would then work with the full range of policy teams to develop options for your consideration to achieve the budget goal.

A. The Deficit Outlook

We now have preliminary budget estimates from OMB staff using updated economic assumptions developed by Christina Romer. Although they are not final, they seem reasonably close to the estimates that would form the basis of the budget blueprint to be released in mid to late February.

With a short-term economic recovery package, the deficit in fiscal year 2009 is likely to be about $1.3 trillion, which at 9 percent of GDP will be by far the largest deficit in American history excluding World Wars I, II, and and the Civil War. Most economists are not concerned about the near-term deficit deterioration, but the public may be more concerned. As noted above, it is therefore crucial in early January that we make it clear to the American public that you inherited this large deficit rather than creating it.

The more troubling development is shown in Figure X. Since January 2007 the medium-term budget deficit has deteriorated by about $250 billion annually. If your campaign promises were enacted then, based on accurate scoring, the deficit would rise by another $100 billion annually. The consequence would be the largest run-up in the debt outside of World War II, and the highest debt as a share of the economy since the 1950s, as shown in Figure Y.

Note that all of the figures in these charts differ from the official CBO baseline, which will be presented in January, because the numbers here assume that all expiring tax cuts are continued, that the AMT patch is continued and adjusted for inflation, that the Medicare doctors payment fix is extended, and that Iraq and other global operations are continued at their current levels. This is similar to the baseline used by your campaign, Goldman Sachs, the Concord Coalition and other independent analysts. This baseline is useful for understanding a realistic budget outlook and the impact of your proposals, although it is not consistent with the official baseline that has been used in Congress and is particularly controversial with some on the Hill, particularly the Budget Committees and the Blue Dogs. (The official baseline shows a better fiscal picture ñ for example, by assuming that all the tax provisions expire. This approach may be useful for official scorekeeping purposes, but as the tax example illustrates it makes policy assumptions that are widely viewed as unrealistic.)

The question of how you present your budget and what baseline you adopt is an important strategic one that we will discuss with you in the future. For now, the important point to note is that the choice of a baseline does not affect the actual deficit ñ it just affects the framing of how much your campaign proposals add to the deficit. For the purposes of this memo, we will rely on the baseline deficit projections shown above.

B. Campaign Policy Commitments

Your campaign policies were intended to be fully paid for: any additional costs were designed to be fully offset by other explicit savings. The result of full offsets would be a deficit identical to the baseline deficit shown above. Preliminary estimates from OMB, Treasury, and more realistic independent estimates, however, indicate a gap of about $100 billion a year as shown in Table X.

Table X. Campaign Proposals in 2012▯▯Campaign Proposals▯▯Campaign Offsets▯▯▯▯▯▯▯▯Taxes▯▯▯▯▯Making Work Pay▯71▯Repeal tax cuts above $250K▯86▯▯Seniors, mortgage, childcare & other▯39▯Loopholes & other▯20▯▯Patriot employer, small biz & other▯10▯▯▯▯▯▯▯▯▯Health▯▯▯▯▯Plan Subsidies▯190▯Savings▯26▯▯▯▯Pay-or-play revenue▯45▯▯▯▯▯▯▯Energy▯▯▯▯▯Investments▯15▯Carbon auction revenue▯120▯▯Carbon Auction Compensation▯105▯▯▯▯▯▯▯▯▯Domestic Spending▯▯▯▯▯0-5 Education▯10▯Explicit spending reductions▯15▯▯K-12 Education▯18▯▯▯▯Infrastructure▯6▯▯▯▯Scientific Research▯10▯▯▯▯Service, Urban, Rural & Other▯11▯▯▯▯▯▯▯▯Security▯▯▯▯▯Veterans▯25▯CBO assumed Iraq/Afghanistan*▯108▯▯International Assistance▯25▯▯▯▯Counterterrorism▯5▯▯▯▯Additional Troops▯5▯▯▯▯▯▯▯▯TOTAL▯545▯▯420▯▯*The average of CBOís two assumed Iraq/Afghanistan policies, does not reflect the President-electís policy.

C. Alternative Fiscal Goals

Closing the gap between what the campaign proposed and the estimates of the campaign offsets would require scaling back proposals by about $100 billion annually or adding new offsets totaling the same. Even this, however, would leave an average deficit over the next decade that exceeds the worst non-World War II decade in American history. This would be entirely unsustainable and could cause serious economic problems in the both the short run and the long run.

The following presents three alternative fiscal goals. The first goal is to balance the unified budget, a typical goal in normal times but something that would be very difficult to achieve given the current budget outlook. The second goal is to stabilize the debt-to-GDP ratio starting in 2014, the final year of the five-year budget window, keeping it at [59] percent annually. The final goal is to keep the deficit at 3.5 percent of GDP, which would be twice the historical norm and is consistent with the debt eventually stabilizing at around 80 percent of GDP. Table X shows what would be required to achieve these three goals:

Table X. Policy Changes Required To Achieve Alternative Deficit Targets in 2014

Goal	Necessary Spending Cut or Tax Increase in 2014	Deficit as a % of GDP	Debt as a % of GDP
Balance the Budget	835	0%	53%
Stabilize the Debt	346	2.8%	59%
Deficit of 3.5 Percent of GDP	234	3.5%	61%

Note that all of these goals are shown relative to the budget that includes the campaignís policy proposals. So, for example, the rough $350 billion in spending cuts or tax increases required to stabilize the debt as a share of GDP could include new proposals or scaling back existing campaign promises.

D. Illustrative Options to Achieve These Budget Goals

To help you make decisions about an attainable budget goal Table X shows a set of illustrative policy options together with the savings they would generate in 2014, the final year of the five-year budget window. Note that these options are not based on extensive consultations with all of the relevant policy groups ñ they are simply provided to give you a sense of scale for the goals you might choose to try to achieve. Based on your feedback about your overall goal we will work with all of the policy teams to develop and define a menu of individual options, and illustrative packages, to achieve the goals you set.

Table X. Illustrative Budget Options ñ Savings in 2014

Scale Back Campaign Plans	
Drop all tax cuts except Making Work Pay	44
Index health subsidies to CPI, instead of premiums	[35]
Use cap-and-trade revenue for deficit reduction (or to pay for proposals)	120
Phase in discretionary proposals over 8 years rather than 4 years	53
Revenue Options	
Allow all tax cuts to expire except child credit, 10% rate & marriage penalty	109
Limit the deductibility of employer-provided HI	68
Fully offset the cost of AMT reform	129
Tax dividends at income rates above $250K	16
$0.50 tax on cigarettes	3
Tax investment income from life insurance	29
VAT at a 5 percent	

rate�368�����Spending Options���Cut domestic discretionary spending by 10 percent�67��Limit domestic discretionary growth to inflation�47��Assume different CBO path for Iraq/Afghanistan*�9��Use chained CPI [Note ñ affects revenues and outlays]�12��ADD ANOTHER HEALTH OPTION�XX��*Note, this does not represent a different national security choice but a different budgetary assumption.

E. Next Steps

In our meeting with you on Tuesday we will discuss next steps on the budget based on your preliminary feedback on the alternative budget goals and the types of options that could be considered to achieve these goals.

IV. FINANCIAL ISSUES

The following is a discussion of four financial issues: housing, autos, the TARP and financial regulation.

A. Housing (Austan Goolsbee)

Starting more than a year ago, you have expressed great concern with the dramatic rise of foreclosures and wanted a policy to do something about it. There were more than 2 million foreclosures in 2008, but with the deteriorating economy and further decline of the housing market, analysts expect there to be 5 million more non-GSE foreclosures in the next two years.

Here we outline a five-part strategy for foreclosure prevention that is aggressive but targeted. The main component of the program focuses on reducing monthly payments to make mortgages affordable. We forecast that this effort will successfully prevent 1.5 million foreclosures and cost between $20-$40b, to be funded through TARP (and thus not require legislation). Additionally, we suggest four other policies to supplement the main programóprotecting servicers from legal suit, changing the Hope for Homeowners Act, changing the bankruptcy code, and more support for neighborhoodsómany of which would require actual legislation.

This memo walks through our recommendations and some key decisions we reached in order to arrive at them.

In formulating the approach we had extensive discussions with a wide variety of people: the housing agency review teams for transition, officials from Treasury, the FDIC, Fannie and Freddie, the heads of several servicers, lending banks, wall street economists, academic real estate experts, the staffs the banking committees and several other senators, several governors or their staffs, and numerous nonprofit organizations concerned with housing.

1. Main Component: Encouraging Restructurings that Reduce Payments. The primary way we recommend you prevent foreclosures is by giving direct incentives to lenders to reduce the interest rate and the monthly payments of at risk borrowers to make them affordable.

Mechanics: For borrowers qualifying as being at risk of default, a lender agrees to reduce the interest rate on the mortgage to a level that gets the mortgage debt down to 38% of income (DTI) and then the government provides a 50% subsidy for any further interest rate reductions needed to get the payment down to 31% DTI (so long as the interest rate required does not fall below 3%). Modified loans that remain current after 3 years would receive a fixed payment from the government to the borrower and the lender as an added incentive. There would be about 2.5 million loans that could be profitably modified in this way (i.e., save the lender money relative to actually foreclosing on the property) but something like 1 million might redefault later leaving 1.5 million successful modifications.

Basic Eligibility: The program would be designed for people at serious risk of default. We would define this generally as any borrower whose - house value has fallen below the value of the mortgage and where the borrower has DTI in excess of 31%. In determining eligibility, there would be special treatment for anyone that can document economic distress events (like job loss or major medical expenses) or were the victim of loan fraud or predatory mortgage practices. We recommend making only primary residences eligible and forbidding participation by any borrower with total debt exceeding 50% of their income (because restructurings are unlikely to prevent them from ultimately foreclosing).

Taxpayer protection: In return for participating in the program, the borrower would agree to a shared payback in the event of future appreciation. If they sell their house for a gain, the government would get 50% of the appreciation up to a maximum of the amount the borrower received as a subsidy.

GSEs: The GSEs could enact this program without the subsidy since they are in receivership.

2. Address Legal Issues Relating to Servicers. The government should pursue a two track legal strategy to immediately help resolve the uncertainty over servicer rights vis a vis their investors, which has prevented many from modifying mortgages in a way to prevent foreclosures. On the first track, the GSEs would declare that the eligibility criteria in the new government foreclosure plan (stated above) is also their official standard of ìat serous risk of default.î This would help clarify an industry standard around reasonable modifications, liberating servicers to interpret their own contracts accordingly. The second track would organize a servicer summit to explore other legal options to help servicers. One option to be discussed would be conditioning REMIC tax status on whether securitization trust agreements follow the government protocols for modification. Another option to be discussed would be indemnification for servicers who participate in the government program.

3. Strengthen Hope For Homeowners Act To Temporarily Enable Write-Downs. You were an original co-sponsor of the Hope for Homeowners Act- a foreclosure mitigation policy which sought to encourage principal write-downs among investors by splitting the cost with the government. Unfortunately, the program completely failed: 400,000 mortgages were eligible for write-downs but only 111 applied. Mainly, the lenders have proven totally unwilling to write down principal.
Our conversations with industry and community groups have led us to believe that lenders will continue to resist the idea in most cases (and hence our core proposal is the affordability program outlined in Part 1). But there were some flaws in H4H that remainófees that push interest rates up for borrowers, fees that deter lenders, and requirements that lenders eat too much of the mortgage losses for them to be willing to participate. We recommend fixing these flaws so that the program is

more attractive and can function as a ìlast resortî for the deeply underwater mortgages that do not qualify for the affordability restructurings in the main plan. Moreover, keeping H4H on the backburner is a good idea so that if house prices fall further and walk-away defaults become a bigger threat, it can be ramped up.

4. Reform Bankruptcy Code To Begin When Hope For Homeowners Ends. The next step in the housing plan is responsible bankruptcy reform along the lines of the Durbin bill you cosponsored. This would allow bankruptcy courts to write down the principal of primary residences to the current market value. We recommend announcing this reform to begin immediately following the close of the enhanced Hope for Homeowners period. This would give lenders an even stronger incentive to actually write down principal under H4H because of the prospects they would face in bankruptcy court.

5.Put A Focus On Other Housing And Community/Neighborhood Issues. An important complement to the specific plans to fight foreclosures is to strengthen the organizational safety net for communities under threat and to help invest in the kinds of assistance that can help get the anti-foreclosure policies to succeed. There are many individual policies we have considered but they include things like: protecting renters forced to exit foreclosed homes, expand and enhance pre-purchase and default counseling, strengthen HUDís Neighborhood Stabilization Program, make the federal government an active partner with leading private and nonprofit ìresponders,î invest in conversion of existing units into rental housing
Key Decisions We Made In Reaching This Approach. In coming to support the five-part strategy above ñ and particularly the main program ñ we used dealt with several important judgment calls:

Targeted Foreclosure Prevention as the Right Approach: We rejected two alternatives to the basic approach we recommend. The first was the argument that foreclosure policy is pointless and merely delays the inevitable expulsion of millions of people from homes that they cannot afford. We think this case is too extreme, and ignores both economic reality and human suffering. There are in fact many people to be foreclosed from homes that they can afford ñ with temporary help ñ which is what our policy seeks to achieve. We have a reasonable goal of preventing 1.5 million foreclosures, but understand that there are still 3.5 million foreclosures that we cannot prevent.

We also rejected the argument on the other side that we should have a broad policy to help the housing market - not just one for those at risk of foreclosure. A targeted policy will, undeniably, leave some out, and picking a boundary is difficult. Designed poorly, it could even encourage negative behavior for people trying to qualify (such as if you conditioned qualifying on being delinquent). Realistically, though, there are about 5 million non-GSE mortgages in threat of foreclosure but around 55 million total mortgages. To broaden the program away from targeting the risk of foreclosure would be dramatically more expensive and the government would spend most of the subsidy on people that would not have been in danger of losing their homes. We have spent significant attention on making the design as streamlined and fair as possible, however. It is easy to go too far, however, and insist on such tight criteria in order to make sure the recipient is deserving that in the aggregate almost no one actually qualifies. We tried to strike a defensible line between the extremes.

Affordability Modifications Rather than Principal Write-Downs. We recommend putting the main focus on getting monthly payments down through lower interest rates rather than trying for principal write-downs. First, historically, the main driver of foreclosure has been economic distress, rather than borrowers just walking away because the mortgage is underwater (less than one fifth of owner-occupied foreclosures right now are assumed to be due to walk-aways). . Reducing the size of the payments so that the borrower can afford them will keep many from foreclosure. Writing down principal is an inefficient way of reducing monthly payments (since it gets amortized over 30 years). Second, principal write downs are likely to be costly. There is something like $1 trillion of negative equity in the U.S. today so the prospect of trying to significantly reduce it, even if the cost were split between lenders and the government, would be daunting. Making the monthly payments affordable is much cheaper if the people are willing to stay. Third, it is easier, legally, for servicers to justify modifying interest rates than writing down principal. And the lenders themselves are utterly averse to write downs because they believe it sets a terrible precedent for other borrowers.

It is important to raise the prospect, however, that the current foreclosure crisis which is largely driven by economic distress and affordability, could morph into a new foreclosure crisis driven by walk-aways. If that happened, we would have to contemplate a policy geared explicitly toward negative equity.

Reducing Interest Rates Rather than Guarantees Against Redefault as in FDIC/Bair Plan. Our recommended plan is based on the government subsidizing lenders to reduce the interest rate, rather than asking them to reduce the interest rate on their own in exchange for a guarantee of half the loss in the event the restructured mortgage redefaults. The guarantee is especially attractive to lenders but we found it problematic given the enormous uncertainty it puts on the cost to the government from redefault risk, the scary numbers coming out of the IndyMac experience thus far and the incentives it gives lenders to modify the worst performing loans and pass the costs on to the government. In a typical case, the government could end up paying something like $25,000 to $50,000 to a lender for restructuring mortgages that redefault in rapid order thus leaving almost none of the money going to help the troubled homeowners.

We are still very much in the she spirit of the FDIC/Bair plan, though, in that we are aiming at making the mortgages affordable so that we can get a lot of them done quickly and we take advantage of the basic fact that the people we are wanting to keep from losing their homes are exactly the ones that want to stay in them and will do so as long as we can get their payments down.

B. Autos

[TBD]

C. TARP (Tim Geithner)

This section outlines the steps we are working on to stabilize the financial system. Our judgment is that we will need to move quickly in January to put in place a very robust program of further support for the banking system and credit markets. This is a necessary complement to your Economic Recovery Program and to our efforts on housing described elsewhere in this memo. We believe this ultimately will require more resources than those authorized under the TARP. Conditions in financial markets are still very fragile. There is material risk of another acute episode of panic over the course of the next several weeks, particularly if the auto problem is managed poorly or if markets come to believe that the political will to make the next $350B of TARP funding available is lacking.

Current Situation

The worsening economic outlook heightens the risk of feedback from the weakening economy to the already-stressed financial sector, and back again to the real economy. Deep concerns persist about the health of banks and other financial institutions and the size of future losses. With securitization markets impaired, credit to households and businesses via auto loans, credit card borrowing, and small business loans is constrained. Investment grade bonds are trading at rates that imply higher default rates than seen in the Great Depression.

Estimates of the scale of potential future losses for the banking sector alone are daunting, and appear to be escalating dramatically as the economy worsens and more sectors are affected.

The most recent estimates available were computed back in October, when the outlook for the real economy overall was stronger, and asset classes such as commercial real estate had not begun to deteriorate to the extent we are now witnessing. Under a severe recession scenario, the total need for new capital at banks alone could range from 250 to 500 billion. Private capital seems unlikely to fill the gap.

At present, $335B of TARP funds from the first tranche have been committed to recapitalize and stabilize banks and other firms and for a new program to support consumer and business lending (credit cards, auto loans, small business related asset-backed securities). Not all of this has been disbursed. To provide bridge loans for the automakers before the next tranche of TARP funds is released, Paulson may need to reprogram some of these prior commitments. This is more feasible in some areas than others.

Part of the challenge is the very real public frustration about Treasuryís handling of the program and the concern raised by the Oversight Board and others about whether firms receiving assistance are passing the benefits on to households and businesses.

Policy Objectives

In order to restore confidence and begin to repair the financial system, we must bring forward a proactive and comprehensive strategy, supported by adequate resources. Our goals for the use of public funds to support financial stability should be to:

Decisively stabilize core financial institutions to help create the conditions for recovery and growth.

Help facilitate the necessary restructuring of the financial system and provide greater clarity on how the government will deal with distressed firms that would disrupt the system if they were to fail.

Support the flow of credit to households and businesses and restore the healthy functioning of capital markets.

Support well designed initiatives in the housing sector, including a program to avoid avoiding preventable foreclosures.

Take great care with taxpayerís money ñ support should come with conditions and strong oversight to reduce risk to the taxpayer and help ensure that shareholders and senior executives do not unreasonably benefit from government support.

Plan for a careful exit strategy from broad government involvement in the financial sector even while providing necessary support.

These objectives and principles are widely accepted. The challenge is designing programs that are effective in meeting them and offer the prospect of broader public and Congressional support. We believe that it will be more effective and ultimately less costly to the taxpayer to escalate sooner and to err on the side of doing too much rather than too little.

Shortcomings of the Current Approach

Our judgment is that the broad strategy of the Bush Administration, the Fed and the supervisors has suffered from five key problems:

(1) Although in some areas policy makers moved aggressively to address the intensifying crisis, policy has been late to escalate, erratic, piecemeal, and without

an effectively communicated broad framework that market participants and the public can understand or predict.

(2) Interventions to address the resolution of failing firms (Bear Stearns, Indymac, Fannie and Freddie, Lehman, AIG, Wamu, Wachovia, Citi) have been inconsistent, in part because of limits on authority and in part because of conflict among the responsible agencies over how to balance the political and moral hazard concerns about bailouts with the potential damage caused by default of large institutions.

(3) The initial program of capital injections and guarantees were essential, but policy makers recognized at that time that substantial additional capital would be essential and they were unable to move quickly enough to that next phase of support.

(4) Poor communication, misleading statements about strategy and objectives, broad based public aversion to assistance without harsh conditions, and the lags in putting in place adequate oversight further undermined public support.

(5) The rapid deterioration in the U.S. and global economy overwhelmed the very substantial policy actions put in place, undermining the perceived effectiveness of policy.

Direction We Are Considering

Given the size of the problem we are confronting and the current lack of confidence, we must take further steps to reinforce the stability of banks and systemically-significant firms through capital injections and decisively expand support for lending and credit markets. A more forceful and comprehensive financial stabilization plan should:

Inject additional capital into banks and systemically-significant financial institutions in a form that provides more confidence among creditors and rating agencies, but without leading to expectations of government ownership and control.

Consider whether this may be best done through a combination of capital injections and insurance for tail risk on these firmsí most problematic assets.

Dramatically expand support for lending and credit markets to ensure credit continues to flow to households and businesses, leveraging our resources via structures in which limited funds act as a security for asset purchases or for long-term Federal Reserve credit.

Explore changes to reserve, capital, accounting and disclosure practices that can both improve confidence in bank balance sheets and avoid adding to pressures to deleverage.

Support targeted housing initiatives to prevent avoidable foreclosures and bring down mortgage interest rates.

Consider targeting some funds at areas like small business lending, student loans, and other non-bank financial firms to support those sectors directly.

Develop an architecture that would provide for more predictable resolution of systemically-significant firms at risk of disorderly bankruptcy.

Redesign the governance/oversight framework.

Sets expectations for firms that benefit and metrics for tracking and communicating about lending and developments in capital markets,

Has carefully designed conditions to make sure that shareholders and senior executives do not benefit inappropriately from government support,

Improves confidence in oversight and controls designed to reduce risk to the taxpayer.

Unfortunately, the credibility of the TARP program itself is so damaged that it will be very difficult to secure the second $350B tranche and achieve our goals within this program. Phil Schiliro suggest that we consider repealing TARP and replacing it with a new program that we design and propose as part of the Economic Recovery Plan .

Process

Whether we decide to support an early January request by the Bush administration for the second tranche of TARP funds or to replace TARP with a program of our design, we would propose to use the resources for a program along the lines proposed above.

We envision outlining a broad strategy shortly after Inauguration with a comprehensive speech and coordinated announcement with the Fed and FDIC.

Over the next two weeks, we will be working on alternative approaches, and will plan to present you with options and recommendation in early January.

We believe the financial resources necessary to accomplish our agenda ultimately will be greater than the funds available under TARP. We will update you as our work progresses and our results become clearer.

D. Financial Regulation (Tim Geithner)

Reform of the financial system will be a significant part of the economic agenda during the next one to two years. It is necessary both to restoring consumer and investor confidence in the short term and promoting stability and growth in the long-term. The current crisis reveals serious failures in traditional areas of regulation such as bank supervision, market integrity, consumer and investor protection. In particular, it underscores the need for a more stable financial system, more able to withstand shocks and distress, and less vulnerable to crisis. The general public and members of Congress have an appetite for meaningful regulatory changes in light of the damage to the real economy and the scale of fiscal resources required to stabilize the system. The new Administration has an opportunity to lead forcefully on this issue right away, and we will have to move quickly to shape the important international dimension of a credible reform agenda.

The challenge, however, will be to balance this imperative of early progress in outlining a comprehensive agenda for reform with the reality that we are likely to be still in crisis management mode. We have to get this right. The technical challenges are enormous, apart from the political difficulty of legislating meaningful reform. If not managed carefully, the central reform imperative of inducing more conservatism in leverage requirements and risk management will risk intensifying the ongoing de-leveraging process.

With those qualifications, we want to be in a position where, within 30/45 days of taking office, the new Administration can present the broad outlines of a reform plan that would offer the prospect of a more stable financial system, with greater protections for consumers and investors, with a more simple, integrated oversight structure. As part of this process, we need to explore whether to proceed in a two staged approach, with an early round of initial reforms, perhaps as part of the post-TARP financial recovery plan, followed by a more comprehensive package, or to move the full agenda in one step.

Principles:

The starting point for regulatory reform is the set of principles outlined in the March 2008 Cooper Union address and elsewhere on the campaign. These principles establish a baseline for a system that is safer and more just for all participants. In short,

Any institution that is sufficiently significant that it could borrow from government liquidity facilities in a crisis should be subject to appropriate government oversight and supervision.

We need to reform and strengthen capital, liquidity, and disclosure requirements for all regulated institutions and must work with international arrangements to address similar problems abroad.

We must streamline overlapping and competing regulatory agencies to provide better oversight of increasingly interdependent and complex institutions.

We must regulate institutions for what they do rather than the precise legal form they take.

We must crack down on activity that crosses the line to market manipulation.
We need a more effective approach to mitigating systemic risks to the financial system.

Consumers and borrowers must be protected in financial transactions by improving consumer education and product transparency while also prohibiting predatory practices.

What ever we do in the United States will have to be complemented by a consensus among other major and emerging economies.

Over the next three weeks we will be adding more detail and definition to these principles, and exploring applying them to the assessment and redesign of the TARP and other programs.

Administrative Actions:
A significant part of the fault for the current crisis lies in the failure of regulators to exercise vigorously the authority they already have. Because considerable discretion is required in the financial regulatory process to deal with the specific circumstances of different financial institutions or market conditions, a first important step towards reform is to appoint strong regulators who share your basic principles and will use existing (and new) authorities to implement them. They should also be oriented towards a dynamic process for streamlining the regulatory structure, even at the potential jurisdictional expense of the agencies to which they are appointed. Finally, enactment of these principles will require greater coordination of regulatory initiatives through the Presidentís Working Group on Financial Markets, the Financial Stability Forum, and other relevant international fora.

Statutory Changes:
In the near term, the main elements of regulatory reform legislation are expected to include the following:
Stronger authority for mitigating systemic risks, concentrated in the Federal Reserve, but with Treasury playing a stronger coordinating role in defining the full range of policies and regulations that are relevant to this challenge, from capital requirements to tax and accounting.
Increasing the level of consumer protection related to mortgage fraud prevention and mortgage transparency, abusive credit card practices, and student loan abuses.
Centralize regulatory authority over payment systems and other aspects of market infrastructure, including the derivatives markets.

New authority for crisis resolution, including creation of a special insolvency regime for bank holding companies and, where necessary, systemically significant non-bank financial companies, modeled on the regime which currently exists for commercial banks, and greater flexibility for FDIC interventions in institutions in crisis.

A process to flesh out the substance of these proposals as well as choreograph the sequencing and packaging of necessary legislation is underway. We want to avoid the risk of over-legislating while providing sufficient leadership and direction to Congress to instead provide all the legal powers needed to build a stronger regulatory framework. We also believe it is advisable to worry first about necessary objectives and authorities rather than seeking immediately to move or restructure existing regulatory bodies.

We also need to decide the future structure and mandate of the GSEs. Finally, of course, we will want to propose changes to consolidate and rationalize the panoply of federal financial regulators. With the possible exception of a consumer financial services agency, this step should probably come later, rather than sooner, since the turf politics among agencies, regulated market actors, and Congressional oversight committees are likely to deflect attention from substantive regulator reforms

Next Steps:
We recommend taking an early lead on these issues with a definitive address that outlines the broad objectives and strategy. Certain priority elements of the agenda can be spelled out in considerable detail while others should leave legislative detail up to Congress.

Some elements of this agenda could be announced early. Among the candidates for early introduction are campaign promises such as the Credit Cardholder bill of rights, which bans certain practices, some of which have already been banned by the Federal Reserve, and the StopFraud Act, which, among other things, creates a federal definition of mortgage fraud and allocates additional law enforcement resources to combat fraud and increase consumer protection. Other options include stepping out early in favor of simple anti-usury legislation (capping all consumer lending interest rates) or significantly more complicated financial product safety legislation expected to be proposed by Senator Durbin.

APPENDIX ñ ECONOMIC RECOVERY PACKAGE DETAILS

1. EnergyóSubmitted by Energy Policy Team [TBD]
2. InfrastructureóSubmitted by the NEC
3. HealthóSubmitted by the Health Policy Team [TBD]
4. EducationóSubmitted by the DPC
5. Protecting the Most VulnerableóSubmitted by the NEC
6. Other PrioritiesóSubmitted by the NEC

DRAFT -- Transforming the Federal Commitment to Strengthening our National Infrastructure

President Elect Obama will make the single largest investment in our nationís infrastructure since the creation of the federal Interstate Highway System. The Obama-Biden Administration will transform federal infrastructure policy by demanding greater accountability for infrastructure projects, ensuring that our focus is on projects that expand opportunities for economic growth, and fostering innovation to ensure our infrastructure policy helps America achieve critical national goals including energy independence and bottom-up economic growth.

OVERVIEW

The President Electís economic recovery plan will create millions of new jobs by focusing on three critical infrastructure areas: immediately restoring crumbling infrastructure neglected by years of failed policies; jumpstarting construction of new capacity projects that will allow American businesses to grow; and targeting federal funds to high-priority projects that have strong potential to spur regional and national economic growth.

The President Electís plan will meet these important goals by implementing new, tough accountability measures that will allow the President, Congress and the American people to track the progress of funded projects:

No Earmarks. Under the President Electís plan, Members of Congress and the Administration will not be allowed to ìearmarkî recovery package funding for specific pet projects.
Use it or Lose it. The President Elect and his Secretary of Transportation will require that federal funds for ready-to-go projects are obligated within a reasonable timeframe ñ 120 days ñ to maximize job creation and productivity during this recession. Funds that are not obligated will be reassigned to other projects that are truly ready-to-go.
Oversight. All states will be required to send detailed progress reports for all initiatives supported under this plan to the Inspector General of the Department of Transportation every six months. These progress reports will be made available to President, Congress and the public.

RESTORE NEGLECTED INFRASTRUCTURE

After decades of underfunding, too many components of our national infrastructure system are is in disarray, creating tens of millions in economic costs to American workers and businesses and adding tremendous pressure to our global competitiveness. The President Electís plan immediately tackles the backlog of repair and restoration projects across the country by making nearly $40 billion in immediate investments in these areas:

$20 billion to reverse state and local government funding cuts to infrastructure repair, safety and capacity projects on our roads and bridges, and incentivizing states to spent money in first year by fully eliminating state match requirement in the first year, followed by an increasing match that fully restores existing requirement in subsequent years.
$5 billion to strengthen the safety and efficiency of our overtaxed wastewater and drinking infrastructure systems across the country, including in rural areas which have been especially underfunded in federal appropriations processes
$8 billion to restore and improve the efficiency of federal buildings and institutions, including research facilities, office buildings, and border ports-of-entry
$5 billion to increase the availability of affordable housing by making necessary repairs to public housing units across the country
$500 million to clean up hazardous waste in industrial sites across the country and create new opportunities to use these spaces for economically productive purposes

ENHANCE ECONOMIC GROWTH BY JUMPSTARTING 21ST CENTURY INFRASTRUCTURE PROJECTS

The President Electís plan makes critical, short-term investments in bold initiatives that have strong potential to ensure decades of new economic growth. The President Elect transforms existing infrastructure policy by no longer relying on failed Washington politics to meet our short and long-term economic goals, and instead implementing new mechanisms to ensure federal funding is meeting our highest priorities in a timely manner without unnecessary pork or waste. The economic recovery plan jumpstarts exciting infrastructure projects around the nation by:

Creating a new, independent National Infrastructure Reinvestment Bank to select and finance the highest-priority infrastructure projects in the country. The Bank will receive an infusion of $10 billion from the federal government over 2 years to use innovative financing mechanisms to support projects that enhance national economic, energy, safety and transportation objectives.
Requiring states to set up rigorous economic analysis units for all state-supported transportation proposals to ensure efficient project selection in the years to come ($100 million)
Making an unprecedented new investment in public transit systems to enhance capacity in our nationís busiest transportation centers ($5.5 billion)
Modernizing our airports and air traffic control system to minimize airline delays and improve runway safety by beginning to replace the decades old computer systems that are used by our air traffic controllers and shifting to performance-based navigation ($1 billion)
Jumpstarting restoration of American leadership on broadband access by enacting creative incentives to increase the availability of broadband networks across the country ($10 billion)

EDUCATION AND ECONOMIC RECOVERY:
Investments to grow the economy and make America more competitive
The economic recovery plan provides an opportunity to create jobs by modernizing schools so that they can meet the challenges of the 21st century, reform schools and improve teaching so that students have the skills they need to succeed in the technology- and information-driven economy, and ensure more Americans can afford to attend college.

I. Modernize Schools for the 21st Century
The economic recovery package modernizes our schools to meet the technology, environmental and academic demands of the 21st century by tackling the enormous existing backlog in maintenance and construction for public schools, including charter schools.

At present, there are two distinct school modernization proposals under consideration.

The first option provides $6.9 billion in funds to States for school modernization to create safe, up-to-date, and green schools. Funds would generally support renovations to:
Repair and refurbish schools, including charter schools and community colleges;
Make schools energy efficient;
Update technology in classrooms, including broadband.

In addition, this option provides about $100 million for targeted investments in the repair and renovation of K-12 schools serving military bases or Indian lands.

Alternatively, a second option is to base funding for school modernization on a specified goal. Specifically, the $x billion proposed for the stimulus bill would be sufficient to (1) clear X% of the backlog of identified, necessary repairs and assist Y schools and colleges in making green renovations, (2) provide enough funding to repair X schools and colleges and help another Y schools and colleges go green, and (3) provide sufficient funding to pay for emergency renovations to ensure schools meet health and safety code requirements, and are accessible to individuals with disabilities.

The school modernization proposal will also provide schools with better data to track outcomes and improve student learning. The plan increases funding for longitudinal data systems by $500 million, which would ensure States and districts can measure growth by tracking individual students over time and providing real help for teachers in tailoring their instruction and to administrators in targeting interventions and funding.

II. Strengthen Teaching and Learning to Improve American Competitiveness ($7 billion)
The economic recovery package will improve teaching and learning in Americaís public schools and early childhood education centers.

The plan would transform the teaching profession in three ways: first, providing funds to states to develop innovative approaches to recruit, retain and pay teachers by directing funding to the such State activities as set-aside within Title II of NCLB; increasing funding for the Teacher Incentive Fund and tying its receipt to the use of other Federal dollars (especially Title II dollars) for similar reforms to how teachers are evaluated and compensated; and expanding TEACH grants to cover up to $25,000 in tuition, which is similar to the campaignís Service Scholarship program.

Additionally, the recovery package will target resources where they are needed most to improve schools. The plan increases funding by $1 billion for, and revising, School Improvement Grants by: 1) targeting funds to serve the lowest performing schools (schools in restructuring and corrective action); 2) allowing the Department of Education and States to use funds to establish effective school support teams, implement school improvement audits, and share best practices; 3) establishing partnerships between effective and low-performing schools and technical assistance providers, as needed; and 4) requiring participating schools to implement data use best practices (provide funds through data systems grants if necessary). Also, provide $1 billion for the base Title I program to fund schools low-income schools impacted by the economic downturn.

The package also provides for (1) an increase in IDEA funding by increasing the federal share of the excess costs of educating 6.8 million students with disabilities by $1.8 billion and (2) an investment in early childhood by increasing funding by $2 billion in additional child care assistant for low-income working families, doubling Early Head Start, and increasing funding for IDEA infants and toddlers by 70 percent.

III. Get More Americans Enrolled in College and Job Training Programs
The plan sets forth measures to assist more Americans enroll in college and job training programs during this economic downturn. The plan will help ensure that every academically qualified student can realize the potential of a postsecondary education.

Specifically, the proposal increases the maximum award for Pell Grants to encourage low-income individuals to use this period of economic downturn to upgrade their skills or obtain a postsecondary credential. The plan pays off the estimated $8.3 billion shortfall resulting from the increased numbers of students receiving Pell Grants, and invests an additional $5.3 billion to increase the maximum award by $500, from $4,731 to $5,231, in the upcoming academic year and sustain this increase in future years.

Finally, as a complement to the Pell increase, which will fund training for those who do not yet have college degrees, the plan makes targeted investments in training programs to serve vulnerable populations that will be most affected during this economic downturn. Specifically, the plan includes:
a Vocational Rehabilitation program, which provides $500 million in one-time additional funding for Vocational Rehabilitation (VR) State Grants and the American Indian VR program, to provide job training to individuals with disabilities;
Dislocated Worker Formula Grants, which provides a one-time $500 million increase for Dislocated Worker formula grants, funding training, job search, and placement assistance for individuals who have lost their jobs;
a YouthBuild proposal, which provides an additional $40 millions for low-income youth with opportunities to obtain education, employment skills, and on-the-job work experience in the construction of affordable housing;
Youth Formula Grants, which provides a one-time $500 million increase for WIA Youth Formula grants, which fund education and training services for low-income, at-risk youth aged 14-21 who also face barriers to employment; and
a Green Jobs proposal, which funds two competitive grant programs authorized in the Green Jobs Act of 2007.

DRAFT ñ OVERVIEW OF STIMULUS PROPROSALS TO PROTECT THOSE HARDEST HIT BY THE RECESSION

While all Americans are struggling with the difficult economic climate, low-income families and the unemployed are being particularly hard hit. The proposed plan delivers $58 billion in immediate relief now and also strengthens the automatic-stabilizer safety net for the future.

Assistance for the unemployed. This plan extends the Emergency Unemployment Compensation (EUC) program through December 2009 ($24 billion). It would also temporarily increase the weekly UI benefit payment by $25 ($5.3 billion), and provide a temporary increase in UI administrative funding to help states make prompt benefit payments while dealing with substantially higher workloads ($0.2 billion).

Modernize the UI system. This proposal would provide $7 billion in financial incentives for states that modernize their UI systems to expand coverage. In addition, the plan would reform the triggers for the permanent extended benefit program to make the system more responsive to future economic downturns.

Temporarily increase SNAP benefits (Food Stamps). The proposal provides for a 10 percent increase in monthly SNAP benefits. Households would receive an average of $34 increase in monthly benefits in the first year ($7 billion). The proposal phases out after 24 months by suspending price indexing of benefits for two years. It would also provide a one-time SNAP ìbonusî payment in March equal to a householdís monthly allotment ($4.2 billion), temporarily modify the SNAP participation time limit for childless adults to 6 months out of every 12, and provide a temporary increase in SNAP administrative funding to prevent enrolment delays in light of rapidly rising caseloads.

Increase spending on other nutritional programs. The plan will provide $500 million in contingency funds for WIC to deal with projected shortfalls in FY09 and FY10. Additional funds could also be provided for food banks (TEFAP) and for state food authorities to procure new equipment to replace old, and worn out equipment, thereby enabling them to serve more nutritious meals, but there are concerns that states do not have the capacity to spend this money quickly and effectively.

Replenish the TANF Contingency Fund. Because of rising unemployment and food stamp caseloads, the contingency fund will likely run out in FY09 and states may not be able to provide all of their needy families with cash assistance or other critical work supports needed during a recession. This proposal provides $4 billion to ensure that states can continue to meet these needs, but up to $5.4 billion could be provided to replenish the entire shortfall.

Additional cash assistance to Supplemental Security Income (SSI) recipients. This proposal would provide $450 per recipient in additional cash assistance to the 7.5 million blind, disabled, and aged SSI recipients for a total cost of $3.4 billion

Program Performance and Integrity. The proposal provides funds to make sure the government can determine eligibility accurately and pay benefits promptly. This proposal provides $400 million to build SSAís New National Computing Center in time for it to be in operation by 2012 ñ when the current center will no longer be able to meet capacity. This proposal would also provide administrative funding for SSA to hire additional staff, including ALJs, to reduce disability insurance claims-processing backlogs. The plan would create a new federal-state partnership for program integrity to incentivize states to modernize administrative processes for state-administered means-tested programs in order to (1) reduce error and improve accuracy of eligibility determinations and payments; and (2) improve and simplify the delivery of services.

Bolster child support enforcement activities. In 2006, the federal government cut support for state child support enforcement efforts by 20 percent. As a result, an estimated $1 billion in child support funds goes uncollected each year. This proposal would enact a 2-year moratorium on the 2006 federal funding cut ($1.1 billion over 2 years) to help ensure that mothers and children receive funds to assist their daily needs.

DRAFT APPENDIX ñ ADDITIONAL STIMULUS OPTIONS UNDER CONSIDERATION

In addition to developing strong proposals in our key focus areas ñ energy, infrastructure, health, education and direct relief to families ñ we have also been working with a number of transition policy advisors to examine the potential for stimulus proposals in other subject areas. This section contains information about the options we are currently analyzing.

Providing Immediate Support to Law Enforcement. We have been working closely with the Vice President-Electís staff to develop options to support local law enforcement agencies across the country. The largest challenge we face is structuring a proposal that does not require significant amount of funding in the out years. For example, while there is a desire to immediately hire more police officers through the COPS program, this would require a long-term funding increase rather than just ramping up funding for one or two years that expires in years 3 or 4. We are working to determine if there are short-term projects (implementing new computer systems, developing new crime prevention strategies, etc) that we could include in the stimulus package to avoid this issue.

Creating an Interoperable Communications Network for First Responders. The existing federal effort to build a national interoperable communications network for first responders across the country has stalled, and the transition technology team is working with a number of other policy groups to determine short-term proposals to jumpstart the construction of this network. In addition to bolstering our preparedness for natural disasters or terrorist attacks, building this network would also help bring broadband access to underserved areas across the nation. Complications potentially include new regulatory schemes and gaining buy-in of local law enforcement agencies to move from the existing federal effort.

Increasing the Availability of Short-term Research Funds. Given the high rejection rates of federal scientific institutions for high-quality grant applicants, there exists a strong demand for additional funding for scientific research to strengthen our international competitiveness. There are several short-term grant programs that could be phased up for one or two years, and then potentially reduced in later years but the optics of reducing science funding poses complications. We are working with the innovation policy group to explore additional options, including short-term investments to upgrade our federal and academic research institutions.

Supporting Our Nationís Nonprofit Institutions. Nonprofit service organizations across the country are considering job layoffs and reducing services in response to declining revenue streams, just as demand for their services is increasing. We are working with public service leaders to determine the best mechanism to provide support to these critical institutions, while also catalyzing the reforms in the nonprofit sector that you proposed on the campaign trail. Limitations to including this set of proposals in the stimulus package include no existing federal program to distribute funds to a wide group of nonprofits, a potentially long start-up time for a Social Investment Fund, and accountability concerns.

Bolstering International Assistance. There are several proposals to include an international component to the stimulus plan, including some ideas that would include spending federal funds in the United States such as renovations of the UN buildings in New York. We are working to identify ideas that will help directly stimulate the U.S. economy, while also helping address campaign foreign policy commitments.

 Note: This area provides overlap between tackling fraud and reducing entitlement spending.

Should be $1.7 trillion, right?
You listed six, counting "other"
These items are not listed or discussed on pages 36-37, where this package is explained., even though sound as thought they could be useful.

The items add to $66 billion, not the $58 billion stated.

On the other hand, page 37 includes a very good proposal to undo the cut in Child Support Enforcement that Congress enacted in 2005 ó but it is a far smaller item than $10 billion, so the components do match the $58 billion target.
The $10 billion in flexible block grants was distributed in strict proportion to state population EXCEPT for a provision that each state get at least $50 million. Of course, this latter provision benefited the le4ast populated states, such as Wyoming. This provision was later criticized by GAO, though it had very little real effect. See HYPERLINK "http://www.cbpp.org/6-15-04sfp.pdf" http://www.cbpp.org/6-15-04sfp.pdf.
It will be scored at $410 billion if the remaining "bills" in the omnibus ó other than the three already enacted ó come in at budget resolution levels, which is the plan.

(The actual value of the additional funding will likely be about $420 billion plus perhaps $55 billion in non-scored "transportation obligations." RK
The debt increased by 30% of GDP during the civil war, WWI, and the Great Depression, comparable to the increase you show. And deficits during the other two wars were notably higher than 9% of GDP in some years. Yes, WWII had the highest deficits and the most run-up of debt, but it goes to far to suggest that there were no other periods comparable to what we project.

In fact, the revolutionary war was probably had deficits and debt increases like this, though I can't prove it. RK
The figure currently only goes back to 1970, and so does not show what you say. But older figures are immediately available.
No: see above.
If neither congress nor the administration chooses which projects get funded and which don't, who decides?