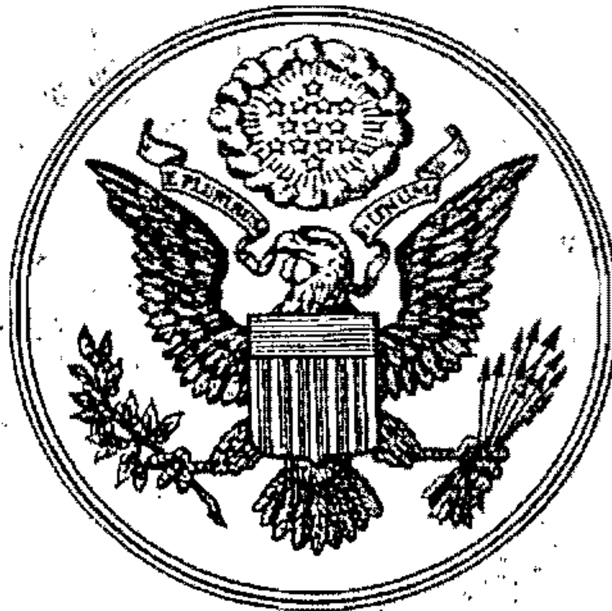
A History of the United States Department of the Treasury During the Clinton Administration 1993-2001



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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

SECRETARY'S PREFACE
DEPARTMENT OF THE TREASURY
SUBMISSION TO THE CLINTON ADMINISTRATION HISTORY PROJECT

January 16, 2001

It is my great pleasure as the departing Secretary of the Treasury to present this account of the Department's achievements during the eight years of the Clinton-Gore Administration. As the following pages make clear, this was a period of unique challenges and opportunities for the US and broader global economy, and no less a unique time for the Department of the Treasury.

Whether it was the historic move from budget deficit to budget surplus, the emergence of the "new" economy, or the speed and breadth of global economic integration, later historians may well come to consider the economic developments of the period as the most significant. Thanks, in large part, to the strong leadership of Secretaries Lloyd Bentsen and Robert Rubin, the Department of the Treasury helped to craft the Administration's economic strategy during this period - and thereby greatly advance the economic and broader interests of the American people. I am thus profoundly grateful to the many career and political staff at the Treasury who have contributed to this volume and thereby preserved a record of the Administration and the Department's economic achievements for the generations to come.

Lawrence H. Summers

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A HISTORY OF THE U.S. DEPARTMENT OF THE TREASURY DURING THE CLINTON ADMINISTRATION 1993 – 2001

INTRODUCTION

Under the leadership of Secretaries Lloyd Bentsen (1993-1994), Robert Rubin (1994-1999), and Lawrence H. Summers (1999-2001), the Treasury Department played a critical part in many of the more memorable events and achievements of President Clinton's two terms.

In line with the responsibilities of the Department and the priorities of the Administration, each of the three Treasury Secretaries shared a commitment to pursuing six key objectives:

- First, maintaining a strong economic strategy, based on continued fiscal discipline and assuring the long-term solvency of Social Security and Medicare.

- Second, assuring that a strong economy translated into higher living standards for every American, and that no region or group of Americans was left behind.

- Third, promoting a strong, stable, more integrated global economy.

- Fourth, working to build a stable and competitive American financial system that meets the needs of American consumers and businesses.

- Fifth, strengthening the nation's capacity to fight violent and financial crime and protect the nation's borders.

- Sixth, strengthening Treasury's management of core public missions such as tax administration, and currency design and production, as well as its custodianship of the historic Treasury Building itself.

In this introduction we summarize the Department's main activities and achievements in these six areas between 1993 and 2001, which are then discussed in greater detail in the succeeding chapters.

I. Maintaining a Strong Macroeconomic Strategy Based on Fiscal Discipline

President Clinton came to office at a time of economic pessimism. Although America had emerged from the recession of 1991, it was commonplace for academics and commentators to opine that America had won the Cold War but had fallen behind Germany and Japan in the economic league tables. In such a context, the Clinton-Gore Administration believed that it was critical that America take radical steps to restore the country's economic competitiveness.

Of these, the most important step was to regain control of the Federal budget, because the presence of very high Federal budget deficits meant that domestic savings that might otherwise have funded private investments was instead being absorbed by government debt. It was

generally accepted by economists that high budget deficits produced something of a vicious circle; whereby heavy public borrowing put upward pressure on long-term interest rates, which, in turn, helped to reduce private investment, leading to lower economic growth and thus even higher budget deficits.

At the Little Rock Economic Summit in December 1992, it was agreed that putting at end to the vicious cycle by reducing the deficit would be a central plank of the incoming Administration's economic policy. From January 1993 on, President Clinton and his economic team were to be consistent in their pursuit of this goal. But it is fair to say that even the policy's strongest proponents at the Little Rock summit underestimated how successful this basic shift in policy would be. The Federal budget moved from a deficit of $290 billion in 1993 to a surplus of $237 billion in 2000, with enormously positive implications for the rate of economic growth and employment, the level of interest rates and the volume of private investment.

Exactly how this turnaround was achieved, year by year, is the subject of much of Chapter 1. But there were four critical turning points:

The 1993 Deficit Reduction Package

On August 10, 1993, President Clinton signed the Omnibus Budget Reconciliation Act of 1993 (OBRA 93). This represented the first major effort to reduce the federal budget deficit since 1991. At the time, it commanded no bipartisan support. It also came without the modest short-term economic stimulus measures that the President had initially proposed. In retrospect, however, it helped to create a climate of fiscal restraint, within both of the major parties, for the remainder of the 1990s.

By shifting downwards both the actual and the expected future level of the deficit, the 1993 package can also be said to have helped lay the foundation for the prolonged economic expansion that followed. This was partly foreshadowed in the reaction of the financial markets to both the announcement and eventual passage of the Act. On Election Day 1992, the yield on the 10-year Treasury bond was 6.87 percent. At the end of February 1993, following the unveiling of the President's economic plan, the 10-year Treasury yield had fallen to 6.02 percent. By the time the modified version of the plan was enacted, the 10-year yield was 5.51 percent.

Revenue estimates contained in OBRA 93 projected that the measure would reduce the Federal budget deficit by $496 billion over the subsequent five years, with the savings more or less evenly divided between spending cuts and tax increases. In addition to the revenue raisers, the budget also enacted measures that would increase incentives for Americans to rejoin – or remain within – the labor force. The Act consisted of three main elements:

- Steps to raise new tax revenues of $241 billion over five years, with more than three-quarters of the increased burden falling on the top one percent of taxpayers, through an increase in the statutory income tax.

- Some 150 specific spending cuts, including a 25 percent reduction in White House staff; the elimination of 100,000 positions in the broader Federal workforce; and cuts in domestic non-defense appropriations of $20 billion.

- New investments in improved economic opportunities and work incentives for low- and middle-income working families: including, notably, a major expansion of the Earned Income Tax Credit.

The Contract with America and the 1995 - 1996 Budget Impasse

With the fiscal progress that had already been achieved, the Administration decided it was in a position to make targeted cuts for middle class families the centerpiece of the President's budget proposals for FY 1996. Called the "Middle Class Bill of Rights," the tax-cut package included (i) a $500 per child tax credit, (ii) a tax deduction of up to $10,000 for post-secondary education and training expenses; and (iii) an expansion of the deductibility of contributions to Individual Retirement Accounts.

However, the newly elected Republican majority in Congress had a very different agenda, in the form of the "*Contract with America*" -- the ten-point plan that the Republican leadership had campaigned on in the 1994 mid-term elections. In addition to large tax cuts favoring wealthier Americans, the Republican budget program included deep cuts in Medicare and Medicaid intended to balance the budget in seven years.

As the congressional Republicans advanced their program in the spring and summer of 1995, President Clinton decided to propose a responsible budget plan of his own that achieved balance "the right way": in other words, without imposing unacceptable cuts in critical government programs. By June, with the help of a number of officials at Treasury, the President was able to unveil a plan that achieved this objective, and also contained targeted tax cuts for middle class families.

Throughout the summer and the fall of 1995 the congressional majority and minority did battle over the competing proposals. Aware that they did not have enough votes to override a Presidential veto, the congressional leadership decided to use two weapons to force the President's hand.

The first weapon was the threat of government shutdown. There were ultimately two such shutdowns, as Congress and the President failed to come to terms on a large number of appropriations bills, and the necessary continuing resolutions were not enacted. Yet the weapon backfired. By the time the second shutdown had dragged on more than three weeks, public opinion had so turned against the congressional majority that the strategy had to be abandoned.

Their second weapon was a refusal, on November 15, 1995, to raise the statutory limit on Federal debt, which ultimately risked default by the Federal government for the first time in its history. Once again, the Administration decided to stand its ground, although this time with Secretary Rubin in the spotlight. In response, Treasury officials devised ad hoc -- and hitherto unexplored -- mechanisms to avoid a formal default, and Secretary Rubin defended these actions publicly: "the question of default is of the utmost importance to the nation's economic health.

Our credit worthiness is an enormously important national asset, and it should never be tarnished. . . We are not going to break our word, and we are not going to default."

Members of the congressional majority vigorously opposed Secretary Rubin's actions, with some even calling for his impeachment. Ultimately, the congressional majority was once more forced to stand down without having obtained the concessions it sought.

When the smoke cleared, Congress and the President were able to agree on a modest budget and tax package, without deep cuts in Medicare or Medicaid, and the dynamic within the Congressional leadership had shifted firmly in the direction of seeking common ground. This, in turn, helped to set the stage for the bipartisan Balanced Budget Act of the following year.

The Balanced Budget Act of 1997

Despite the sharp improvement in the budget balance during the previous several years, in early 1997, official forecasts continued to suggest a persistent, and ultimately rising federal budget deficit. Accordingly, the Administration set the goal of eliminating the deficit in five years, and constructed a plan to reach that goal.

When President Clinton presented his budget on February 6, many observers believed that a balanced budget agreement would likely be reached that year. But it was not until House Speaker Newt Gingrich expressed his willingness to scale back tax-cut plans that budget talks between Congress and the Administration made headway. The outlines of an agreement were announced in early May, and after further wrangling and prolonged debate, the Taxpayer Relief Act (TRA) and Balanced Budget Act (BBA) of 1997 were finally passed on July 31. The President signed the two bills into law on August 5.

These bills included, first, tax cuts of approximately $100 billion through FY 2002. Of these, the largest tax cut was associated with the new Child Tax Credit. There were also expansions in individual retirement accounts, a cut in the capital gains tax rate and an increase in the estate and gift tax exemption. Second, reductions in payments to Medicare providers that were estimated to reduce outlays by about $100 billion through FY 2002. And third, BBA 97 included new limits on discretionary spending, modifying and extending the caps imposed in OBRA 93. The discretionary caps were estimated to reduce spending by about $100 billion over the following five years.

The following year, well ahead of all previous expectations, the Federal budget moved out of deficit, with a unified surplus of $69.2 billion in FY 1998, the first since 1969.

"Save Social Security First," and a New Era of Fiscal Surplus

The fourth landmark event in the fiscal policy area during President Clinton's Administration was his commitment, in his State of the Union address in early 1999, to "save Social Security first." By this time, very large budget surpluses were being forecast for many years to come. The essence of the President's pledge was that he would not enact legislation that allocated a

significant proportion of those future surpluses to tax cuts or any other purpose -- until the long-term solvency of Social Security and Medicare had been assured.

This pledge grew out of months of high-level discussion at the White House led by Secretary Rubin, then-Deputy Secretary Summers, NEC Chairman Gene Sperling and others. Arguably, it was the most consequential sentence in any of President Clinton's State of the Union addresses. Before that speech, with rosy budget forecasts and a general election the following year, nearly every seasoned observer had expected that the congressional leadership would propose, and succeed in enacting, large scale tax cuts in 1999. After the speech, the terms of the debate had shifted; and the opponents of large tax cuts had public opinion on their side.

The President's strategy was successful in preventing large-scale dissipation of the surpluses in the first year that those surpluses were projected. It was less successful in promoting lasting reform of Social Security, which was to be one of the most important pieces of unfinished business of President Clinton's Administration. But it can be said to have strengthened Social Security indirectly; because the stalemate created by the absence of either large-scale tax cuts or Social Security reform led to a large proportion of the unified surplus being used to pay down the debt instead. This further strengthened the government's capacity to respond to future problems and had a favorable effect on long-term interest rates and the economy.

II. Increasing Economic Inclusion Through Targeted Tax Relief and Other Measures

In helping to devise and enact the Administration's budgets during this period, it was the responsibility of Treasury's Office of Tax Policy to make the means of the Administration's tax policy meet the ends: to ensure that the nation's budget promoted not only the Administration's macro-economic objectives -- providing fiscal discipline, eliminating the budget deficit, keeping interest rates low, and preserving the surplus for Social Security and Medicare -- but also its core micro-economic priorities and values. These included: making the tax system fairer and more progressive; tax relief for middle-income working families; moving people from welfare to work; revitalizing communities; expanding educational and training opportunities; and helping low and middle-income families save for retirement.

A large proportion of these efforts came down to a single goal of promoting economic inclusion and working to bring every American into the economic mainstream. There had always been a strong social and moral argument for such an objective. As the expansion continued, there was also, increasingly, an economic justification: Any successful effort to expand the productive potential of the economy would also enable the economy to grow faster without inflation.

Within this broad framework of values and priorities, the problem of economic exclusion was tackled from a number of different directions, by different parts of the Administration. For its part, Treasury focussed on three broad areas: increased support for the working poor; expanded access to capital and the private financial system; and improved retirement security for Americans.

Increasing Support for Working Families

By providing America's workers with the skills, education, and opportunities to participate in the mainstream economy, the Administration aimed to include all Americans in the country's prosperity. At the same time, with unemployment falling to its lowest rate in a generation, the Administration recognized that the durability of the economic expansion hinged to some extent on its ability to equip workers with new skills and to recruit new workers into the labor force.

There were many strands of this strategy: including efforts to make college education more accessible to every American, and measures to broaden access to health care. However, the measures that may ultimately have the greatest impact, and in which Treasury was most closely involved, were the Administration's positive efforts to assist the working poor.

The landmark Welfare Reform legislation of 1996 addressed this issue by introducing time limits and other new conditions for unemployed families with dependent children to receive federal cash support. But nearly all proponents of welfare reform had also underscored the importance of creating positive incentives, of "making work pay." That is why the Administration accorded such a high priority to expanding the EITC. In retrospect, the EITC expansion was the largest formal tax cut the Administration enacted. Spending on the program rose to more than $50 billion per year by 1999, more than ten times its level in 1985, when the EITC was first enacted. As a result, in 1999, the EITC lifted 4.1 million people out of poverty, nearly double the number it lifted out of poverty in 1993. Finally, as part of its strategy of economic inclusion, in 1996 the Administration was able to win congressional support for a two-step increase in the minimum wage, from $4.15 to $5.15 by October 1997.

Expanding Access to Capital and the Financial System

During a period of increasing sophistication in financial markets, senior officials at Treasury came to realize that the definition of economic inclusion was expanding. If the challenge of inclusion used to be about having access to electricity, running water and a telephone, then the challenge of the 1990s and beyond was to have access to a bank account and other basic financial services.

In seeking to broaden access to the financial system, Treasury focussed on two key goals:

- First, attracting capital to America's deprived areas. By providing incentives to banks to lend more capital to inner city and poor rural areas, Treasury aimed to enhance economic opportunity by stimulating the creation of more small businesses and attracting more businesses to re-locate. Significant measures included the revitalization of the Community Reinvestment Act, which led to a surge in capital lending in deprived areas, President Clinton's New Markets Initiative, which was designed to stimulate $15 billion in equity investment in deprived areas, and the creation of the Community Development Financial Institutions (CDFI) Fund within Treasury, which between 1996 and 2000 directly contributed close to $300 million in new equity investments to CDFIs around the country, and helped leverage many times that amount in new private investment and small-scale lending.

- Second, efforts to encourage and enable more Americans to open a bank account: including the Electronic Transfer Account (ETA) initiative, which provided recipients of Federal benefits with a low-cost transaction account to receive Federal transfers electronically, and the First Accounts initiative, which was designed to provide those who did not receive Federal benefits with low-cost accounts. In the latter years of the Administration, Treasury also launched a broader initiative to expand popular awareness of the merits of bank accounts and other financial products -- in part, as a means of promoting personal savings. This included the launch of the National Partners for Financial Education in April 2000.

Improving Retirement Security for Middle Class Families

The turnaround in the federal budget had a dramatic impact on the rate of national savings, which almost doubled, to 6.8 percent of GDP, between 1993 and 2000. However, this masked a decline in the rate of personal savings to its lowest level in more than half a century -- at a time when the baby boom generation was fast approaching retirement.

The very low rate of personal saving was worrying on two counts: First, at a micro-economic level, it meant that the majority of low- and mid-income individuals and their families in America were ill-prepared for any downturn in economic conditions in the years to come. Second, from the macro-economic standpoint, it left the economy as a whole highly dependent on foreign borrowing -- and correspondingly high current account deficits -- if the high rate of domestic private investment was to continue.

As the Administration proceeded, Treasury became progressively more focused on devising ways to encourage personal savings. The most successful of these were the campaigns to simplify pensions, enhance their portability, and to encourage greater participation in 401(k) plans by lower and middle income workers. The latter process exploited the power of inertia: A 1998 IRS revenue ruling permitted 401(k) plans to enrol new employees automatically at a specified level of savings (unless the employee declines). A series of revenue rulings and notices in 2000 progressively extended this approach.

Other efforts by the Administration, specifically, the ambitious effort to develop new, more progressive, savings vehicles during 1999 and 2000, were less successful. As Chapter 4 outlines, the Administration proposed to create Universal Savings Accounts (USAs) to help working Americans achieve retirement security, largely by providing retirement savings for the 75 million workers and their spouses who then lacked pension coverage. But the Administration was unable to garner sufficient support for either USAs or their more toned-down successor, Retirement Savings Accounts (RSAs), before President Clinton left office. More generally, it is fair to say that, as with similar efforts in other countries and earlier Administrations, the expansion of personal savings was a long-term problem, against which the Administration made only modest headway. .

III. Supporting a Strong, Stable, More Fully Integrated Global Economy

Treasury's approach to the global economy was animated by two central themes from President Clinton's 1992 campaign: that global economic integration was a fact of modern economic life;

and that in a more integrated world, a nation's economic and foreign policies would be increasingly intertwined. These themes were reflected, in the earliest days of President Clinton's term, in the decision to create the National Economic Council.

Events were to underscore the growing role of economic issues in American diplomacy. Indeed, the Treasury Department during this period was to have some involvement in nearly every aspect of the Administration's foreign policies: whether as part of the annual G7 Summit process; or the provision of technical assistance to transition economies of Central and Eastern Europe and the Former Soviet Union; or the negotiation of an international treaty in Kyoto to combat global warming.

By and large, the Treasury's largest contributions came in five key areas: first, support for regional and multilateral trade liberalization; second, leading the US and global response to financial crises; third, the reform of the international financial architecture; fourth, strengthening international support for the poorest countries; and fifth, starting to build international consensus on new global challenges, such as the rise of international money laundering and finding the right global approach to the taxation and regulation of e-commerce.

Promoting Economic Integration Through More Open Trade

Between 1993 and 2000 the Clinton-Gore Administration successfully concluded more free trade agreements than any of its predecessors. Treasury played a key role in many of these agreements, particularly in the early years of the Administration, when the Department and the Administration as a whole benefited greatly from the unrivaled hands-on support and personal commitment of Secretary Bentsen.

Three achievements in this area were especially consequential:

- In 1993, the Administration completed the negotiation of NAFTA, a comprehensive accord that opened markets and provided fair rules for investment and trade in goods and services across North America. NAFTA created a huge market, comprising some 400 million consumers, with a combined GDP of $10.4 trillion. The Agreement virtually eliminated duties on U.S.-Canada trade and reduced average tariffs on U.S.-Mexico trade to around 1.3 percent by 2000. Treasury led the negotiation and implementation of NAFTA's critical investment and financial services chapters. Arguably, however, Treasury's greatest contribution came through Secretary Bentsen's pivotal role in winning sufficient support for the NAFTA agreement in Congress.

- Secretary Bentsen was also a key figure in the passage of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), which was concluded in 1994. This created the World Trade Organization, and established the first ever formal mechanism for resolving global trade disputes. Probably the most sweeping global trade agreement in history, the Round further reduced tariffs on industrial products, but also extended market access commitments into previously neglected sectors, such as agriculture, textiles and clothing, and services. It also introduced new disciplines on the protection of intellectual property rights, trade-related investment measures, and standards.

- China's fourteen-year long effort to accede to the World Trade Organization (WTO) received critical impetus following the conclusion of a U.S. – China market access agreement in November 1999 and congressional approval of PNTR for China in 2000. Under the agreement, China committed to reduce significantly its tariffs in sectors of high priority for U.S. producers, to allow U.S. firms the right of full distribution for their products in China, and to eliminate quantitative trade restrictions and export subsidies for agriculture products.

Response to Global Financial Crises

In December 1994, Mexico devalued the peso, leading to a dramatic outflow of capital. Initial efforts to stem the panic were unsuccessful, so that by the start of 1995 Mexico was close to exhausting its reserves, and a serious default seemed imminent. However, opinion in the Congress and the public at large continued to oppose U.S. involvement in a large-scale program of international support. Acting on the advice of Secretary Rubin, the President decided that the risks of market contagion following a Mexican default were such that the U.S. should support a $50 billion package of international support for Mexico, including up to $20 billion in U.S. loans through the Exchange Stabilization Fund. Secretary Rubin signed the resulting emergency support agreement on February 21, 1995, which was backed by Mexican oil proceeds and conditioned on Mexican adherence to a rigorous economic adjustment program.

At the time the decision was highly controversial, particularly since use of the ESF, in contrast to more traditional forms of bilateral support, did not require Congressional approval. By and large, however, the opposition grew more quiet when faced with Mexico's surprisingly remarkably rapid economic recovery -- and with Mexico's repayment of the $12.5 billion it had borrowed, plus interest, on January 15, 1997. This was three years ahead of schedule, and resulted in a net gain of nearly $580 million for the American taxpayer. These developments in large part vindicated the decision to intervene in a situation that then-Under Secretary Summers dubbed the "first 21st century financial crisis." The episode had also provided the policy makers concerned with some useful preparation for the more global financial crises of 1997-1999.

The events that came to be called the "Asian financial crisis" began in July 1997, with Thailand's decision to devalue the Baht. The crisis was reminiscent of Mexico's in the speed at which an attempted modest devaluation turned into a full-scale market rout. As in the Mexican case, the government had permitted, indeed encouraged, the accumulation of very large volumes of short-term foreign debt -- and as confidence shifted these inflows turned very quickly into outflows, with very severe consequences for the stock of foreign reserves. The difference, in the Thai case, was the degree of market contagion. In the months that followed, the crisis of confidence spread first to Indonesia and then to Korea, with observers marvelling each time at the sheer pace of the deterioration in conditions.

Chapter 2 describes in greater detail Treasury's role in crafting the response of the U.S., and the international community as a whole, to these events, which centered around a series of multi-billion dollar programs of conditioned emergency assistance for the affected countries, in part using a new, very short term, IMF "Supplemental Reserve Facility" which the Treasury promoted for just these kinds of circumstances.

While these programs ultimately helped lay the ground for economic stabilization and recovery in the countries that implemented them, investors remained wary of emerging market economies throughout 1998, and the downturn in Asian growth was associated with a more general decline in global demand, and a dramatic decline in global commodity prices in particular. All of these developments greatly worsened the economic and financial outlook in Russia, which was highly vulnerable to crisis after years of stop-start economic reforms.

In August 1998, following a series of near-crises in the preceding months and a July package of international support, Russia devalued the Ruble and defaulted on its domestic government bonds, or GKOs. This turned out to have very immediate, and severe, effects on the demand for higher risk assets around the world, including instruments in which a number of leading U.S. hedge funds had significant positions. Most notably, this "flight to safety" led to the near bankruptcy of Long Term Capital Management, a hedge fund to which leading U.S. and international banks had high levels of exposure.

The U.S. Federal Reserve helped organize a response to the LTCM failure by persuading the hedge fund's main creditors to rollover their exposure. But by the fall of 1998 there was widespread global agreement that broader efforts were needed to restore confidence and growth. With Treasury's support and counsel, the President unveiled just such a response, in conjunction with the other G7 economies, in his September speech to the Council on Foreign Relations. The details of this response are contained in Chapter 2, but it is fair to say that it was at this moment that the tide was turned on what President Clinton termed "the most serious situation in global financial markets in 50 years."

Reform of the International Financial Architecture

A central element of the U.S. response to the crises in Mexico, Asia, Russia and Brazil was the call for lasting reform of the international financial system to make it better at preventing such crises, and more effective at responding to them when they took place. President Clinton began this effort at the Naples Summit in 1994, but it is fair to say that it gained prominence and momentum as a result of subsequent crises in emerging market economies.

In shaping the international response to the Mexican and later financial crises, Treasury emerged with a more sophisticated understanding of what had given rise to them in the first place. They were attributed to the combustion of two distinct elements: first, pre-existing weaknesses in economic fundamentals, including high levels of short-term foreign borrowing; and second, a cumulative loss of confidence on the part of investors when the weaknesses became more apparent, ending in a kind of bank run psychology.

Under the leadership of then-Deputy Secretary Summers, this diagnosis gave rise to a number of medium and long-term reform initiatives, including: the development of better global surveillance systems to monitor economic fundamentals; the creation of improved vulnerability indicators to detect potential crises in advance; the establishment of international fora, such as the Financial Stability Forum and the G20 to promote better surveillance and transparency; and

efforts to reduce "systemic" risk by improving standards of disclosure and counterparty risk management for hedge funds.

A second wave of reform pressure began in December 1999 in London, where Secretary Summers unveiled a more detailed reform agenda for the IMF. The underlying premise of this reform agenda was that the IMF needed to adapt itself to a world in which private markets were the overwhelming source of global capital flows. This suggested a more focused role for the Fund in those countries with access to private finance, a role centered more clearly around promoting the flow of information from governments to markets and investors, and providing very short-term emergency assistance to countries in crisis, with lending priced so as to encourage countries to seek out private sector alternatives. As Chapter 2 outlines, by the time President Clinton left office, a number of reforms taking the IMF in this direction had been agreed to by the IMF's Board and major shareholders and had started to be put into place.

More Effective Support for the Poorest Countries

The rise and fall of the emerging market economies, along with other challenges of global economic integration, captured a good part of the international economic spotlight during President Clinton's two terms. But there was an even greater humanitarian problem presented by the many countries that global economic integration had so far left behind. Between 1993 and 2000, the Administration undertook a range of initiatives to strengthen U.S. and global support for these very poor economies, who were far from having "emerged."

As Chapter 2 describes, these efforts ultimately culminated in four major policy initiatives:

- First, the African Growth and Opportunity Act. This attempted to translate the common nostrum that "trade is better than aid" into a new operational approach to U.S. policies in Sub-Saharan Africa. It also incorporated another lesson of past development assistance efforts: that assistance would be wasted in countries that were not themselves committed to reform and good policies. The idea was to offer reduced trade barriers in key sectors and other forms of financial technical assistance to countries that were committed to effective economic reforms, including open markets. The legislation proved controversial, both in some of the African countries and among producer groups in the U.S. But in the summer of 2000, three years after it was first proposed, the President was finally able to sign the legislation into law.

- Second, the Highly Indebted Poor Countries (HIPC) Initiative. This was created in 1996, in response to a global concern that previous, bilateral debt relief initiatives by the U.S. and other Paris Club donors had still left many of the highly indebted countries with large debt service obligations to the IFIs. In part as a result of a vast "Jubilee 2000" coalition of pop singers, religious leaders, and NGOs, the HIPC initiative was expanded at the Cologne Summit in the summer of 1999. President Clinton made a further contribution to the campaign in September 1999, when he pledged to forgive all of HIPC-qualifying countries' bilateral debts to the U.S. Most of the other G7 countries later followed suit. As in previous years, it proved difficult to win congressional support to finance the US contribution to the enhanced HIPC program, but sufficient funding was finally approved in the fall of 2000.

- Third, continued efforts to reform the World Bank and other international development institutions, culminating in the unveiling of an agenda for continued reform by Secretary Summers in the spring of 2000. These reform efforts focused on increased transparency and accountability, a greater focus on poverty reduction and growth in the poorest countries, a more targeted role in the emerging market economies, and increased efforts with respect to global public goods. These efforts met with some success, but were sometimes hampered by the continued battle to meet U.S. obligations to the development institutions, and resulting 40 percent cut in annual payments to the World Bank.

- Fourth, efforts to combat AIDS and to promote "Global Public Goods," including vaccines and cheap and effective treatments for HIV/AIDS, malaria, tuberculosis, and other infectious diseases. The Clinton-Gore Administration had begun with a sharp increase in the amount of U.S. bilateral assistance devoted to combating HIV/AIDS overseas. But this sum did not increase significantly in subsequent years, even as the death toll in Africa continued to mount. The Global Public Goods initiative was partly a response to these concerns. Unfortunately, the Administration proved unable to obtain the necessary support for the initiative in Congress.

Promoting a Coordinated Response to Global Problems in a More Integrated World

In an increasingly borderless world, policy makers in the 1990s faced a broad class of so-called "global public goods," problems governments would need to confront collectively as well as nationally: everything from curbing the growth of international financial crime and money laundering, to combating global warming, to developing the right framework for supporting the global growth of e-commerce.

The Clinton-Gore Administration took the lead in responding to many of these challenges, with Treasury often playing a critical role. Three initiatives are worthy of particular attention: first, strengthening global efforts to combat the rise of international money laundering and tax havens; second, devising the U.S. approach to global efforts to combat climate change; and third, working with other nations in shaping an international consensus on the taxation of e-commerce.

- Treasury recognized that the proliferation of international money laundering, offshore banking centers and tax havens all had the potential to create macroeconomic distortions, and at the limit, undermine the stability and integrity of the international financial system. In response, Treasury helped to lead a multinational effort to strengthen national and international counter-money laundering regimes, and arrangements to limit lax financial supervisory systems or rules against money laundering and tax evasion within the 26-member Financial Action Task Force, the Financial Stability Forum, and the OECD Committee on Harmful Tax Competition, and to identify countries whose counter-money laundering, financial supervisory, or non-resident tax regimes fell far below international standards. Treasury also supported defensive measures and sanctions against havens that did not begin to take corrective measures within an appropriate period of time.

- With regard to the international Internet taxation issues, the U.S. took the lead in persuading America's partners to adopt the same principles to the taxation of e-commerce -- neutrality, efficiency, certainty and simplicity, effectiveness, fairness and flexibility -- that guided the Administration's approach to this question on the domestic front. The Administration sought to implement its Internet tax policy principally through the OECD. At the end of the Administration, discussions were still proceeding with business and non-OECD countries through the OECD, regarding implementation of the 1998 Ottawa principles, which broadly tracked the principles the U.S. had developed domestically.

- With regard to climate change, the Administration focused on finding an answer to the question that the UN Framework Convention on Climate Change in Rio de Janeiro of 1992 had left unresolved: namely how, precisely, the desired global reduction in the emissions of greenhouse gases was to be achieved. In debating this question, particularly in the negotiation of the UN-sponsored Kyoto Protocols in 1997, Treasury consistently pressed for a clear-minded consideration of both the benefits and the costs, and advocated approaches that used market mechanisms to achieve the desired environmental result: most notably, an emissions trading regime that would give countries maximum flexibility in meeting their Rio Treaty obligations. As Chapter 2 describes, in pursuing these goals at both Kyoto and later in the negotiations at The Hague in 2000, U.S. and Treasury officials had only moderate success.

IV. Strengthening America's Financial System

The fourth pillar of Treasury's work was to ensure that the American financial system was as safe, competitive and efficient as possible in meeting the needs of American consumers and businesses. Treasury efforts in this area fell into four broad categories: first, strengthening the financial services industry; second, improving regulation of financial markets; third, managing the Treasury securities market in an era of debt paydown; and fourth adapting the financial markets to an era of new technology.

Strengthening the Financial Services Industry

In response to the dramatic changes taking place within financial markets and financial services during the 1990s, the Clinton-Gore Administration took steps to modernize the regulatory framework governing the financial services industry. In particular, Treasury was intensively involved in four important changes:

- First, the enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act, which President Clinton signed in Treasury's Cash Room on September 29, 1994. This law permitted a bank holding company to acquire a bank located in any state, beginning one year after enactment. It also permitted a bank holding company that owned banks in different states to turn them into branches beginning June 1, 1997, or earlier if a state permitted it. This groundbreaking legislative initiative enhanced the competitiveness of, and reduced risk in, the U.S. financial system, authorizing national banks to operate on a nationwide basis and permitting states to authorize state banks to branch across state lines. For the first time, these changes permitted the creation of a truly national market in bank products and services.

- Second, agreement and eventual enactment of the Gramm-Leach-Bliley Act in 1999, which repealed the Glass-Steagal Act that had governed the financial services industry since the Great Depression in the 1930s. The Act abolished rules that prevented banks and securities companies, and banks and insurance companies from merging, and allowed for the creation of financial holding companies that included full range of subsidiaries offering all forms of financial service. The Act modernized America's financial system, allowing for a more competitive framework to benefit businesses and consumers. In addition, it instituted new consumer protections that gave consumers much greater control over financial institutions' access to and dissemination of their private data.

- Second, the Administration and Treasury made a concerted effort to rectify the inadequacies that had been brought to light by the thrift debacle of the late 1980s and early 1990s. Treasury worked with Congress to enact several bills between 1993 and 1998 that finally put an end to the thrift crisis while working to minimize the fall out from any subsequent crises. The effort strengthened consumer deposit insurance protections and improved regulation of thrifts.

- Third, Treasury took important steps to redress concerns about issues of systemic risk and market competition that arose from the growth of Government Sponsored Enterprises (GSEs) during the 1990s. These included: the creation of an Office of GSE Policy within Treasury to oversee these issues; reforms to the Federal Home Loan Bank System; expanded oversight of Sallie Mae; and the recommended privatization of Fannie Mae and Freddie Mac.

Strengthening the Regulation of Financial Markets

The rapid growth in both size and sophistication of the financial markets posed a series of challenges to the Clinton-Gore Administration as the boundaries between national markets, different types of traded securities, and regulatory agencies, started to blur or even disappear. Treasury worked on two broad fronts to respond to these developments: first, to modernize and strengthen the regulatory framework governing financial markets; and second, to remove legal uncertainty in the over-the-counter derivatives market.

- Treasury took important steps to make America's financial markets more efficient, and transparent, as well as safer for customers by improving the regulatory framework. These included measures designed to reduce systemic risk and enhance the underlying integrity of our markets. These included: legislation on the netting of financial contracts and foreign currency transactions; improvements to the rules governing circuit breakers in the equity markets; and proposals to tighten counter-party risk management and the oversight of hedge funds following the LTCM crisis.

- Treasury also acted on its long-running concern about the uncertain legal status of swaps and hybrid instruments. This uncertainty stemmed from ambiguities about the scope of the Commodity Exchange Act ("CEA"). Treasury, among others, was concerned that this legal uncertainty had an unnecessarily negative impact on the over-the-counter ("OTC") derivatives markets in the U.S. and, in times of substantial market volatility, could contribute

to systemic risk. As a result, Treasury pushed legislation to remove OTC derivatives from the scope of the CEA.

Managing the Treasury Securities Market in an Era of Debt Paydown

As we have seen, perhaps the single most dramatic accomplishment of the Clinton-Gore Administration was the transformation of the fiscal position of the Federal government. This had far-reaching implications for the management of publicly held debt that is one of the key remits of the Treasury Department.

In adapting the Treasury bond market to changing circumstances, Treasury worked on two broad fronts: first, maintaining liquidity in Treasury bonds while paying down debt; second, reforming the Treasury bond market to make it more attractive and transparent to both institutional and retail investors:

- Treasury took steps to maintain liquidity in the Treasury bond market even as it paid down more than $350 billion of publicly held debt between 1997 and 2000. This entailed a broad reduction in the amount of securities issued, less frequent issuance of certain securities, and the outright elimination of some securities from Treasury's debt issuance schedule. In addition, two other debt management tools were developed to facilitate the process of paying down the debt: debt buybacks and regular reopenings.

- Treasury also took steps to create a more open and transparent market in Treasury securities with the view to lowering costs and providing greater choice for investors. Specifically, Treasury introduced uniform price auctions of Treasury bonds to improve efficiency and reduce costs; created inflation-indexed securities and savings bonds to provide retail investors with attractive and safe ways of saving; and implemented new regulations to make it easier for states and local government to manage tax-exempt bonds.

Adapting Financial Markets to an Era of New Technology

Treasury recognized that new technology could provide enormous benefits both to businesses and consumers by facilitating greater speed, efficiency, and transparency in commercial transactions. This had significant implications for the financial markets, which had embraced the new technology more rapidly than most industries.

To that end, Treasury sought to create the legal and regulatory safeguards necessary to engender business and consumer confidence in e-commerce. This involved providing the same legal certainty for online transactions as for offline transactions; taking the lead in helping to develop a secure and credible electronic payments system; and taking steps to protect the Internet from cyber-terrorism and other threats.

- The Digital Signatures Act in 2000 provided legal certainty to online transactions while preserving important consumer protections. By removing legal impediments to online commerce, the Act provided a solid legal basis for authentication, contracting, and making payments online, removing enormous uncertainty in the electronic marketplace.

- Treasury also faced the challenge of adapting pre-Internet payments systems to the new world of e-commerce. Given the limited usefulness of many of the old payments methods, this was a particularly important challenge. The Treasury Department and its regulatory bureaus took a series of important steps to reduce barriers to electronic transactions.

- The President appointed Treasury as the "lead agency" to work with banks and other financial service firms to develop ways of protecting the critical infrastructure of information technology from cyber-terrorism and other threats. As a result Treasury established the Financial Services Information Sharing and Analysis Center (FS/ISAC), where members of the financial services industry and government agencies could share real-time information about cyber-terrorist threats. These and other technology-related initiatives are addressed in Chapter 6.

V. Strengthened Efforts to Combat Crime

During the Clinton years, crime rates in the United States plummeted to the lowest level in a generation with homicides falling to a 30-year low. Some of the improvement could be attributed to the effects of a healthy economy that induced a sharp fall in the rate of unemployment and an impressive reduction in poverty rates across all ethnic groups.

The Clinton-Gore Administration also contributed more directly to the decline in crime rates with its concrete legislative and other steps to combat violent crime, most notably in the battle against gun violence. The Clinton-Gore Administration also took effective measures to combat other types of crime, including drugs, financial crime, and international terrorism. And as the Department responsible for the Customs Service, the Bureau of Alcohol, Tobacco and Firearms (ATF), the Office of Foreign Assets Control, and the Secret Service, Treasury played a leading role in many of these initiatives.

Treasury's contributions fell into three broad categories: first, steps to combat firearms violence; second, measures to combat financial crime; and third, measures to combat drugs and terrorism.

Combating Firearms Violence

The Administration's record in this area was blighted in its earliest days by unprecedented tragedy. On February 25, 1993, barely a month after President Clinton was inaugurated, an ATF raid on the Branch Davidian Compound near Waco miscued badly, resulting in the death of four ATF agents and six Branch Davidians. After a stand-off lasting 63 days, the FBI attempted a second raid on the compound. The raid went tragically wrong and more than 80 civilians lost their lives in a fire that burned the compound to the ground.

The events in Waco led to a thorough review of ATF that culminated in its reorganization. In the process, the Treasury Department established more direct oversight of the agency that was to prove central to Treasury's efforts to combat firearms violence during the Clinton years. These efforts fell into two broad categories:

- First, Treasury's support proved critical to the successful fight for new firearms laws in 1993 and 1994: including, most importantly, the Brady Handgun Violence Protection Act of 1993, which imposed background checks on purchasers of handguns, and the Assault Weapons Ban of 1994. Passage of the Brady bill at the end of the first congressional session of the Clinton presidency, with the strong personal backing of Secretary Bentsen, was a landmark event. It was the end of a seven-year legislative fight to give law enforcement and licensed dealers the tools they needed to prevent felons and other prohibited persons from buying guns from gun stores. Treasury also took the lead in expanding enforcement activity to address a broader range of firearms crimes, including the illegal acquisition and distribution of guns.

- Second, through a series of reports, initiatives, legislative proposals, and public statements, Treasury significantly expanded the legislative, public, and policy debate to address the need for greater measures to control the illegal market in firearms. This led to some significant successes, including the movement toward greater accountability and responsibility by the firearms industry and gun owners that culminated in an agreement with Smith & Wesson in 2000 to institute important safeguards on its handguns.

Combating Financial Crime

As previously discussed in section 2 of this introduction, a second, and equally important, objective of Treasury's enforcement arms during this period was stepped-up efforts to tackle both domestic and international money laundering. The emergence of more sophisticated technology during the Clinton-Gore years, and the growth of cross-border trade and capital flows, provided opportunities for criminals both to move and to disguise the proceeds of their crimes. New technology also made it easier for criminals to steal identities and to counterfeit money.

Treasury was at the forefront of efforts to counter money laundering within the United States. But the Administration also recognized that, in an increasingly open world, combating domestic money laundering meant also combating international laundering, and vice versa. Treasury emphasized the continued need of its enforcement bureaus to counter money laundering as a means of protecting the integrity of the nation's financial and trading systems, and as a means of fighting the substantive crimes within Treasury's jurisdiction. In addition, it strengthened the ability of federal, state, and local enforcement officials generally to fight money laundering, by strengthening and continuing to foster the evolution of FinCEN, moving to implement the provisions of bi-partisan legislation enacted at the end of the Bush Administration, and supporting the passage and implementation of the Money Laundering Suppression Act in 1994 and the Money Laundering and Financial Crimes Strategy Act in 1998. Treasury also led an attack on the Black Market Peso Exchange (BMPE), the largest operation for laundering narcotics proceeds in the United States.

Treasury made great efforts to turn the tables on international criminals by using new technologies against them. This led to a consistent strategy of employing all the appropriate and available technological and investigatory methods to combat new types of technological crime. This was most notable in Treasury's leadership of Administration efforts to organize an effective law enforcement response to designers and traffickers in counterfeit currency, and to combat the new crime of identity theft.

Combating Drugs and International Terrorism

By going after the proceeds of the crime, the Administration's anti-money laundering efforts almost certainly had a significant indirect effect on narcotics trafficking. At the same time, the Administration took a number of direct steps to improve America's ability to fight narcotics, as well as to combat international terrorism.

- Treasury supported a number of initiatives and new laws that strengthened the nation's ability to fight domestic and foreign drugs traffickers, most significantly in the Foreign Narcotics Kingpin Designation Act which gave the Federal government new powers to impose sanctions on companies suspected of acting as a front for drugs traffickers. In addition, Treasury played a key role in developing Plan Colombia, the lynchpin of the Administration's efforts to fight illicit drugs in the Western Hemisphere. Treasury helped persuade Congress to enact $1.3 billion in assistance for Colombia in 2000.

- Treasury bureaus were extensively involved in a number of Presidential initiatives to combat international terrorism during the 1990s, including new legislation to seize the assets of suspected terrorists, a five-year counter-terrorism plan developed by the White House, and actions against suspected assets of Osama Bin Laden, a leading international terrorist based in Afghanistan.

VI. Strengthening Treasury's Core Public Missions

In addition to the more policy-driven agenda of the Administration, the Treasury Department under President Clinton continued to be the guardian and manager of core public services whose activities affect every American: most notably, those carried out by the IRS; and the US Mint and the Bureau of Engraving and Printing. It also carried out its traditional responsibility to maintain and protect the historic Treasury Departmental Offices in Washington, situated directly beside the White House. As it turned out, all three responsibilities raised consequential issues and concerns during the Clinton-Gore years.

Reform of the IRS

Perhaps more than any since the Truman Administration, the Clinton-Gore Administration invested considerable energy in the reform of the IRS to help it better serve the individual taxpayer. While broadly recognized as an efficient agency for collecting taxes, during the 1980s and early 1990s there had been growing concerns that quality of service had taken a backseat. These and other concerns came to a head in early 1994 with the publication of a General Accounting Office (GAO) report that sharply criticized the IRS Tax Systems Modernization (TSM) program and IRS management practices.

In response to the resulting outcry, inside and outside of government, Secretary Rubin and then-Deputy Secretary Summers called for a "sharp turn" in the IRS modernization program, and took a number of steps to increase oversight. These actions included the creation a new IRS

Management Board (IRSMB), chaired by then-Deputy Secretary Summers, and including senior executives from Treasury, IRS, OMB and the National Partnership for Reinventing Government. The IRSMB moved quickly to recruit new leadership from outside and get the IRS modernization process "back on track."

In tandem with the Administration's reform efforts, Congress established a commission in June of 1996 to find ways to improve the IRS. Its final report, published a year later, contained many recommendations strongly supported by the Administration including a 5-year fixed term for the IRS Commissioner, more stable funding to support multi-year planning, a strong focus on customer service, and a more structured approach to congressional oversight. However, constitutional and administrative concerns prompted the Administration to oppose the Commission's majority recommendation to create an IRS Board of Directors outside the Treasury Department.

The debates over IRS reform between the Administration and the more reformist members of Congress came to a head in the fall of 1997. These debates were heated and much in the public eye, putting a rare spotlight on the failings of the IRS. Unfortunately, the debates also raised many unfounded allegations against that agency. However, after months of negotiation and controversy, the Administration ultimately agreed on a modified reform proposal, and the Board of Directors concept subsequently emerged as the IRS Oversight Board, established by the IRS Restructuring and Reform Act of 1998 (RRA 98).

In many ways, RRA 98 was the culmination of years of work by the Administration, the Congress, tax professionals, and private citizens to implement major tax administration reform. Indeed, RRA 98 codified many of the principal reforms already set in motion by the IRS Restructuring Commission and the Administration's reform agenda: including increased personnel flexibilities to attract top-quality management talent to the IRS; the establishment of an externally-oriented board to better inform IRS management decisions; greater focus on hiring an IRS Commissioner, such as Charles Rossotti, with demonstrated private sector management abilities; a greater emphasis on customer service; and expanded taxpayer rights and remedies.

Reinventing the Mint and Redesigning the National Currency

Between 1993 and 2000, Treasury continued to fulfil its core functions of protecting, designing, minting, and printing the currency that millions of people, in the U.S. and around the world, use every day.

Two particular developments stand out:

- First, the reinvention of the United States Mint, beginning in 1995 with congressional approval of legislation to allow the Mint to operate under a Public Enterprise Fund, independent of congressional appropriations and taxpayer funds. This single-fund structure vastly simplified Mint accounting, reduced costs, and assured continuous operating capital. As a result of the legislation, Mint operations were funded from the sale of circulating coins to Federal Reserve Banks and from the sale of numismatic and bullion products to coin collectors and investors worldwide. In the first four full years operating under the PEF, the

Mint returned more than $5.2 billion in profits to the Treasury General Fund. With the success of the 50 State Commemorative Quarters (Q50) and Golden Dollar programs, Mint profits rose to $2.6 billion annually in FY 2000.

- Second, Treasury's Bureau of Engraving and Printing (BEP), which produced between nine and eleven billion notes annually, oversaw the first major currency redesign in over 70 years. The redesign and launch of new $5, $10, $20, $50, and $100 bills was intended to make it more difficult for criminals to counterfeit the American currency, and to make it easier for the 3.5 million Americans with poor eyesight to distinguish between different denominations. While the redesign incurred a predictable number of complaints, these were soon forgotten as the notes themselves were quickly and smoothly accepted by vending companies, collectors, and the public at large.

Renovation of the Main Treasury Building

On June 26, 1996 the Treasury was damaged by a serious fire, the fourth in its more than 200 year history. The fire originated on the north-wing roof and was caused by a welding torch being used for a roof repair. The fire resulted in extensive damage to one-third of the Main Treasury building, with estimated costs of nearly $20 million.

The fire, in turn, was the catalyst for a nearly $200 million restoration effort which finally began in 1999. This effort, formally known as The Treasury Building and Annex Restoration and Renovation (TBARR) project, involved the temporary relocation of a large number of Treasury employees and significant closures and disruption, both within the building and in the immediate vicinity. The ultimate goal, however, was one that all could share: to preserve the historic integrity of the Treasury building, while allowing it to meet more effectively the needs of a modern office environment. When President Clinton left office, TBARR was ongoing, with restoration of the Main Treasury and Annex buildings slated for completion early in 2004.

CHAPTER ONE

MAINTAINING A STRONG ECONOMIC STRATEGY BASED ON FISCAL DISCIPLINE

Introduction

In 1992, Governor Bill Clinton and Senator Al Gore published a book entitled *Putting People First: How We All Can Change America.* The book set out a plan for the renewal of the American economy. It argued that over the previous decade America suffered from poor economic management, resulting in the worst economic record in over 50 years.

To remedy this, the authors advocated replacing the failed "trickle down" theory of the previous decade with an economic and budget plan that emphasized the values of opportunity, responsibility, and community. The plan was designed to cut the budget deficit in half within four years to free up resources for private sector investment. In turn, greater private investment would generate faster productivity growth, increased economic output, and higher incomes – which would produce more rapid growth of government revenue and lead to yet lower deficits, in a type of virtuous circle. The plan was also designed to invest in people, giving them the education and training that would enable them to thrive in an increasingly competitive world where knowledge and skills were becoming ever more important.

This chapter discusses the Treasury Department's most significant efforts and achievements in the areas of fiscal and tax policy during the Clinton-Gore Administration, focusing first on the Administration's eight years of commitment to fiscal discipline, and second, on the Treasury's development and promotion of targeted tax relief and other tax system improvements, within the framework of fiscal discipline.

I. Fiscal Discipline: Moving from an Era of Deficits to an Era of Surpluses

At the end of 1992, as President Clinton and Vice President Gore prepared to take office, ten million Americans were unemployed, the country faced record budget deficits, poverty and welfare rolls were growing, family incomes were losing ground to inflation, and job growth was sluggish. At the end of the Clinton-Gore Administration in January 2001, America enjoyed the strongest economy in memory.

The economic expansion of the 1990s set a record for longevity, passing the previous record in February 2000 with the 107th month of consecutive growth. Unemployment averaged 4.0 percent in 2000, the lowest rate in over a generation. Total payroll employment increased by over 22 million in the eight years since January 1993. Productivity growth averaged 3.0 percent annually during the five years between 1995 and 2000, well above the average pace of the preceding 20 years. Poverty rates were down for all ethnic groups, and home ownership hit a record high for all Americans.

The transformation of the nation's budgetary position was equally stunning. Between 1981 and 1992, the debt held by the public quadrupled. In 1992, the annual budget deficit grew to $290

billion, the largest ever, and was projected to grow to $475 billion by century's end. By fiscal year 2000, however, there was a surplus of $237 billion, the third consecutive surplus and the largest ever. Between 1998 and 2000, the Federal government's publicly held debt was reduced by $363 billion. Relative to GDP, debt held by the public fell from 48.2 percent at the end of fiscal year 1992, to only 34.7 percent at the end of fiscal year 2000. Indeed, at the close of the Administration, the President put forward a concrete plan founded on prudent economic assumptions that would eliminate the Federal debt held by the public by 2010.

The economy's historic performance in the 1990s resulted fundamentally from the confluence of two factors. First, the expansion reflected the entrepreneurial drive of Americans, the advent of new technologies, and the dynamic and flexible character of the American economy. Second, the nation's ability to exploit these opportunities depended critically on the Clinton-Gore Administration's ability to forge a new consensus around sound macroeconomic policies – and, especially, a new paradigm for the management of our nation's budget. Only a minority of economists would dispute the central role that the Administration's fiscal policies played in fostering the nation's remarkable economic situation. And the Treasury Department played an integral role in the story.

At the outset of the Administration, the Treasury Department was headed by Senator Lloyd Bentsen, the 69th Secretary of the Treasury. Bentsen had been Chairman of the Senate Finance Committee and a former Vice Presidential candidate. Roger Altman, Vice Chairman of the Blackstone Group, a Wall Street firm, was named Deputy Secretary. Frank Newman was named Under Secretary for Domestic Finance, and Lawrence Summers was named Under Secretary for International Affairs.

Secretary Bentsen outlined the Administration's main economic objectives in his February 1993 testimony before the Senate Budget Committee: first, to emphasize fiscal discipline so that the country could move away from an era of massive budget deficits and ballooning debt; second, to bring all Americans into the economic mainstream and raise productivity growth by investing in education, training, and welfare reform; and third, to promote global market integration, a subject addressed in greater detail in chapter two. These objectives were to play a guiding role in Treasury's actions over the following eight years.

The 1993 Deficit Reduction Package

Under the economic and budget policies of the two Administrations preceded President Clinton, the national debt quadrupled, Federal budget deficits increased to over $200 billion annually, and the United States was transformed from the world's largest creditor into the world's largest debtor. The 1993 deficit reduction package dramatically reversed our national fiscal and economic course.

The Economic Backdrop

In the early stages of the recovery from the 1990-91 recession, job growth was atypically slow. The 1994 *Economic Report of the President (ERP)* attributed the so-called "jobless expansion" to a variety of factors. For example, the ERP estimated that reductions in defense spending

associated with the end of the Cold War subtracted half of a percentage point from the growth of GDP in 1993 alone, and had "a further adverse impact on aggregate demand through the expenditure multiplier." Similarly, the ERP pointed to continuing weakness in foreign economies, and estimated that the deterioration in net exports during 1993 subtracted another percentage point from the growth of GDP. Additional factors cited by the ERP included an oversupply of commercial buildings in the wake of the building boom of the 1980s, the growing national debt, and a wave of corporate downsizings.[1]

The President's 1993 Budget Proposal and the Omnibus Budget Reconciliation Act of 1993

President Clinton's first budget proposal tackled head on the challenges identified in *Putting People First*. The sharp changes recommended in both tax and expenditure policy aimed to stimulate the economy and invest in the future, through both increased public investment, and deficit reduction that would increase private investment.

In his budget testimony before the Senate Budget Committee, Secretary Bentsen added a personal note. As the former Chairman of the Senate Finance Committee, Secretary Bentsen said that he had seen a lot of Federal budgets, but that the 1993 deficit reduction package "signals a new era of economic leadership by a President who knows more about these issues than any President" he had ever seen. Moreover, Secretary Bentsen noted that the budget was not based on misleading economic predictions and that it would "stand the light of day, from Main Street to Wall Street."

The major elements of the budget proposal were (i) a two-year, $30 billion stimulus package, (ii) a detailed road map for more public investment, and (iii) significant deficit reduction. Secretary Bentsen noted that, during the 1992 Presidential campaign, President Clinton and Vice President Gore focused on four investment themes: rebuilding America; lifelong learning; rewarding work and families; and providing incentives for private investment. Those commitments were honored in the 1993 deficit reduction plan, stated Secretary Bentsen.

The stimulus package was based on four principles: first, that every initiative should fit into the long-term investment plan; second, that the funds should get into the economy quickly; third, that the plan should be kept to a moderate size so as not to risk overheating the economy or rekindling inflation; and fourth, that it should strike a proper balance between private and public investment. Examples of the proposed investments included increased funding for infrastructure improvements such as highways and mass transit; a summer jobs program; child immunizations; the Women, Infants, and Children (WIC) program; and Head Start. The plan was expected to create 500,000 new jobs.

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[1] Economic Report of the President (1994), p. 56.

President Clinton's deficit reduction package included long-term investments – such as one-stop worker training, National Service, and a high-speed information highway -- linked with deficit reduction and a tax increase targeted to upper income taxpayers. Other revenue raisers included an increase in taxes on transportation fuels based on British Thermal Units (discussed in more detail below), removal of the wage cap for Medicare taxes, increased taxation of Social Security benefits, and an increase in the top corporate income tax rate. The package also included a number of tax reductions, including a major expansion of the Earned Income Tax Credit (EITC), a new "enterprise zone" tax incentive program to spur economic growth and job creation in distressed communities, an extension of the low-income housing credit, an extension of the research and experimentation tax credit, an increase in the expensing allowance for small businesses, a new targeted capital gains exclusion for long-term investments in small businesses, and a relaxation of the minimum tax depreciation rules. Treasury's Office of Tax Policy described these proposed changes in the "Summary of the Administration's Revenue Proposals" and the "Supplement of the Administration's Revenue Proposals."

The package also included 150 specific permanent spending cuts. These reductions included: a 25 percent reduction in White House staff; an elimination of 100,000 positions in the Federal government workforce; conversion to a direct student loan program; and $20 billion in domestic, non-defense appropriations cuts. Treasury's Office of Public Liaison helped to persuade over 100 companies and business associations, including more than a dozen oil and gas companies, to endorse the President's economic package.

On Thursday, March 18, 1993, the House passed a budget resolution approving the framework of the President's deficit reduction plan. The next day, the House passed the President's stimulus package. On March 25, 1993, the Senate passed its budget resolution approving the President's plan and began to focus on the stimulus package. However, the stimulus package soon ran into a Senate filibuster extending through their two-week Easter recess. After the Senate reconvened, the filibuster was still in place, and the Administration and Senate Democratic leadership could not pull away three Republicans to break the logjam. With the filibuster holding up other Senate business, President Clinton announced on April 21, 1993 that he would withdraw the stimulus package in order to save his deficit reduction package. A $4 billion extended unemployment compensation bill, which had been part of the stimulus package, was passed separately.

Energy Conservation and Independence – Debate over the BTU Tax

In his first budget, the President proposed a broad-based energy tax based on British Thermal Units (BTUs). While the United States imposed excise taxes on motor fuel used for highway transportation, coal, crude oil received at domestic refineries, and certain other petroleum products, no broad-based energy tax was in place at the time. The Administration believed that such a tax would help reduce the deficit and put the government on a pay-as-you-go basis for needed public programs. In addition, the tax would advance three goals: reduction of environmental damages, energy efficiency and conservation, and reduced dependence on foreign sources of energy. The proposed BTU tax and several smaller energy tax increases would have raised an estimated $80 billion over five years.

As a Texan with strong ties to that state's oil industry, Secretary Bentsen's endorsement of the BTU tax was legislatively significant. Nevertheless, this proposal became a central sticking point during the debate on OBRA 93. The BTU tax passed in the House, but the proposal encountered strong opposition in the Senate. Eventually, the BTU tax was rejected and replaced by an increase in the excise tax on motor fuels that was estimated to raise only $32 billion over five years. This 4.3 cent-per-gallon increase was imposed on most transportation fuel, including gasoline and diesel fuels used in highway transportation, diesel fuels used in railroad trains, gasoline used in noncommercial motorboats, fuels used in inland waterways transportation, and gasoline and jet fuel used in aviation.

The defeat of the stimulus plan led to a public misperception that the President's entire economic plan had been rejected or was heading for defeat. Aware that the vote would be close, the Administration continued to press forward over the summer.

On August 5, 1993, the House of Representatives approved the deficit reduction package by a 218 to 216 vote -- with all Republicans voting against. The next day, the Senate passed the bill on a vote of 50-50, with Vice President Al Gore casting the tie-breaking vote, one of the most dramatic legislative victories the Clinton-Gore Administration would achieve during its eight years in office. On August 10, 1993, President Clinton signed the bill into law as the Omnibus Budget Reconciliation Act of 1993 (OBRA 93).

Throughout the debate, prominent Republicans prophesied doom. Congressman Newt Gingrich of Georgia stated: "I believe this will lead to a recession next year. This is the Democratic machine's recession, and each one of them will be held personally accountable." Senator Phil Gramm of Texas called it "a one-way ticket to a recession." And Republican Budget Committee member John Kasich of Ohio stated that "this plan will not work. If it was to work then I'd have to become a Democrat and believe that more taxes and bigger government is the answer." These projections would soon prove false, given the country's remarkable economic and budgetary performance over the coming years.

The final bill was estimated to reduce the Federal budget deficit by $496 billion over five years, with $255 billion of those savings derived from lower spending and $241 billion from net revenue increases. The $255 billion of lower spending over five years consisted of roughly $70

billion in net savings on entitlement programs (due in large part to a slowing in the growth of Medicare payments to doctors and hospitals); nearly $110 billion in reduced discretionary outlays; and about $75 billion in savings on interest payments on the publicly held debt.

OBRA 93 also included many of the President's core tax incentives, including expansion of the EITC, creation of empowerment zones, a targeted capital gains exclusion for small business investments, and an extension of the low income housing credit and the R&E tax credit.

Fair and Progressive Taxation

During his budget testimony, Secretary Bentsen stated "For 12 years now, the affluent have really not been paying their fair share of the cost of government. . . . [B]etween 1980 and 1993, the income of the top 1 percent rose 47.6 percent, while their effective tax rate declined by 24.6 percent. . . . The revenue changes we propose restore greater progressively to the individual tax system, making it more fair and equitable." Reflecting the priorities established in the President's budget, the OBRA 93 tax increases fell most heavily on the highest income-earners. Roughly 80 percent of the total revenue increase was levied on households making more than $200,000 -- the wealthiest 1.3 percent of the population. Middle income households, with incomes between $20,000 and $100,000, experienced only moderate increases in their average tax rates, less than one percentage point. Their tax burden increased primarily as a result of the 4.3 cent-per-gallon increase in the transportation fuels tax. Households with incomes below $20,000 – almost 20 million families – actually experienced a *reduction* in their tax burden under OBRA 93. This reduction resulted from the expansion of eligibility for, and the substantial increase in, the Earned Income Tax Credit. Thus, while achieving the largest deficit reduction in our nation's history, OBRA 93 substantially advanced the Administration's objective of making the tax code more progressive and fair.

The Significance of the Package

The economic blueprint enacted in 1993 set America on a course of fiscal discipline and laid the foundation of the country's prolonged period of economic growth. The economic strategy was predicated on the view that a deficit reduction plan weighted toward the out-years (a so-called "back-loaded" plan) would be expansionary. The theory, unproven at the time, was that the bond market would look ahead, and see a reduced set of future pressures on credit markets, and hence a lower level of future short-term interest rates. The market would then bring that observation into the present in the form of lower long-term interest rates – those rates generally being thought of as determined roughly as an average of current and expected future short-term rates. Accordingly, long-term rates could fall *today* because a significant step had been taken toward a more restrictive fiscal policy *tomorrow*. A commonplace argument of the 1980s was that additional Federal borrowing, by driving up market interest rates, reduced (i.e., "crowded out") private investment. Fiscal policy in the 1990s was based on a reversal of this argument: Lower interest rates induced by fiscal discipline would increase business investment in productive plant and equipment and other forms of interest-sensitive spending.

The financial markets reacted positively to the new direction in fiscal policy, and interest rates declined even as the momentum in the real economy improved. On election day 1992, the yield

on the 10-year Treasury bond had been 6.87 percent. At the end of February 1993, following Secretary Bentsen's announcement of the proposed energy tax and the unveiling of the President's economic plan, the 10-year Treasury yield was down to 6.02 percent. By the end of August, after the final enactment of the Administration's economic plan, the 10-year yield fell to 5.51 percent.[2] The nation was on the road to long-term economic recovery.

The Road to Balancing the Budget the Right Way: 1994 to 1996

From 1994 through 1996, employment and output expanded smartly, and the unemployment rate fell to 5.4 percent. During these years, the Administration's fiscal policy continued to combine deficit reduction with key investments in the American people. Health care reform, welfare reform, education initiatives, tax relief for middle-class families, and restructuring of the Federal government all played important roles. Each of these policies was designed to keep the economic expansion and deficit reduction on track while enabling all Americans to enjoy the benefits of a growing economy.

However, many of these policies were opposed by congressional Republicans, who had come to power in the mid-term elections of 1994 and would remain in control of the House and Senate through the end of the Clinton-Gore Administration. The Republicans espoused an economic approach that was strikingly different from President Clinton's, and this clash of philosophies would play a central role in the fiscal debates and outcomes between 1994 and 1996.

Resignation of Secretary Bentsen and Nomination of Secretary Rubin

On December 7, 1994, Secretary Lloyd Bentsen announced his intent to resign as Secretary of the Treasury. Secretary Bentsen, who had served more than two decades in the Senate before joining the Clinton-Gore Administration, was not only a strong force in economic policy but also one of President Clinton's most experienced political advisors.

In a Rose Garden ceremony, President Clinton said of Secretary Bentsen, "As Secretary of the Treasury his work has touched nearly every field of accomplishment of this Administration – making our economy work again for ordinary Americans, restoring discipline to our budget, helping private enterprise create new jobs, expanding trade, passing the Interstate Banking Act which saved billions in regulatory costs, ensuring greater tax fairness in our tax code through giving a tax break to 15 million hard-working American parents. And he's also made the Treasury Department a full partner in our fight against crime and drugs."

Secretary Bentsen's departure had been expected. He had originally announced that he planned to retire at the end of his fourth term in the Senate, but instead accepted the Treasury Secretary position in the new Clinton-Gore Administration. Following a Secretary with a strong role as economic and political advisor to the President, Treasury Secretary-designate Robert E. Rubin's ability to deal with the new Republican leadership in both houses of Congress was questioned by the press. Secretary Bentsen sought to reassure the Washington establishment that Rubin could

[2] Economic Report of the President, (1994), p. 78.

hold his own, saying of Rubin, "anybody who can deal with the egos of Wall Street can deal with the egos of Congress."

Defeating the Contract with America and the 1995 - 1996 Budget Impasse

Tax relief for middle class families had been a priority of the Clinton-Gore Administration from its inception. Having achieved impressive deficit reduction with the OBRA 93, in 1994 and 1995, the Administration had the fiscal latitude to propose a package of middle class tax relief. In December 1994, President Clinton announced a package of fiscally responsible tax cuts for middle class families. Called the "Middle Class Bill of Rights," the tax-cut package included (i) a $500 per child tax credit, (ii) a tax deduction of up to $10,000 for post-secondary education and training expenses; and (iii) an increase in the deductible contribution limits of Individual Retirement Accounts (including a proposal to double existing income limits on deductible IRAs for taxpayers with employer-provided pension coverage). An estimated 87 percent of the benefits of the proposed tax cuts would go to families with annual incomes under $100,000. What tied the package together was the belief that appropriately structured tax relief and support for training could help middle class Americans invest in their own future earning power and that of their children. These proposals were contained in President Clinton's fiscal year 1995 and 1996 budget proposals.

The Republican-controlled Congress, however, had its own, strikingly different agenda, called the *Contract with America*. The *Contract with America*, the central Republican campaign promise during the 1994 mid-term congressional elections, was a ten-point plan featuring, among other things, a number of large tax cuts that favored upper income taxpayers. These tax cuts included, among other things: a $500 per child refundable tax credit; a 50 percent capital gains exclusion and an indexing of capital gains for inflation; a "neutral" cost recovery system; backloaded IRAs; a phaseout of the 1993 tax increases on Social Security benefits; and a tax credit to reduce marriage penalties. The Administration expressed serious concern about the tax provisions in the *Contract with America*, particularly their detrimental effect on the deficit. Treasury estimated that the *Contract's* tax cuts would cost $205 billion over five years and $725 billion over 10 years.

Treasury Assistant Secretary (Tax Policy) Les Samuels testified on January 10, 1995 before the House Ways and Means Committee:

> [T]he tax provisions in the Contract would increase the deficit unless they are fully and permanently offset by specific financing proposals. We learned an important lesson in the 1980s: The responsible thing to do is to make certain that tax cuts and spending increases are paid for at the outset. Our evaluation of the tax proposals in the Contract is based on three basic principles of tax policy: fairness, simplicity and efficiency. We are concerned that several provisions in the Contract do not fully satisfiscal year these criteria. In particular, they would provide disproportionate benefits to high income taxpayers, would make the tax law more complicated, and would encourage unproductive tax shelter activity.

In addition to large unpaid for tax cuts for wealthier Americans, the Republican budget program included deep cuts in Medicare and Medicaid designed to balance the budget in seven years. These Republican proposals were contained in budget reconciliation bills passed by the House and Senate in May 1995.

Throughout this period, the deficit picture continued to improve. In fiscal year 1995, the unified deficit was $163.9 billion. In fiscal year 1996, it came in at $107.5 billion, and in fiscal year 1997, it fell further to $21.9 billion.

As the congressional Republicans advanced their program in the spring and summer of 1995, President Clinton was developing his own proposals to balance the budget in the near term. Initially, it had appeared impossible to achieve this goal without proposing deep cuts in the Medicare and Medicaid budgets. However, the Treasury Department led the way in solving the quandary. On April 9, 1995, Secretary Rubin's Senior Budget Advisor, Alan Cohen, constructed a balanced budget framework that did not necessitate deep cuts in key spending areas. Mr. Cohen found that, if the budget were balanced in 10 or 11 years under Office of Management and Budget (OMB) projections, rather than five or seven under Congressional Budget Office (CBO) projections, as Republicans were proposing, the Administration could eliminate the deficit while protecting key entitlement and discretionary programs.

On April 10, Secretary Rubin presented the plan to President Clinton, who asked OMB and Treasury to flesh out the details. Just over two months later, on June 14, 1995, the President formally announced a plan that balanced the budget in ten years, but required much smaller cuts in Medicare and Medicaid than those proposed by the Republicans. Moreover, the President's program included fiscally responsible tax cuts, many of which had been proposed in the Administration's February budget, that were targeted to benefit middle class families. On the eve of his departure for the G-7 Summit in Halifax, Canada, President Clinton said, "I am proud that our deficit today is now the lowest of all the G-7 countries. Our new budget proposal to balance the budget in 10 years will permit us to do this and continue to invest in the education and development of our people." For the remainder of the summer and fall of 1995, the budget debate focused on the competing plans advanced by President Clinton and the congressional Republicans.

President Clinton and his Administration contended that it was important to balance the budget, but, the President stated, "there is a right way to do it and a wrong way to do it." The Administration argued that the Republican bill – which called for deep cuts in Medicare and Medicaid, and included large tax cuts for the wealthy -- was the wrong approach. Indeed, the Democrats described the Republican plan as paying for these large tax cuts through Medicare and Medicaid cuts, which was unacceptable to the Administration. The Administration favored a more gradual path to eliminating the deficit, which permitted a balanced combination of spending restraint and measured tax reduction. Secretary Rubin noted that "the President has been involved in a lengthy process of focusing on the tradeoffs with respect to all the factors that will determine what kind of an economy we're going to have in the years ahead -- jobs increases, increasing standards of living. And this is the fruit of an enormous amount of work about what we need to do for our economy."

In spite of the President's commitment to veto the bill, in November 1995 Congress passed a Conference Report containing the Republican budget framework. Congressional Republicans, aware that they did not have enough votes to override a Presidential veto, pursued two strategies designed to force the President to accept the Conference Report.

The first strategy, which related to appropriations bills, resulted in two Federal government shutdowns. By November 14, only three of the 13 appropriations bills for fiscal year 1996 – which had commenced on October 1 – had been completed. The completed bills were Military Construction, Agriculture and Energy and Water. Agencies covered by the remaining bills – including the Treasury Department – had been kept running through a series of temporary continuing resolutions (CRs). When the CR that carried forward to November 14 expired, the Republicans refused to pass an additional continuing resolution without a concession from the White House on the balanced budget package. Republicans demanded that the White House agree to balance the budget in seven years using CBO projections, rather than the more optimistic (but still prudent) OMB assumptions on savings and costs. The President would not accede to this demand.

When congressional Republicans refused to pass a new CR, the agencies without appropriations – including Treasury – were forced to shut down. Public safety functions were exempted, but otherwise only essential personnel were permitted to work. The initial shutdown, which lasted from November 14 through 19, was temporarily settled when Congress passed and the President signed a new CR that included an agreement to eliminate the deficit in seven years. During the negotiations to reopen the Federal government, appropriations bills for the Treasury Department and Postal Service, and Legislative branch were enacted.

On December 7, 1995, the Treasury released a package of budget proposals in connection with the negotiations. Nevertheless, within several weeks, negotiations between the Administration and Congressional Republicans broke down and the government was again forced to shut down. The second shutdown began on December 16 and continued through January 7, 1996. Federal agencies forced to shut down a second time included the Departments of Education, Labor, Interior, State, Commerce, Justice, Veterans' Affairs, Housing and Urban Affairs, Health and Human Services, and the Environmental Protection Agency.

As the second shutdown dragged on over three weeks, public opinion turned against the Republicans, and on January 7, 1996, they abandoned the shutdown strategy without having gained any leverage on the Administration.

The Republicans' second strategy, pursued concurrently with their appropriations strategy, centered on a threat not to increase the statutory limit on Federal debt, that could be reached by November 15, unless President Clinton acceded to their budget framework. Failure to raise the debt limit had two potential consequences: First, it would cause the Federal government to default on its debt for the first time in its history, and second, it would render the Federal government unable to make payments on certain checks presented to it. Led by Secretary Rubin, Treasury defeated this Republican strategy by, among other things, implementing a complex legal method to preserve the Treasury's authority to make payments on all claims, thereby

avoiding the default and maintaining the full faith and credit of the United States. (See box below for a more detailed discussion of the 1995 debt limit crisis.)

Following the collapse of the Republicans' twin strategies, Congress and the President were able to agree on a modest budget and tax package, without deep cuts in Medicare or Medicaid. The final bill, enacted on April 11, 1995, simply funded the government for the following fiscal year and reinstated and made permanent a percentage deduction for health insurance costs of self-employed individuals. To offset the cost of the health insurance extension, the legislation also contained small revenue-raising measures, including changes in eligibility for the Earned Income Tax Credit and changes in the tax treatment of spectrum auction contracts.

The Debt Limit Impasse: November 15, 1995 through March 29, 1996

As discussed above, the Administration and Congress became embroiled in a fierce standoff over the Republican budget reconciliation plan at the start of fiscal year 1996. At the same time, Congress refused to increase to the statutory public debt limit in the absence of a resolution to the budget debate. Beginning in October 1995, Treasury reduced the issuance of various Treasury securities in order to keep the debt within the statutory limits.

In spite of these measures; the total amount of Treasury obligations outstanding was set to reach the statutory limitation on November 15, 1995, setting the stage for a debt limit impasse that lasted nearly four and a half months. Secretary Rubin repeatedly warned members of Congress that he would be forced to take extraordinary measures to avoid default if acceptable legislation to raise the debt limit was not passed. On November 13, 1995, President Clinton vetoed a temporary debt limit increase that included unacceptable restrictions.

On November 15, Secretary Rubin authorized several extraordinary actions to decrease the outstanding amount of Treasury obligations to a level below the current statutory limitation, thus allowing Treasury debt managers to raise the cash needed to cover payments on obligations of the United States and avoid default. The primary actions taken were the suspension of new investments for the Federal Employees' Retirement System Thrift Savings Plan (the so-called "G-Fund") and the redemption prior to maturity of some of the investment holdings of the Civil Service Retirement and Disability Fund. In taking these actions, Secretary Rubin stated on November 15, "The question of default is of the utmost importance to the nation's economic health. Our credit worthiness is an enormously important national asset, and it should never be tarnished. . . We are not going to break our word, and we are not going to default."

Republican members of Congress strongly criticized the actions taken by Secretary Rubin. On January 4, 1996, House Rules Committee Chairman Gerald B.H. Solomon issued a public call for his impeachment. On February 15, 1996, as the impasse continued, Secretary Rubin authorized additional measures. These included entering into a series of asset exchanges among a government trust fund, a government corporation, and the Treasury, redeeming prior to maturity additional investment holdings of the Civil Service Retirement and Disability Fund, and suspending investment of Treasury's own Exchange Stabilization Fund. Ultimately, it became clear that Congress's efforts to force President Clinton to sign an unacceptable budget or face

default on the obligations of the United States would not be successful. The impasse was finally resolved on March 29, 1996, with President Clinton signing H.R. 3136.

When the impasse was resolved, investments of those trust funds impacted by the impasse were adjusted pursuant to existing statutory authority in order to replicate the investments that each would have held if there had not been an impasse. Pursuant to that authority, interest lost as a result of actions taken during the impasse also was restored. Each of the critical actions taken by Secretary Rubin was later deemed lawful by the General Accounting Office.

The Aftermath of the 1995-1996 Shutdowns

The goals of the Republican-led Congress were much more modest following the fallout and negative publicity from the government shutdowns. Perhaps the most contentious political and legislative issue in 1996 centered on a proposal to provide tax-preferred Medical Savings Accounts (MSAs) in health insurance reform legislation. The health bill originally sailed through both chambers of Congress, though the House bill contained MSAs, while the Senate's did not. A standoff over MSAs ensued and stalled other legislation as well. Concurrently, congressional Democrats and President Clinton began a broad movement to increase the minimum wage, which the Republican leadership resisted.

As time dwindled in the 1996 congressional calendar, many observers began speculating whether there would be any tax legislation approved before the November elections. But after months of arguing and many late-night negotiations, the Republican and Democratic leadership and the Administration, led by Secretary Rubin, finally agreed to a compromise allowing a limited MSA pilot project. This compromise paved the way for passage of several other tax bills.

In July 1996, Congress and the Clinton-Gore Administration agreed to enact the Taxpayer Bill of Rights 2 legislation, which contained a number of provisions providing taxpayers with increased protection in their dealings with the IRS. These included the establishment of a taxpayer advocate within IRS; modification of installment agreement provisions when agreements are terminated; expansion of the IRS's authority to abate interest and to award costs and certain fees in taxpayer disputes; and relief from retroactive regulations. To offset the revenue losses associated with these provisions, changes were made to the "failure to pay" penalty and intermediate sanctions (based on an Administration budget proposal) were authorized where tax-exempt organizations engage in certain "excess benefit transactions" with persons who have substantial influence over the affairs of the organization.

On August 20, 1996, President Clinton signed into law the Small Business Job Protection Act of 1996, marking the end of two years of gridlock on the legislation. The Act contained an increase in the minimum wage (in two increments) and provided close to $20 billion in tax relief to small businesses and workers, including a large pension simplification package (described more fully in Chapter Four). The small business tax relief included an increase in section 179 expensing from $17,500 to $25,000, and S corporation reform. The bill also extended certain expiring provisions, including a reinstatement of the research and experimentation tax credit, and retroactive extension of the section 127 employer-provided educational assistance exclusion. The cost of these changes was offset by a number of revenue increases, including the

Administration's proposed foreign trust rules (described more fully below), modification of the Puerto Rico and possession tax credit, repeal of the 50-percent exclusion for interest from financial institution loans to employee stock option plans, and reform of the depreciation rules under the income forecast method.

Finally, also at the end of August 1996, Congress and the Administration agreed to enact the Personal Responsibility and Work Opportunity Reconciliation (Welfare Reform) Act of 1996 and the Health Insurance Portability and Accountability Act of 1996. Both of these Acts are discussed in Chapter Four.

The 1997 Balanced Budget Agreement

By the beginning of 1997, economic and budget conditions had improved sharply. Employment by then was 11.6 million above its level in early 1993, and the unemployment rate was down to 5.3 percent, compared to 7.3 percent in early 1993. Equity prices had increased nearly 60 percent during the previous two years. The budget picture was also much brighter, with a deficit in fiscal year 1996 of $108 billion, compared with $290 billion in fiscal year 1992.

Despite the sharp improvement in the budget picture during the preceding several years, projections in early 1997 implied that deficits would persist and eventually increase again under then-current law. The Administration set an ambitious goal of eliminating the deficit in five years, and constructed a specific plan for reaching that goal.

In his February 1997 budget testimony to Congress, Secretary Rubin explained that the gathering U.S. economic strength resulted from having "squarely faced our challenges – in both the private and public sectors – including the dramatic progress in restoring fiscal order." In particular, Secretary Rubin noted that (i) the Administration's commitment to deficit reduction had inspired broad business confidence and reduced interest rates, resulting in faster economic growth, and (ii) the nation would not have been in a position even to set a goal of balancing the budget in near term without the 1993 deficit reduction package.

In presenting the Administration's plan for achieving budget balance, Secretary Rubin emphasized that this goal could be achieved without gimmicks and while protecting other national priorities. Among these priorities were measures to enhance research and development, education and training, and healthcare for children. Rubin also emphasized that strengthening America's global leadership was in the nation's economic and security self interest. Needed international investments included support for the United Nations and the international financial institutions, such as the World Bank and International Monetary Fund.

When the Clinton-Gore Administration presented its budget on February 6, 1997, many observers were optimistic that a balanced budget agreement would be reached that year. Negotiations began among the Administration, congressional Republicans, and congressional Democrats. The negotiators decided to use a two-step process to try to reach a deal. The first step would be to agree on a framework for a deal. The second step would be to agree on actual legislation that met the criteria of the framework. Negotiations on the framework stalled,

however, until mid-March, when House Speaker Newt Gingrich expressed his willingness to scale back Republican tax cut plans. Talks resumed in early April.

Secretary Rubin played a key role in both steps of these negotiations, ensuring that the aggregate size of the tax cuts in any agreement did not threaten fiscal discipline. All parties had agreed that the framework in step one must balance the budget by fiscal year 2002 (i.e., in five years). Although the Republicans sought to include tax cuts in the framework that were modest enough to allow budget balance within five years, the cost of their tax cut proposals exploded over the subsequent five years. Secretary Rubin argued relentlessly that the framework must include a reasonable restriction on the size of the tax cuts over ten years, not just over five years. Secretary Rubin's efforts resulted in an agreement limiting the size of tax cuts over ten years to $250 Billion.[3] By negotiating this agreement, Secretary Rubin made a critical contribution to maintaining fiscal discipline.

The outlines of the framework were agreed upon and announced on May 2. A complete framework was presented to the public on the evening of May 15. Then began the process of enacting legislation that abided by the framework. In June, the Administration announced specific tax cut proposals that met the five and ten-year cost limitations. The Republicans also proposed tax cuts that met these limitations, but their proposals exploded in cost in the *second* ten years. Once again, Secretary Rubin argued relentlessly against such fiscally irresponsible tax cut proposals. In the end, he was successful in maintaining fiscal discipline: The final legislation included tax cuts whose costs did *not* explode after the first ten years. Final tax and budget bills were passed by wide margins in the House and Senate at the end of July and the Taxpayer Relief and Balanced Budget Acts of 1997 were signed by the President on August 5.

These bills included the following main features. First, taxes were decreased by about $80 billion through FISCAL YEAR 2002. The largest tax reduction came from the new Child Tax Credit, with substantial further tax savings through the new HOPE and Lifetime Learning tax credits. Other tax cuts included expansions of individual retirement accounts, a cut in the capital gains tax rate, and an increase in the estate and gift tax exemption. These tax measures, and their relationship to the Administration's overall goals for tax policy, are examined in greater detail later in this chapter. A second central feature of the 1997 budget agreement was reduced payments to Medicare providers – partly by stamping out waste, fraud, and abuse – estimated to reduce outlays by about $100 billion through fiscal year 2002. The third key element of this package was new limits on discretionary spending, modifying and extending the caps imposed in OBRA 93. The discretionary caps were estimated to reduce spending by about $90 billion over the following five years. The net result of these changes was a projected elimination of the budget deficit by 2002 – a watershed event in the nation's fiscal history.

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[3] The cost over five years was to be limited to $85 billion. A package of tax cuts that cost $85 billion over the first years and whose cost grew at the same rate as GDP, would costs $ [250] billion over ten years. The Republicans, however, were proposing packages that cost far more than $250 billion over ten years.

President Clinton's First Exercise of the Line-Item Veto

After passage of TRA 1997, the President had five days to decide whether to exercise his new line item veto authority. Pursuant to the Line Item Veto Act of 1996, the Joint Committee on Taxation had identified 79 provisions that could be subject to line item veto as "limited tax benefits." Treasury staff, led by then-Tax Legislative Counsel Jon Talisman and Deputy TLC Clarissa Potter, worked with NEC Director Gene Sperling and his staff to cull the list and make veto recommendations to Secretary Rubin and White House Chief of Staff Erskine Bowles. Items were dropped from the list because they fixed flaws in present law, properly eased transitions to the new law, or were plainly part of the understandings reached by the President and the Congress as part of the budget process.

Eventually, the list was narrowed to two items, which the President line-item vetoed on August 11, 1997. First, he vetoed a provision providing the financial services industry with a temporary exemption from paying current U.S. tax on their foreign income under subpart F of the tax code. The President stated that, while the primary purpose of the provision was proper, it was drafted in a manner that would have permitted substantial abuse and created major tax loopholes for these companies. Second, he vetoed a provision that allowed gain on the sale of certain farmer coops to be deferred. The President stated that, while he wants to encourage value-added farming, he was concerned that the proposal did not include appropriate safeguards to ensure that the gain was ultimately recognized. Moreover, the proposal was not targeted to small and medium sized coops.

The Line Item Veto Act was eventually ruled unconstitutional by the Supreme Court and the two provisions were reinstated.

The Era of Budget Surpluses: 1998 - 2000

Well ahead of all previous expectations, the Federal budget moved out of deficit in fiscal year 1998 for the first time since 1969, registering a unified surplus of $69.2 billion. The improved fiscal outlook resulted primarily from the 1993 and 1997 budget agreements, exceptionally strong economic performance, and favorable changes in revenue collections and health spending. On the revenue side, tax collections were boosted by the increased share of income earned by higher-income taxpayers, resulting in significant part from large gains in the stock market. At the same time, as discussed more fully below, tax burdens on working families were actually lower than they had been in many years. For example, for a family of four with a median income, the Federal income and payroll tax burden was at its lowest in two decades. Spending in Medicare and Medicaid was restrained by the provider payment reductions contained in the Balanced Budget Act of 1997, by slow growth in health costs in the private sector, and by vigorous Administration efforts to root out waste, fraud and abuse.

Save Social Security First: 1998

By early 1998, it appeared that the booming economy and the other factors described above would generate increasing budget surpluses, under baseline assumptions, well into the future.

Accordingly, the Clinton-Gore Administration now faced the new and welcome challenge of formulating appropriate fiscal policy in an era of budget surpluses.

The central feature of the Administration's new budget framework was to reserve the entire surplus pending reform of Social Security. In his State of the Union speech on January 27, 1998, President Clinton insisted that the Federal government should "save Social Security first." This approach proposed to put the country on the path of unprecedented fiscal discipline – namely, not using *any* surplus funds – either for additional spending or for tax cuts – until long-term entitlement reform was enacted. In the meantime, the surpluses would be used to reduce the debt held by the public, which would save the Federal government money by reducing the interest payments on the debt, as well as putting further downward pressure on interest rates. At that time, the old budget restraints – which consisted of caps on discretionary spending and the so-called "paygo" requirement that any reduction in revenue or increase in mandatory spending be paid for by an offsetting change in revenue and mandatory spending – were likely to come under increasing pressure. Therefore, the importance of the President's challenge to reserve all projected surpluses pending enactment of entitlement reform is difficult to overstate.

In his testimony to the Senate Budget Committee, on February 3, 1998, Secretary Rubin reiterated the Administration's strongly held principle that any surplus-reducing measures, such as increased spending or reduced taxes, had to be fully paid for. At the same time, within that framework, the budget actively focused spending and tax policies on helping American families, investing in areas critical to future productivity, and promoting and protecting the United States' interests in the global economy. Secretary Rubin noted that "we have finally put our nation's fiscal house in order. That is an enormous achievement, but by no means can we rest on our laurels."

The Administration's "save Social Security first" strategy was extremely successful in preserving and promoting fiscal discipline in the face of Republican pressure for large tax cuts. For example, in the summer of 1998, then-Speaker Newt Gingrich and other House Republicans proposed a tax cut totaling as much as $700 billion over 10 years. But this proposal was defeated in significant part due to the political potency of the President's message that resources needed to be reserved for Social Security and Medicare reform. To a very large degree, the public accepted and supported the underlying idea that, once the projected surpluses were tapped for spending or tax cuts, it would be very difficult indeed to know where to draw the line. Thus, compelling logic supported the Administration's argument that using "just a little" of the surpluses would not be the best approach, and that a "bright line" approach was preferred. The House subsequently passed a smaller $100 billion tax package that died in the Senate.

Throughout 1998, the President led a national debate about Social Security reform. At the beginning of the year, he enunciated five principles to guide the Social Security reform process. First, reform must strengthen and protect Social Security for the 21st century, guarding against proposals that are not comprehensive solutions to the solvency problem. Second, reform must maintain universality and fairness. Third, reform must provide a benefit that people can count on, which precludes radical privatization that would undermine Social Security as a foundation of retirement income security. Fourth, reform must preserve financial security for low-income

and disabled beneficiaries. Fifth, reform must maintain fiscal discipline and preserve the surpluses until Social Security is reformed.

Over the course of the year, the President hosted three town meetings on Social Security. The first was held in Kansas City on April 8, 1998. At that meeting, the President, accompanied by Secretary Rubin, laid out a broad picture of the current status of the Social Security program, and the various approaches then under discussion (some favored by the Administration and some not) to reforming the program. A second town meeting, held in Providence, Rhode Island on July 1, focused on issues specifically related to retirement, including the differential ability of individuals to continue working past age 62, the earliest eligibility age in Social Security. The third town meeting was convened on July 27 in Albuquerque, New Mexico. During that meeting, a debate on the merits of introducing individual accounts featured Peter Diamond on the skeptical side and Michael Boskin on the supportive side. Another debate about whether the Social Security trust fund should invest part of its assets in private securities featured Carolyn Weaver on the skeptical side and Robert Reischauer on the supportive side. This process of national dialogue culminated in the White House Conference on Social Security on December 9, 1998.

Supporters of individual accounts were divided over whether they should form a substitute for, or an addition to, the existing program. This was a key point of contention. Though not generally receptive to proposals of the former type, the Administration supported those of the latter type, to the extent that they would provide a fair, progressive mechanism for individuals to improve their financial security in retirement. Another potential reform was investment in assets whose expected return exceeds the expected return on the Treasury securities held by the Social Security trust fund. In 1998, the Administration favored investing a limited fraction of the Social Security trust fund in equities in a manner that was cost-effective, passive rather than active (thus investing in one or more broad-based indexes of equities), and immune from political influence. Many Republicans attacked the idea of investing part of the trust fund in equities, in part based on the argument that it would inevitably lead to inappropriate government intervention in the affairs of business.

Treasury played a central role in the Administration's evaluation of reform proposals. Deputy Secretary Summers, along with National Economic Council (NEC) Chairman Gene Sperling, chaired a Technical Working Group to consider the economic and budgetary implications of alternative options for reform. In addition, Assistant Secretary for Economic Policy David Wilcox, then-Assistant Secretary for Financial Markets Gary Gensler, Alan Cohen, the Secretary's budget advisor, and Deputy Assistant Secretary for Tax Analysis Leonard Burman participated in the Working Group and undertook a large amount of the required analysis. The Treasury team established a close and effective relationship with the NEC staff working on this issue – first Peter Orszag and then Jeffrey Liebman. Douglas Elmendorf also played a key role, first from his position on the staff at the Council of Economic Advisers, then briefly at the NEC, and finally at Treasury as Deputy Assistant Secretary for Economic Policy.

Internal Revenue Service Restructuring and Reform Act of 1998

On July 22, 1998, President Clinton signed the IRS Restructuring and Reform Act of 1998, which set in motion the most comprehensive overhaul of IRS's internal operations in more than four decades, put new emphasis on electronic filing, and put in place new rights and protections for taxpayers dealing with the IRS. To offset the cost, the Act contained several revenue-raising measures from the President's budget. These included provisions to overturn a 1996 Tax Court decision (*Schmidt Baking, Inc.*) concerning the tax treatment of vacation and severance pay; to freeze the grandfather status of "stapled" real estate investment trusts; and to preclude certain taxpayers from prematurely claiming losses from receivables. (The major provisions of the Act are more fully discussed in Chapter 7.)

The Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999

After haggling for almost a year over the makeup of the fiscal year 1999 budget, Congress finally passed an all-inclusive budget and tax plan. This Act, which was signed by President Clinton on October 21, 1998, represented a significant step forward for America, helping to protect the surplus until Social Security is reformed, forging a bipartisan agreement on funding the International Monetary Fund and putting in place critical investments in education and training. The Act provided an expanded self-employed health deduction and provided tax relief for farmers and ranchers, including permanent extension of income averaging. The bill also extended several expired tax and trade provisions, and provided for a moratorium on new taxes on the Internet (for an expanded discussion on the Internet Tax Freedom Act, refer to Chapter 6). The ten-year cost of the bill, $9.2 billion, was offset mostly by the adoption of the Administration's proposal to shut down the so-called "liquidating REIT" tax shelter (described more fully below), which had allowed banks and other taxpayers to avoid tax on their operating income. Shutting down this shelter, which had been identified by then-Deputy Assistant Secretary (Tax Policy) Jon Talisman, saved the government $34 billion over 10 years, as estimated by Treasury.

The $520 billion omnibus spending bill also included current fiscal year funding for the Department of Treasury, the IRS, and other Federal agencies. Other important items included technical corrections to previous tax bills and a clarification in the tax treatment of nonrefundable personal credits under the alternative minimum tax (described below). The vote drew bipartisan support in both house of Congress, which approved the bill to avert a shutdown of the Federal government. There was some opposition, largely on procedural grounds, regarding the unusual decision to enact tax relief through a spending bill.

A Budget Framework for Social Security and Medicare Reform, and Long-Term Fiscal Discipline: 1999

In his January 19, 1999 State of the Union address, President Clinton built on his decision to save Social Security first by proposing a specific budget framework for Social Security reform and long-term fiscal discipline. This framework allocated projected unified surpluses for the next 15 years in the following way. First, 62 percent of the surpluses were allocated for Social Security, and 15 percent for Medicare. These resources would be transferred to the Social

Security and Medicare trust funds to extend their solvency. Because the funds were not needed to pay current benefits, they would be used predominantly to pay down publicly held debt of the Federal government. A limited amount of the revenue transferred to the Social Security Trust Fund would be used to purchase corporate equities under strict guidelines to ensure independent and non-political investments. This would also contribute to the betterment of the Federal government's net financial position.

Under the Administration's framework, another 12 percent of the surpluses were allocated to create new Universal Savings Accounts. (This progressive approach to increasing private saving and helping all Americans to build wealth is discussed further in Chapter 5.) Additional targeted tax cuts – for child care, long-term care, school construction, and investment in economically depressed areas – were financed by curtailing unwarranted tax subsidies, closing tax shelters and other loopholes, and otherwise improving compliance. The final 11 percent of the surpluses were allocated for military readiness and other important national priorities. Critically, these other uses of the surpluses were conditioned on the prior saving of Social Security.

On February 3, 1999, Secretary Rubin testified before the Senate Budget Committee to discuss the President's fiscal year 2000 budget, the first budget of the 21st century. At the outset of his testimony, Secretary Rubin reviewed the economic and budget record of the past six years. He stated that the President's economic strategy had "contributed greatly to moving us from deficits to surpluses, and to what many consider to be the best economic conditions in recent memory – the longest peacetime economic expansion in our history, a very high rate of job creation, the lowest unemployment in decades, and real increases in income across all income strata." Secretary Rubin further noted that "tax burdens on working families [we]re at record lows for recent decades," in part because of the child tax credit enacted in the 1997 balanced budget plan. He added that for a family of four with half the median income, the income and payroll tax burden was at its lowest level in 31 years. This was due, in part, to the OBRA 93 expansion of the Earned Income Tax Credit. Moreover, the Secretary noted that for a family of four with double the median income, the federal income tax burden was at its lowest level since 1973.

In this economic context, the President proposed that the best way to generate jobs, raise standards of living and promote retirement security was to save the preponderance of projected budget surpluses and not consume them with tax cuts and spending programs. This was the principle embodied in this fiscal year 2000 budget proposal.

The Republicans charged that the Administration was "double-counting" Social Security surpluses in its budget framework, because those surpluses represented part of the unified surpluses that were allocated under the budget framework. Indeed, the unified budget surplus represents the sum of the Social Security surplus, labeled "off-budget," and the surplus in other government activities, labeled "on-budget." However, the Administration pointed out that the traditional goal of balancing the unified budget would allocate the projected Social Security surpluses to other spending or tax reductions. The central innovation of the Administration's budget framework was to allocate those surpluses to debt reduction. Thus, the Administration's framework would have paid off most of the outstanding debt held by the public over 15 years, the most fiscally disciplined budget in memory.

In contrast, the Republicans continued to focus on tax cuts that would have favored high income taxpayers at the expense of strengthening Social Security or paying down the Federal debt. In January and February of 1999, both the Senate and House leadership introduced legislation that would have used much of the projected Social Security surplus (along with the projected surplus outside of Social Security) for a 10 percent across-the-board tax cut.

A Consequential Change of Framework

On June 28, 1999, with the release of the Clinton-Gore Administration's Mid-Session Budget Review, Secretary Rubin, then-Deputy Secretary Summers, and OMB Director Jacob Lew announced a modified budget framework to strengthen the protections for Social Security. This new framework would balance the budget in each of the next ten years and beyond *without using any Social Security surpluses*. Indeed, the fiscal year 2000 budget would show an on-budget surplus (over and above the amount of the Social Security surplus) for the first time in 40 years.

The central feature of the new framework was a proposal to create a Social Security "lockbox." This lockbox was to contain both the current-law Social Security surpluses, and additional funds transferred from the on-budget account, to ensure that they be used only to pay down the debt held by the public. The amounts to be transferred would equal the interest savings from using the Social Security surpluses to pay down debt instead of paying for other government spending or tax cuts. These transfers were projected to be sufficient to keep Social Security solvent until 2053. In addition, the framework would have paid off the debt held by the public, on a net basis, by 2015.

The framework also incorporated a comprehensive reform of Medicare, including the provision of a long-overdue prescription drug benefit. In 1999, more than three-in-five Medicare beneficiaries did not have dependable drug coverage, including many beneficiaries with incomes well above the poverty line. At the same time, the Medicare system provides ineffective competition among health plans, and was projected to run short of funds in the mid-2020s. To address these concerns, the Balanced Budget Act of 1997 created the National Bipartisan Commission on the Future of Medicare, with a mandate to make recommendations about the program's long-term financial condition. This Commission was unable to reach a consensus on reform, and the Administration then developed its own proposal.

The Administration's proposal included a voluntary drug benefit with subsidies sufficient to achieve near-universal participation. It also provided a novel mechanism for effective competition, based on work done by Treasury Deputy Assistant Secretary Mark McClellan, that protected beneficiaries from paying higher premiums than under current law. Finally, significant transfers of general revenue to Medicare would extend solvency of the Medicare Trust Fund. (Further discussion of the Medicare reform debate appears in Chapter 4.)

During the ensuing budget dialogue with Congress, the shift from unified budget accounting to on-budget accounting was a complete success, as it redirected the political conversation away from allocating the roughly $4 trillion in projected unified surpluses between 2000 and 2010, and toward $1.9 trillion in on-budget surpluses over the same period. A strong bipartisan consensus emerged that the Social Security surpluses should be used only to pay down public debt. In this

way, the buildup of bonds by the Social Security Trust Funds would be matched dollar-for-dollar by a reduction in debt held by the public, and thus an improvement in the Federal government's overall financial position.

Resignation of Secretary Rubin and Nomination of Secretary Summers and Deputy Secretary Eizenstat

On May 12, 1999, President Clinton announced that Secretary Rubin would step down and that Deputy Secretary Summers would be the 71st Treasury Secretary. He also announced that Stuart Eizenstat, Under Secretary for Economic Affairs at the State Department, would become Deputy Secretary. Eizenstat had earlier served in the Clinton-Gore Administration as Ambassador to the European Union, and Under Secretary of Commerce for International Trade, and in the Carter Administration as White House Domestic Policy Advisor.

In the May 12 Rose Garden ceremony announcing the change in leadership at Treasury, President Clinton noted that Secretary Rubin had been acclaimed as the most effective Treasury Secretary since Alexander Hamilton. The President also stated that Secretary Rubin "cares very deeply about the impact of abstract economics on ordinary people . . . I can tell you that for all these years, he has always been one of the administration's most powerful advocates for the poor and for our cities."

Turning to Treasury's new leadership, the President noted that, from the beginning of his Administration, Secretary-designate Summers had been a critical part of his economic team. President Clinton said of Summers, "rarely has any individual been so well-prepared to become Secretary of the Treasury." The President said of Deputy Secretary-designate Eizenstat, that "with his legendary grasp of policy and the art of practical government, his long experience, his stamina and his steady judgment, he will be a vital, full member of our economic team."

As if in tribute to Secretary Rubin, the Dow Jones industrial average dropped more than 200 points when the news of his resignation was first reported, but in recognition of the strong economy, and confidence in the new Treasury team, the market bounced back and closed for the day down just 25 points.

Fiscal Policy in 2000 and Beyond

In February 2000, the U.S. economy achieved the longest economic expansion in American history. Real GDP increased by a stunning 5.0 percent during the four quarters of 1999, marking a fourth successive year during which real growth had been above 4.0 percent. Investment in business equipment and software had jumped nearly 130 percent during the previous seven years (after adjusting for inflation), and productivity growth had averaged a strong 2.8 percent during the previous four years. The unemployment rate had fallen to 4.1 percent by February 2000, and remained around 4% through the end of the Administration.

On February 8, 2000, Secretary Lawrence H. Summers presented the Administration's fiscal year 2001 budget to the Senate Finance Committee. At the outset, Secretary Summers explained that the Administration's three-pronged economic strategy -- based on fiscal discipline, investing

in people, and engaging in the international economy – had resulted in the first back-to-back unified budget surpluses in more than 40 years: roughly $69 billion in fiscal year 1998 and $124 billion in fiscal year 1999.

Secretary Summers focused his budget testimony on five economic objectives:

- Reducing Federal debt to safeguard the economic expansion.
- Meeting the needs of an aging society by laying the foundations for the secure retirement of the baby boom generation.
- Providing new incentives through the tax system to strengthen our communities and encourage people to work and save more.
- Pursuing well-targeted initiatives that invest in health, education and other national priorities.
- Redoubling our commitment to opening markets and sustaining American leadership in order to bolster international economic opportunities and strengthen our national security in an uncertain world.

To meet these objectives, the budget framework included the following main elements. First, the Social Security surpluses were again protected in a "lockbox," and the interest savings from debt reduction during 2000-2010 would be transferred to the Social Security Trust Fund and placed in this "lockbox" annually beginning in 2011. This step alone locked in nearly $2.2 trillion for debt reduction in the next ten years. Second, roughly $300 billion would be transferred to the Medicare trust fund and used for debt reduction. Third, almost $200 billion was allocated to a prescription drug benefit for Medicare beneficiaries and health insurance coverage for low-income Americans. Fourth, more than $250 billion was allocated to a net tax cut, focusing on retirement savings, marriage penalty relief, the expansion of educational opportunities, community revitalization, affordable health care, and tax simplification. The role and design of these tax incentives are discussed more fully later in this chapter.

When President Clinton announced his Mid-Session Review of the Budget on June 26, 2000, projected baseline surpluses had again increased substantially relative to the previous projection. The President's revised budget framework applied his consistent principle of fiscal discipline to this greater bounty.

The President proposed protecting Medicare surpluses in the same way that Social Security surpluses were protected. Placing Medicare surpluses in a lock-box would ensure that they be used to strengthen the government's balance sheet, thus leaving it in a better position to meet the nation's existing commitments to Medicare beneficiaries. The analysis underlying this proposal was largely conducted by Assistant Secretary for Economic Policy David Wilcox.

The Administration maintained its proposals for Medicare reform, health coverage, and targeted tax cuts, but saved $500 billion of the increased baseline surpluses as a "reserve for America's future." Even if all of these funds were used for spending increases or tax reductions, the Office of Management and Budget projected that the Administration's framework would eliminate debt held by the public, on a net basis, by 2012.

Secretary Summers often explained that paying down the debt represented the best course for our economy for five reasons:

- First, because paying down the debt will maximize investment at a time when the reward for investing is especially great.
- Second, because it will help to increase supply in our economy, rather than demand.
- Third, because a failure to pay down debt is likely to exacerbate the U.S. trade deficit.
- Fourth, because a failure to pay down debt will reduce our capacity to meet the demographic challenges ahead.
- Fifth, because the current strength of our economy and budget, combined with the enormous uncertainty attached to budget projections, make this a time when we should be prudent in our commitments.

Ultimately, Congress did not adopt many of the central features of the President's budget. Medicare was not taken off-budget, and neither Social Security nor Medicare reforms were enacted. Indeed, Congress proved unable even to complete work on most of the annual appropriations bills before the beginning of the new fiscal year on October 1, and a succession of continuing resolutions kept the government functioning until Congress approved the final appropriations bills on December 15. In a notable achievement, the final omnibus appropriations bill included an important set of tax provisions to encourage investment in so-called "New Markets." (The New Markets legislation is discussed later in this chapter and in Chapter 4.) Moreover, the vast majority of the projected unified surpluses were not used for either tax reductions or spending increases.

On December 28, 2000, President Clinton announced the Administration's final budget projections. He noted that, if the entire surplus were committed to debt reduction, America could be debt-free by 2009. Nevertheless, the President argued that a portion of the surplus should be used to meet pressing national priorities. Debt held by the public could be paid off no later than 2010, even with spending and tax provisions similar to those in the Mid-Session Review. He urged policymakers to meet that goal. This is one of the greatest fiscal legacies of the Clinton Administration: Even though fundamental reforms of Social Security and Medicare were not enacted, the resources have been preserved to enact proposed solutions in the future.

Conclusion

When President Clinton and Vice President Gore entered office in 1993, the Federal debt had quadrupled over the preceding 12 years. The Federal deficit in 1992 was $290 billion – an all time high. These huge deficits kept interest rates high, diminished confidence, lowered investment, and stifled growth.

In 1993, President Clinton and Vice President Gore fought for, and Democratic members of the Congress approved, a powerful deficit reduction plan based on conservative economic assumptions, that brought the deficit down by $500 billion over five years. The Administration's sustained commitment to fiscal discipline increased market and consumer confidence and helped bring interest rates down. These trends, in turn, helped generate and sustain the economic recovery, further reducing the deficit. The result was a healthy, mutually reinforcing interaction of deficit reduction policy and consequent economic growth, that eliminated the deficit and led to surpluses large enough to eliminate a significant portion of the national debt.

II. Providing Targeted Tax Relief While Maintaining Fiscal Discipline

Over the course of the Clinton-Gore Administration, Treasury's tax strategy focused on providing fiscal discipline, eliminating the budget deficit, keeping interest rates low, and preserving the surplus for Social Security and Medicare, all while maintaining the fairness and integrity of the tax system. In 1993, for example, the President's proposed tax measures provided approximately half of budget's overall $500 billion in deficit reduction. In 1997, the Balanced Budget Act provided fiscally responsible tax relief as part of an overall framework that eliminated the budget deficit for the first time in three decades. Because of the President's insistence on fiscally responsible tax measures within the context of a balanced budget, larger tax cut plans put forth by Republicans were abandoned. Moreover, upholding his 1998 pledge to "save Social Security first," President Clinton vetoed several large Republican tax cut bills that would have jeopardized America's fiscal progress. The tax relief enacted in the last three years of the Clinton-Gore Administration was fiscally responsible and targeted to address key areas of need.

The President's tax program was designed to make the tax system more progressive and fair. Targeted relief was designed to lower tax burdens for typical middle-income working families; to help move people from welfare to work; to revitalize communities; to expand educational and training opportunities; to help families save for retirement; to provide tax incentives for energy efficiency and the environment; and to prevent harmful tax policies. In addition, the Administration and Treasury worked to simplify the tax code and strengthen its integrity by, for example, closing down corporate tax shelters.

Finally, the Clinton-Gore Administration and the Treasury reversed serious management and customer service deficiencies at the Internal Revenue Service (IRS) in the 1990's. Through heightened oversight and management, and through its efforts to shape, pass and implement the IRS Restructuring and Reform Act of 1998, Treasury helped turn the IRS around, making it a more responsive, fair and efficient organization. (The historic reform of the IRS is discussed fully in Chapter 7.)

Reduced Tax Burden for Middle-Income Working Families

Relief for middle-income families was a hallmark of President Clinton's tax program. This program, led by Treasury, reduced the Federal tax burden for middle income American families to their lowest levels in many years.[4] For example, at the end of the Clinton-Gore Administration, a median family of four paid less in federal income taxes than at any time in 35 years and their federal income plus payroll tax burden was lower than at any time in the previous two decades. Even for a four-person family with twice the median income, the federal income tax burden was lower than at any time in the previous 25 years. These reductions in tax burdens resulted largely from the enactment of the $500 per child tax credit and education credits proposed by President

[4] See Washington Post, "A Shrinking Burden" (February 21, 1999), quoting then-Deputy Secretary Summers, "Tax burdens on middle income families are lower than they've been in decades."

Clinton. The child tax credit, for example, provides relief to over 27 million families with children under the age of 17. (The child and education tax credits are discussed below.)

Some argued that federal tax burdens were high because the ratio of federal receipts to GDP had risen above 20 percent. While aggregate revenues were up relative to GDP, this rise was due in large part to an increasing share of income going to high-income families (whose tax rates are higher), rising corporate profits, and extraordinary capital gains on stocks. The higher overall rate was also partially attributable to the increase in 1990 and removal in 1993 of the wage cap for the HI (Medicare) tax, and the income tax rate increases enacted in 1990 and 1993 for higher income taxpayers. All of these factors increased the share of taxes paid by high-income families and, hence, the overall receipts-to-GDP ratio.

Providing Incentives to Work

One of the Administration's strongest commitments was to encourage work, create jobs, and lift people out of poverty. Tax initiatives played an integral part in that effort. As part of his first budget, the President proposed a major expansion of the earned income tax credit (EITC). First, President Clinton's proposed that the credit rates be substantially increased for taxpayers with children. These increases were designed to ensure that every family with a full-time worker would be above the poverty line. Second, the President proposed that taxpayers with no children also be eligible. This expansion, passed as part of OBRA 93, resulted in a tax cut to 15 million of the hardest-pressed American workers. In 1999, the EITC lifted 4.1 million people out of poverty, nearly double the number it lifted out of poverty in 1993.

The Treasury Department also defended the EITC against attacks by its detractors. In June 1995, Congressional Republicans, led by Senators Roth and Nickles, proposed reducing the EITC by $66 billion between fiscal year 1996 and 2002. EITC opponents leveled four charges against the credit, alleging that noncompliance was too high; that the credit's growth was explosive; that it discouraged work; and, lastly, that it was poorly targeted.

The Administration successfully responded to these charges. First, the Administration pointed to its aggressive efforts to improve EITC compliance. Second, the Administration explained that the rapid growth in the EITC could be largely attributed to the three major legislative expansions enacted by Congress during the past decade. The Administration responded to the third charge by pointing to academic research, showing that the EITC encourages non-workers to enter the workforce and that this positive effect dominates any work disincentives caused by income effects or the high marginal tax rates in the credit's phase-out range. Finally, the Administration anticipated the fourth concern by proposing ways to better target the EITC to deserving working families.

As the Administration successfully made its case for the EITC, Congress dropped its plans to scale back the credit. Instead, during the next two years, Congress enacted Administration proposals to improve EITC targeting and compliance. Subsequently, the Administration made several new proposals to simplify the credit and improve compliance, thereby enhancing the integrity of the tax system and protecting the EITC from further attacks.

Treasury also was instrumental in the passage (and extensions) of the Work Opportunity Tax Credit and the welfare-to-work tax credit, which provide incentives to hire individuals who have had difficulty entering the work force. First, in 1993, the Administration proposed the extension and expansion of the Targeted Jobs Tax Credit (TJTC). A two-year extension of the TJTC was passed as part of OBRA 93. Later, as part of the fiscal year 96 budget, the President proposed an extension and modification of the TJTC. These proposed changes led to replacement of the TJTC with the Work Opportunity Tax Credit (WOTC) in 1996. In 1997, the President proposed that WOTC be extended and that a new tax credit be created to move long-term welfare recipients from welfare to work. This new "welfare-to-work" tax credit provided employers with a credit for eligible wages for two years in order to encourage investment in training and long-term employment. Both of these changes were adopted as part of the Taxpayer Relief Act of 1997 (TRA 97). The welfare-to-work tax credit provided a 35 percent credit for up to $10,000 in wages paid in an eligible employee's first year of employment and rose to a 50 percent credit for up to $10,000 in wages paid in an eligible employee's second year of employment. Long-term extensions of both the Work Opportunity Tax Credit and the welfare-to-work tax credit were adopted as part of the Ticket to Work and Work Incentives Improvement Act of 1999.

Encouraging Education and Training

From the inception of his first budget in 1993, President Clinton made promotion of education and training a major priority. He has consistently provided a complementary mix of spending and tax initiatives to spur these activities. In his first budget, he proposed a permanent extension of the exclusion for employer-provided educational assistance and expansion of the TJTC to promote youth apprenticeship training. As discussed elsewhere, both of these provisions were subsequently extended.

Beginning in 1995, the President's budgets recognized the increased burdens faced by middle-income families paying for education and training. To help alleviate this burden and encourage greater investment in these activities, the President first proposed that a deduction be allowed for certain educational and training expenses incurred by the taxpayer, the taxpayer's spouse, or dependents. This proposed deduction eventually became part of the President's "Middle-Class Bill of Rights" and was transformed into two components: the Hope Scholarship and an education and job training deduction, which was subsequently reconfigured as the Lifetime Learning tax credit. The Hope Scholarship, based in part on a program in Georgia, was designed to make at least two years of college the norm in America. It provides a maximum credit of $1500 annually for tuition costs paid in the first two years of college. The Lifetime Learning credit provides families with a 20 percent tax credit for certain education or training expenses. At the insistence of the Administration, both of these programs were enacted as part of TRA 97. In 2000, the Hope Scholarship provided $4.9 billion in relief for American families paying for a college education, and the Lifetime Learning Tax Credit reduced the cost of higher education and job training for American families by $2.4 billion.

Treasury also assisted on creating Education IRAs, which allow earnings to accumulate and be withdrawn tax-free if the money is used to pay for college. A second Administration initiative allowed taxpayers also were allowed to withdraw funds from a traditional IRA without penalty to pay for higher education for themselves, their spouse, child, or even grandchild. Finally,

Treasury played a leading role in allowing investments in state prepaid tuition programs to grow on a tax-free basis.

Despite the success of these prior initiatives, the Clinton Administration believed that more could be done to encourage employers to invest in worker training, and to encourage individuals to invest in their own skills. To that end, the Administration's budget for fiscal year 2001 included several important proposals to improve educational opportunities and encourage individuals and employers to undertake more education and training.

First, the Administration proposed a new College Opportunity Tax Cut, which would expand the Lifetime Learning credit by increasing the credit rate (from 20 percent to 28 percent) and by raising the income range over which the credit would be phased out (by $10,000 for singles and by $20,000 for joint returns). It would also allow taxpayers to elect to take an above-the-line deduction for qualified tuition and expenses in lieu of the Lifetime Learning credit. By lowering the after-tax cost of post-secondary education, the College Opportunity Tax Cut would have encouraged families and workers to invest in the training and education they most need to prepare for and keep up with the demands of the new economy.

Second, the Administration proposed a tax credit for certain employer-provided education programs. This proposal would have allowed employers to claim a 20 percent credit, up to a maximum of $1,050 per participating employee per year, for the provision of certain workplace literacy, English literacy, basic education and basic computer training programs to employees in need. The proposed credit would have helped the disadvantaged attain the first rung of the technological ladder.

Third, President Clinton was concerned that many children attended schools that needed extensive repairs or replacement. The President therefore proposed a new school modernization proposal that would allow school districts to borrow close to $25 billion on an interest free basis.[5] Modeled in part after Congressman Charles Rangel's Qualified Zone Academy Bonds (which passed as part of TRA 1997), the President's proposal would have provided tax credits to bondholders in lieu of interest payments from school districts. The proposal, which would have allowed 6000 schools to be modernized nationwide, had the bipartisan sponsorship of Representatives Nancy Johnson and Rangel and Senators Mosely Braun and Robb.

Spurring Economic Growth in Distressed Communities

When President Clinton took office, he wanted to ensure that all communities shared in the benefits of economic growth. Thus, over the course of the Administration, Treasury led efforts to stimulate public and private investment in low-income communities through development and enactment of specific tax initiatives, such as the empowerment zone program, the New Markets Tax Credit, the brownfields initiative, and extension and expansion of the low-income housing tax credit.

[5] President Clinton also requested an appropriation of $1.3 billion to make urgently needed repairs at thousands of schools.

In the President's first budget, he proposed tax incentives aimed at stimulating revitalization of distressed areas, including creation of "enterprise zones" and permanent extension of the low-income housing tax credit. As a result, OBRA 93 authorized the designation of nine empowerment zones and 95 enterprise communities. Businesses located in empowerment zones were initially eligible for, among other things, three tax benefits: an employment and training wage credit, an additional $20,000 per year of small business expensing, and eligibility for a new category of tax-exempt financing. OBRA 93 also adopted the President's proposal to permanently extend the low-income housing tax credit.

In his 1997 budget, the President called for a substantial expansion in the number of empowerment zones and enterprise communities. Consequently, TRA 97 authorized the designation of two new empowerment zones with the same tax benefits as the original zones (so-called Round 1 empowerment zones), and the designation of 20 other empowerment zones with slightly different tax benefits zones (Round 2 empowerment zones). The President's budget also provided a tax incentive to encourage the cleanup of polluted and neglected sites in distressed areas. Under the proposal, known as the Brownfields initiative, remediation costs could be deducted immediately. This proposal was enacted on a temporary basis as part of TRA 97.

To build on his prior steps in revitalizing communities, President Clinton's last two budgets proposed a further expansion of the empowerment zones program, a substantial increase in the low income housing tax credit, and permanent extension of the brownfields deduction. In addition, he proposed a "New Markets Tax Credit" designed, as Secretary Rubin testified in 1999, to "spur $15 billion in new capital investment in businesses in underserved inner cities and rural areas." In May of 2000, President Clinton was joined by Speaker Hastert to announce a bipartisan agreement on a New Markets and Community Renewal legislative package. The essence of this agreement was incorporated into the Community Renewal Tax Relief Act of 2000, which was signed into law by the President on December 21, 2000. This legislation provides for the designation of 9 additional empowerment zones, extension of all the existing empowerment zones through 2009, as well as the designation of 40 so-called "Renewal Communities." With respect to the empowerment zones, the employment and training wage credit was expanded, an additional $35,000 per year of small business expensing was allowed, and additional incentives were enacted to encourage investment in the distressed areas. In addition, the Community Renewal Tax Relief Act of 2000 authorized the President's $15 billion New Markets Tax Credit program, as well as a 40-percent increase in the low-income housing tax credit authority of the States, extension through 2003 of special tax incentives to promote investment in the District of Columbia, and permanent extension and expansion of the brownfields deduction. (The New Markets legislation is discussed in further detail in Chapter 4.)

Thus, by the end of the Clinton Administration, 40 empowerment zones and 95 enterprise communities had been established around the country, with tax incentives to spur investment and hire workers. To date, the tax incentives for empowerment zones and enterprise communities have leveraged over $10 billion in new private sector investment and have created thousands of new jobs for local residents. Treasury efforts to expand the Low-Income Housing Tax Credit will create nearly 700,000 new units of affordable housing.

Promoting Tax Incentives for Energy Efficiency and the Environment

In the Administration's 1998 budget proposal, President Clinton presented his plan to begin addressing climate change. That plan included $3.6 billion of tax incentives to encourage energy efficiency and renewable energy sources. These incentives targeted energy efficient new homes, building property, and vehicles, solar energy systems, electricity produced from wind and biomass, and certain other initiatives. The proposed tax incentives were part of a larger package of technology initiatives that also included $2.7 billion for R&D and deployment of energy efficiency, renewable energy, and carbon-reducing technologies. Thus these proposals would have provided a total of $6.3 billion in new funding and tax incentives over five years. The Treasury Department played the lead role in developing the tax incentives for the climate change package. (Treasury's role in the Kyoto Protocol and international climate change negotiations is discussed in Chapter 2.)

In response to comments received from industry representatives and environmental groups, the Administration modified the tax proposals for the fiscal year 2000 budget, and Representative Matsui and others introduced them in H.R. 2380. While many of the proposals were not enacted in 1999, P.L.106-170 extended for 30 months (through 2001) the tax credit for electricity produced from wind and biomass, which had been scheduled to expire. In the fiscal year 2001 budget, the tax proposals were modified to support a new directive announced by the President in 1999 aimed at making biomass a viable competitor to fossil fuels by encouraging its use in generating electricity. The proposals were also modified to encourage electricity generation from methane found in landfills, a significant source of warming caused by U.S. emissions, and to simplify and expand the credit for new homes. The fiscal year 2001 budget increased the size of the tax package to $4.0 billion. The following tax proposals were contained in the FISCAL YEAR 2001 budget: (i) a tax credit for energy efficient building equipment; (ii) a tax credit for new energy efficient homes; (iii) an extension of the electric vehicle tax credit and a tax credit for hybrid vehicles; (iv) provision of a 15-year depreciable life for energy efficient distributed power property; (v) an extension and modification of the tax credit for producing electricity from wind or "closed-loop" biomass; and (vi) a new tax credit for certain solar energy systems.

These proposed tax incentives, which were not enacted in the 106th Congress, would have encouraged businesses and consumers to increase their investment in energy-efficient items, new technologies, and renewable and alternative energy sources. The investments induced by the credits would have been long-lived and, therefore, would have produced energy savings and reductions in greenhouse gas emissions for many years. The increase in the market penetration of energy-efficient technologies, new technologies, and renewable energy sources may have led to lower cost production and increased awareness of the benefits of such technologies. Reductions in greenhouse gas emissions, however, are not the only benefits that would have been realized from these incentives. The incentives also would have reduced local air pollution, as well as providing private benefits, such as energy savings for consumers and businesses.

Value Added is the Absence of Value Subtracted

Secretary Summers often said that "value added is sometimes the absence of value subtracted." Some of the Administration's and Treasury's most significant victories have been in preventing poor tax policy from being enacted. Examples include:

Estate Tax Relief

The Clinton-Gore Administration and Treasury supported a variety of estate tax reform provisions, including estate tax reductions and provisions to curtail abuses or close loopholes within the estate tax. Most significant of the provisions supported by the Administration were the estate tax reduction measures enacted as part of the Taxpayer Relief Act of 1997, which provide substantial relief for small businesses and family farms, while increasing the unified credit for all estates. The Administration supported additional relief for small businesses and family farms, but strongly opposed outright repeal of the estate tax.

In 2000, legislation providing for outright repeal of the estate tax, although not for 10 years, was approved by Congress by significant margins and sent to the President. The President vetoed the legislation, stating that it was fiscally unwise, would have reduced the overall fairness and progressivity of the tax system, would have undermined the income tax, and would have harmed charitable giving. The President's veto was sustained in the House of Representatives.

In prior years, Congress had approved repeal or unwarranted reduction of the estate tax within the context of omnibus tax bills vetoed by the President.

Marriage Penalty

In the early 1980's during the Reagan Administration, a two-earner deduction designed to alleviate the effects of the marriage penalty was enacted. In 1986, this deduction was repealed as part of the Tax Reform Act of 1986, sought and approved by President Reagan, in which many targeted tax deductions were eliminated in exchange for lower marginal tax rates. A similar idea was resurrected as part of the *Contract with America,* but not passed.

Subsequently, marriage penalty relief became a hot issue in the later years of the Clinton-Gore Administration. In its fiscal year 2001 budget, the Administration proposed marriage penalty relief for two-earner families who take the standard deduction. The Administration proposal provided properly targeted marriage penalty relief, in a progressive fashion, that would have simplified the tax code.

The Republican-sponsored provision ultimately considered by the Congress was poorly targeted, expensive, and would have added complexity to the tax code by causing millions of taxpayers to be subject to the Alternative Minimum Tax ("AMT"). In part because of poor targeting, the total cost of the House proposal would have been more than $173 billion over 10 years. The Senate version was even more expensive. Moreover, Republican plan's phased-in raising of the 15-percent bracket for joint filers, which accounted for more than sixty percent of the total cost of the House bill, would have provided no tax relief for seventy percent of all married couples.

Because of the Administration's and Treasury's opposition, the marriage penalty bill died in the Congress.

Medical Savings Accounts

The Kennedy-Kassebaum health care legislation also provided, among other things, for a four-year demonstration project allowing individuals covered by catastrophic health insurance to establish tax-favored medical savings accounts (MSAs). Treasury Tax Policy staff, working with White House and HHS officials, led the Administration's effort to analyze the MSA proposal. The Administration concluded that MSAs raised serious health and tax policy concerns: MSAs could harm the health care market by encouraging adverse selection; would constitute a tax shelter for the healthy and affluent; would have a questionable effect on cost containment; would be ineffective in expanding coverage; and would unduly complicate the tax code.

Accordingly, Treasury Tax Policy staff worked to develop versions of MSAs or an MSA demonstration project that would minimize the substantial drawbacks for both tax policy and health policy. This extensive work involved exploring ways to design an MSA experiment that would be meaningful, administrable, and appropriately limited (to minimize the risks that MSAs would lead to reduced coverage for less healthy and for moderate- or lower-income workers). The work was carried out in coordination with Senator Kennedy and his staff. In addition, then-Senate Finance Committee Chief Minority Tax Counsel Jon Talisman and Ways and Means Chief Minority Tax Counsel John Buckley played key roles in developing alternatives.

Between April and July 1996, Treasury Tax Policy staff were among the handful of Administration representatives who took part in negotiations on MSAs and other key health care issues with Joint Committee on Taxation Chief of Staff Ken Kies and representatives of the Republican leadership. The negotiations covered, among other things, possible designs of an experimental MSA program, including possible administration by HHS or IRS, the duration of the pilot program, establishment of a numerical cap on the permitted number of MSAs, special exceptions for MSAs that are associated with new health coverage, and criteria for defining the catastrophic coverage that would qualifiscal year for MSA treatment.

On April 23, 1996, in preparation for the Senate floor debate on MSAs, Treasury staff briefed Senator Kennedy, who was leading the opposition to MSAs as undesirable health and tax policy. Treasury's briefing focused on the threat of adverse selection – the risk that the healthier and more affluent would be more likely to opt for high-deductible catastrophic coverage associated with a tax-favored account. Thus, MSAs would provide disproportionately valuable benefits to high-income individuals who can afford to allow contributions and earnings to accumulate in the account over the long term. Senator Kennedy was receptive and was vigorous in opposing MSAs. Later that day, Senator Kennedy led a heated Senate debate and an upset victory against MSAs. Ultimately, a compromise in the form of an MSA pilot project was signed into law by President Clinton on August 21, 1996 as part of the Kennedy-Kassebaum legislation.

Pension Reversions

In late 1995, the House passed a proposal, as part of budget reconciliation, allowing employers to use "excess" pension assets for unrelated corporate purposes. This provision expanded on the more limited existing Internal Revenue Code section 420 rules that allow an employer to use excess pension assets to provide retiree health benefits to participants in the pension plan. The Administration vigorously opposed this "pension reversion" proposal, and a spirited debate ensued, including a series of studies and counterstudies. The Senate Finance Committee also approved a version of this measure, but the Administration succeeded in stripping the provision out on the Senate floor, on a 94 to 5 vote with the help of Senators Moynihan and Kennedy and their staffs. Although the provision reappeared in the conference agreement, the bill was ultimately vetoed (and the veto message referenced this provision). The reversion proposal was not included in the pension simplification legislation that was enacted the following year, nor had it been enacted as of early 2001.

In early 1998, Representatives Portman and Cardin proposed legislation significantly increasing the amounts taxpayers can save in tax-favored retirement savings vehicles (such as 401(k) plans and IRAs) while weakening a number of the nondiscrimination rules designed to ensure that rank and file employees benefit from tax-favored retirement plans. The bill contained over 50 provisions, a majority of which the Administration supported or did not oppose. Similar or related legislation was introduced by Senators Graham and Grassley and by Senators Roth and Baucus. At a March 1999 hearing before the Ways and Means Subcommittee on Oversight, Assistant Secretary Don Lubick testified regarding both the Administration's support for many of the provisions and its concerns about a minority of the provisions, some of which could lead to reduced benefits for workers. Treasury's analysis of the proposal's potential problems was repeatedly cited by members of Congress, newspaper editors and others who braved the overwhelming support from business lobbying groups and the financial services industry to advocate omission or modification of certain provisions.

The pension proposals, in modified form, were included in the tax bill sent to President Clinton in mid-1999. His veto message cited the skewed distributional effect of the entire bill (including the IRA and retirement plan contribution level increases) and the weakening of the pension anti-discrimination rules. In the fall, when the pension changes were packaged with a minimum wage increase, Treasury Secretary Summers and Labor Secretary Herman wrote to Congressional leaders recommending a veto for many of the same reasons and offering to work with Congress to enact legislation expanding retirement coverage for lower and moderate income workers. These views were reiterated in a March 2000 Statement of Administration Policy (SAP) on the minimum wage bill.

In July 2000, before the House passed the pension proposals by a 401 to 25 vote, another SAP explained how the proposals could lead to lower national savings and advocated progressive Retirement Savings Accounts (RSAs) (described more fully in Chapter 4) to help cover the tens of millions of workers who lack employer-pension coverage. The SAP also addressed the growing cash balance pension controversy, advocating the Moynihan-Jeffords disclosure bill previously developed by the Administration, and a ban on "wearaway" of early and normal retirement benefits, to protect workers affected by cash balance conversions. At Chairman

Roth's request, in August 2000 Secretary Summers provided Senators Roth and Grassley legislative language addressing this wearaway protection.

In September 2000, the Senate Finance Committee reported out a version of the pension bill that included a low-and-moderate income savers credit, based on the RSAs. However, the bill provided little protection for employees affected by cash balance conversions. Indeed, some cash balance opponents felt that the bill provided additional protection for employers, to the detriment of ongoing litigation. The pension proposals foundered in the final days of the 106th Congress, despite the President's efforts (in an October 25 letter) to further them through a compromise providing for increased contribution limits together with certain modifications to prevent harm to workers, protections for workers affected by cash balance conversions, and progressive savings incentives for low and moderate-income workers.

Encouraging Increased Retirement Security and Simplifying the Pension Laws

The Clinton Administration's and Treasury's efforts to strengthen retirement security can be divided into three broad approaches: enhancing pension security, simplifying the pension laws, and expanding pension coverage and retirement savings. For example, a hallmark achievement in expanding coverage and simplifying the pension law was the development of the Savings Incentive Match Plan for Employees (so-called "SIMPLE" plans), which is perhaps the most innovative pension initiative enacted during the 1990s. SIMPLEs are designed to simplify and expand retirement plan coverage for small businesses. (See Chapter 4 for a fuller discussion of the development of SIMPLE plans and other legislative efforts in each of the foregoing three areas.)

Throughout the Clinton Administration, Treasury's Office of Tax Policy was also extremely active in advancing these three pension goals on the regulatory front. As described more fully in Chapter 4, the overall strategy driving pension regulatory activities was to simplify the pension rules, resolve longstanding issues, promote retirement security and saving, and give prompt guidance on newly-enacted legislation. For example, in 1993-94, more than 600 pages of regulations regarding nondiscrimination rules were rewritten to make them less complex, less voluminous, and more flexible for plan sponsors.

Simplifying the Tax System

As part of the Administration's efforts to serve the taxpayer better, in 1997 Treasury assisted in offering a package of more than 60 measures to simplify the tax laws and enhance taxpayer rights. (For a discussion of the taxpayer rights provisions, see Chapter 7's discussion of IRS reforms.) These simplification measures – many of which were enacted in the Taxpayer Relief Act of 1997 -- save individuals, families and businesses millions of dollars in tax preparation fees due to reduced complexity and paperwork burdens. A provision that was particularly helpful to families allowed married couples filing a joint return to exclude from taxable income up to $500,000 (and single taxpayers to exclude $250,000) in gain from the sale or exchange of a principal residence. This change exempted over 99 percent of home sales from capital gains taxes and dramatically simplified taxes and recordkeeping for over 60 million families. The package also increased the filing threshold for estimated taxes, relieving over 600,000 taxpayers

from the burdens of filing and paying estimated tax. In addition, the package relieved small businesses from paying the corporate AMT. As a result of this change, 95 percent of all corporations were relieved of the complexities of computing and paying the AMT. Finally, new simplification measures were provided to improve the ability of American businesses to compete globally, particularly small and newer enterprises establishing foreign operations. For example, simplification was provided for controlled foreign corporations, the claiming of foreign tax credits, and the translation of foreign taxes into U.S. currency.

The Administration also proposed significant relief from the individual AMT. When originally enacted in 1997, the child tax credit, like all other nonrefundable personal credits, could not reduce the parents' tax liability below their tentative minimum tax. In the Tax and Trade Relief Extension Act of 1998, and, pursuant to a proposal in the Administration's fiscal year 2000 budget, in the Ticket to Work and Work Incentives Improvement Act of 1999, Congress enacted provisions to allow the use of the nonrefundable personal credits (e.g., the child credit, the child and dependent care credit, the adoption credit and the education credits) to offset an individual's alternative minimum tax for 1999, 2000, and 2001. To help further ensure that large families with modest incomes do not incur alternative minimum tax liability, and to eliminate the complexity of calculating the AMT for millions more, the Administration's 2001 budget proposed alternative minimum tax deductions for the dependent personal exemptions allowed for regular tax purposes (on a phased-in basis beginning in 2000) and the standard deduction for non-itemizers (for 2000 and 2001).

Strengthening the Integrity of the Tax System

In an effort to preserve the integrity of the tax system, Treasury took a number of important steps to help ensure that all taxpayers are paying their fair share of taxes. As part of the President's 1995 and 1996 budgets, Treasury proposed two important initiatives to prevent taxpayers from avoiding U.S. tax by moving assets out of U.S. taxing jurisdiction. First, Treasury found that many wealthy Americans were abandoning citizenship or residency to avoid tax on appreciated assets and that existing rules were ineffective at preventing this tax avoidance. Accordingly, Treasury proposed that existing rules be replaced with a new regime that would impose a tax on appreciation at the time that the taxpayer expatriates. While this new regime was not ultimately adopted, existing tax rules were strengthened and new immigration rules were adopted in 1996 in an effort to prevent tax-motivated expatriations. At the same time, Treasury also found that foreign trusts and existing grantor trust rules were increasingly being used to avoid U.S. tax. Thus, Treasury proposed several changes to prevent foreign trust tax avoidance, including modifications to prevent unintended uses of the grantor trust rules and strengthened information reporting. These changes were adopted as part of the Small Business Job Protection Act of 1996.

Clinton Administration Efforts to Curb Corporate Tax Shelters

Under the leadership of Secretary Summers, Assistant Secretary (Tax Policy) Jon Talisman, Deputy Assistant Secretary Eric Solomon and Tax Legislative Counsel Joe Mikrut, the Clinton-Gore Administration undertook a comprehensive, multi-faceted effort to tackle the problem of corporate tax shelters -- including legislative proposals to halt the sale and marketing of shelters,

regulatory action to clamp down on illicit activity, and IRS steps to better identify and address abusive transactions.

Many practitioners shared the Administration's concern that the tax shelter problem was large and growing. For example, the American Bar Association, in an appearance before the House Ways and Means Committee[6] noted its "growing alarm [at] the aggressive use by large corporate taxpayers of tax 'products' that have little or no purpose other than the reduction of Federal income taxes," and its concern at the "blatant, yet secretive marketing" of such products.

The President's fiscal year 2000 budget provided a series of legislative proposals to address this problem. The Treasury Department's White Paper entitled *The Problem of Corporate Tax Shelters: Discussion, Analysis and Legislative Proposals*, issued in July 1999, addressed the corporate tax shelter problem in detail, discussing the fiscal year 2000 budget proposals and modifying them to incorporate suggestions made by tax practitioners and corporate officers. The President's FISCAL YEAR 2001 Budget incorporated these modified proposals. The main elements of the proposed legislation included: (a) requiring increased disclosure of certain shelter activities, (b) creating incentives for disclosure by modifying substantial understatement penalties, (c) codifying the judicially-created economic substance doctrine, and (d) providing consequences for all parties to the transaction (including promoters, advisors, and tax-indifferent, accommodating parties). As Secretary Summers stated, these proposals were "designed to change the dynamics on both the supply and demand side of the tax shelter market, making it less attractive for all participants -"merchants" of abusive tax shelters, their customers, and those who facilitate these tax-engineered transactions." The piecemeal approach of addressing shelters on a transaction-by-transaction, after-the-fact basis had proven insufficient.

The Administration also aggressively combated corporate tax shelters with the tools available to it under current law. In February 2000, Treasury issued proposed regulations to require expanded disclosure of sheltering activities. At the same time, Secretary Summers announced that Treasury would strengthen opinion-writing standards under Circular 230, making it harder for promoters of abusive corporate tax shelters to practice law before the IRS. Proposed regulations to do that were issued in January 2001. The Administration also worked with Congress in enacting legislation, and issued various notices and regulations, that shut down specific abusive shelters as they came to light. These included:

- **Lease Strips.** The lease strip shelter involved a multiple-party transaction intended to allow a tax indifferent party to realize rental or other income from property or service contracts and to allow another party to report the deductions related to that income (for example, depreciation or rental expenses). In 1995 and 1996, the Treasury Department issued a notice and regulations to shut down these transactions by preventing the separation of the income from the related deductions.

[6] March 10, 1999

- **Corporate-owned life insurance (COLI).** In 1996 and 1997, two provisions were enacted to prevent the tax abuse of corporate-owned life insurance. Collectively, these two provisions were estimated by the Joint Committee on Taxation to raise over $18 billion over 10 years.

- **Fast-pay Preferred Stock.** Early in 1997, the Treasury Department became aware of several issuances of fast-pay preferred stock, a financing transaction that purportedly allowed taxpayers to deduct both principal and interest. It was reported that one investment bank alone created nearly $8 billion of investments in a few months. The Treasury Department and the IRS shut down the scheme with a notice and subsequently-issued regulations.

- **Liquidating REITs.** This transaction allowed banks and other financial institutions to purportedly create a permanent tax exclusion for certain operating income through the confluence of two incongruent Code sections. The Treasury Department's Office of Tax Analysis estimated that legislation enacted last year to eliminate the use of liquidating real estate investment trusts (REITs) would save the tax system approximately $34 billion over the next ten years.

- **LILO.** Through circular property and cash flows, lease-in, lease-out transactions, or so-called "LILO" schemes, like COLI, offered participants hundreds of millions of dollars in tax benefits with no meaningful economic substance. The Treasury Department and the IRS shut down this scheme with a ruling and regulations.

- **357(c).** On June 25, 1999, President Clinton signed a bill adopting an Administration proposal that eliminates the ability of taxpayers to exploit rules for allocating basis when transferring property between related parties in order to "create" basis in assets far in excess of their value.

- **"Chutzpah Trusts."** The Treasury Department recently issued regulations to eliminate abusive transactions that attempt to use a charitable remainder trust to convert appreciated assets into cash while avoiding tax on the gain.

- **"BOSS" and "Son of BOSS" Transactions.** Treasury and IRS issued notices to shut down marketed tax schemes in which taxpayers used a series of contrived steps in an attempt to generate artificial tax losses to offset income from other transactions.

The restructuring of the IRS into business units, discussed in detail in Chapter 7, was expected to enhance the agency's ability to address the corporate tax shelter problem. In this regard, Treasury and the IRS created an Office of Tax Shelter Analysis to facilitate the centralization and coordination of its efforts. The IRS is expected to employ its newly reorganized structure to identify and address shelter transactions more quickly and efficiently.

Treasury also has been active in addressing challenges posed to our tax system by "globalization." For example, Treasury has taken both unilateral and multilateral actions to identify and combat issues of harmful tax competition. In this regard, Treasury issued new "qualified intermediary" regulations, which streamlined the procedures by which banks can

verify the foreign residence of recipients of interest income from the U.S., and imposed special, more rigorous requirements on banks based in tax havens. These requirements were geared to ensure that such banks have access to and can provide information regarding the beneficial owners of the interest income.

Treasury was also a leader in the OECD's Forum on Harmful Tax Practices, which was established in April 1998 to address the growing problem of unfair tax competition. The Forum, co-chaired by Treasury's International Tax Counsel Phil West, issued a report in June, 2000 identifying 35 jurisdictions as tax havens and 47 tax regimes in OECD member countries as potentially harmful. The identified countries had regimes that lack transparency, that are "ring fenced," or shielded from their own economies and core tax base, and thereby discriminate between residents and nonresidents, or that fail to provide adequate information exchange. Tax systems with these harmful features erode other countries' tax bases and infringe on their ability to implement their own tax policy decisions. Upon release of the OECD report, Secretary Summers welcomed its findings stating, "The identification of tax havens and potentially harmful tax regimes is a crucial step in preventing distortions that could undermine the benefits of enhanced global mobility in today's global economy." As a result of the OECD efforts, over thirty countries already have committed to eliminate their harmful tax practices within five years, and more, including identified tax havens, are expected to do so in the near future. Indeed, both the Cayman Islands and the Netherlands Antilles recently committed to eliminating their harmful tax practices. (Treasury's efforts to address harmful tax competition and other global tax issues are discussed more fully in Chapter 2.)

CHAPTER TWO

INTERNATIONAL ECONOMIC ENGAGEMENT

Introduction

The international economy saw dramatic developments in the eight years of the Clinton-Gore Administration: in the countries of Central and Eastern Europe and the Former Soviet Union, there was the ongoing challenge of economic transition; Japan came the closest that any industrial country has come in the postwar period to a 1930's-style depression; Europe realized a postwar Franco-German dream with the creation of the euro; and in Asia and many emerging market economies, there was great economic progress, only to be followed by a contagious financial crisis that put the stability of the entire global financial system at risk. All the while, the United States enjoyed the longest period of economic expansion in its history.

The sheer scope and often speed of these developments was unprecedented in modern times and posed complex challenges for international policy makers in the US and around the world. The goal was age-old: the development of a strong, stable, more truly integrated global economy. The risks and opportunities on the road to that goal were, in many respects, brand new. In pursuing that goal effectively during the 1990s, a strong U.S. economy was essential -- and certainly highly welcome. But if it was a necessary condition for greater global economic stability and prosperity, it was by no means a sufficient one. Equally crucial would be a concerted effort to promote sound policies around the world, and major reforms of the international system to meet the challenges of a new time.

The Treasury Department led this international effort with concerted engagement at both the bilateral and the multilateral levels. Policy cooperation with our counterparts in the G7 was strengthened measurably, both in the breadth and depth of issues on which the finance ministries coordinated, and Treasury began to use the G7 as a forum in which to develop and build consensus for international financial initiatives and reforms. The result was to greatly enhance the United States' capacity to advance its international policy priorities and obtain the close cooperation of the other major economies. This was to be especially valuable in the latter years of the Administration, when the G7 needed to respond to the spread of international financial crises and achieve major reform of the International Financial Institutions (IFIs).

The focus on promoting sound policies and global reform was evident in the deployment of all the traditional instruments of U.S. international economic policy. Throughout the Clinton years, the Treasury Department concentrated its use of these instruments to promote America's national interests, including most notably, maintaining the strength and integrity of the international financial system, and with it the long-term stability of the U.S. economy:

For example:

- Together with the G7 monetary authorities, Treasury used exchange rate policy judiciously to enhance stability among the three major currencies: the euro, yen, and dollar. It is notable that the frequency and extent of U.S. intervention operations during the Clinton-Gore

Administration were limited. Rather than focusing on the potential for exchange rate intervention, U.S. authorities put increasing emphasis on their preference for sound economic policies that could promote balanced, non-inflationary growth.

- In the IFIs, Treasury pushed for reforms that increased transparency in emerging market economies and lessened the potential for unpleasant market surprises. Treasury also advocated reform of the IFIs' own policies toward such economies: for example, directing resources in a more focused manner, safeguarding against abuse and corruption, and including consideration of the social impacts of economic adjustments.

This chapter will focus on the five leading areas of Treasury activity in the international arena during the Clinton-Gore Administration; first, promotion of international economic integration and more open markets; second, management of emerging market financial crises; third, the reform of the international financial architecture and the international financial institutions (IFIs); fourth, more effective support for the poorest countries; fifth, leadership of global efforts to craft collective response to collective problems. A final, sixth section outlines Treasury's economic engagement with the rest of the world between 1992 and 2000 in a more traditional, geographic fashion.

I. Promoting Economic Integration

From 1992 onwards, bipartisan support for the Administration's trade liberalization agenda helped to intensify the move towards a freer global trading system and produced some of the most significant trade agreements in modern history. And while it was not always popular to say so in the 1990s, no country gained more from this increase in global trade -- exports and imports -- than the United States. By the end of the Administration, trade represented close to one quarter of our economy, the highest it had been at any point in the 20th Century. Between 1992 and 2000, U.S. exports of goods and services rose 74 percent – nearly $500 billion – to top $1 trillion for the first time.

Treasury played an important role in the development of the Administration's overall trade policy during this period: particularly during 1993 and 1994, when Secretary Bentsen's personal involvement was crucial to enacting the North American Free Trade Agreement (NAFTA) and ratifying the Uruguay Round of the General Agreement on Tariffs and Trade (GATT). At a more detailed level, the Department also had lead responsibility in the negotiation and implementation of provisions on financial services, investment, balance of payments, rules of origin, and tax and customs issues. Secretaries Rubin and Summers also played a critical role in the agreement to allow China to enter the World Trade Organization (WTO), and the related enactment in 2000 of Permanent Normal Trade Relations (PNTR) with China.

Major Trade Agreements and Events

Ratification of NAFTA

In 1993, the Administration completed the negotiation of NAFTA, a comprehensive accord that opened markets and provided fair rules for investment and trade in goods and services across

North America. Secretary Bentsen played a central role in securing congressional approval of NAFTA. The Agreement virtually eliminated duties on U.S.-Canada trade and reduced average tariffs on U.S.-Mexico trade to around 1.3 percent by 2000. NAFTA creates a huge market, comprising some 400 million consumers, with a combined GDP of $10.4 trillion. Since NAFTA was implemented, U.S. goods exports to our NAFTA partners grew by about $107 billion or 75 percent (to $249 billion), supporting an estimated 600,000 more jobs.

The Uruguay Round and Creation of the WTO

The Uruguay Round, concluded in 1994, created the WTO and established a more effective mechanism for resolving international trade disputes. The Round further reduced tariffs on industrial products and extended market access commitments into previously neglected sectors, such as agriculture, textiles and clothing, and services. The Round introduced disciplines on the protection of intellectual property rights, trade-related investment measures, and standards.

In response to a successful WTO challenge by the European Union against the U.S. tax regime concerning Foreign Sales Corporations (FSC), in 2000 Deputy Secretary Eizenstat helped to enact new legislation to comply with the WTO finding and thereby reduced the risk of EU retaliation.

Fast Track Authority and the WTO Ministerial in Seattle

The Administration sought "fast track" trade negotiating authority from Congress in 1997, which would have provided for expedited consideration of implementing legislation for free trade agreements, without the possibility of amendment. Congress's failure to pass fast track legislation slowed, but did not halt the momentum to negotiate trade liberalization measures. Even without fast track, the Administration concluded the Jordan Free Trade Agreement and continued to make progress towards a Free Trade Area of the Americas (FTAA).

The primary objective of the December 1999 WTO Ministerial in Seattle was to launch a new round of multilateral trade negotiations. However, the WTO was unable to reach agreement on a broad-based agenda encompassing the complex issues needed for a new round in the midst of serious disruptions of the meeting by protestors. The United States remained prepared and eager to launch a new round at the end of the Administration, but the feasibility of doing so depended on the flexibility of all parties. The start of WTO negotiations on agriculture and services in 2000, as well as trade-related measures to assist developing countries, were encouraging signs of progress. During the September 2000 Bank/Fund Annual Meetings in Prague, Secretary Summers encouraged the IMF, World Bank, and WTO to enhance coordination on trade-related technical assistance, especially for least developed countries.

Caribbean and African Trade Agreements

In May 2000, President Clinton signed into law the Trade and Development Act of 2000, which includes the Africa Growth and Opportunity Act (AGOA) and the U.S.-Caribbean Basin Trade Partnership Act (CBTPA). This law, implemented in October 2000, strengthened our relationship with these regions, expanding two-way trade and creating incentives for the

countries in these regions to continue reforming their economies and to participate more fully in the global economy. Both the AGOA and CBTPA required extensive Treasury/Customs consultations, especially in light of public and congressional concern about potential textile transshipment problems, which Customs is charged with enforcing through its rules of origin and other provisions.

China PNTR

China's fourteen-year long effort to accede to the World Trade Organization (WTO) received additional impetus following the conclusion of a U.S. – China market access agreement in November 1999 and congressional approval of PNTR for China in 2000. Secretary Summers' meeting with Premier Zhu Rong Ji in October 1999 put the issues in context, re-energized negotiations on China's bilateral WTO agreement with the United States. This agreement was concluded in November 1999, under the guidance of USTR Barshefsky and NEC Chairman Sperling. In this agreement, China committed to reduce significantly its tariffs in sectors of high priority for U.S. producers (e.g., technology, autos, chemicals, agriculture), to allow U.S. firms the right of full distribution for their products in China, and to eliminate quantitative trade restrictions and export subsidies for agriculture products. In addition, the bilateral agreement included commitments in numerous services sectors (e.g., banking, insurance, and audiovisual) to eliminate most foreign equity restrictions and to allow the grandfathering of current market access and activities in all service sectors. By January 2001, it was expected that China would enter the WTO upon completion of its final protocol of accession in early 2001.

Trade in Financial Services

The Treasury Department was responsible for negotiating the rules and commitments for the treatment of financial services in international trade and investment agreements involving the United States, improving the international environment for U.S. financial services providers around the world. This required close consultation with the U.S. financial services sector, the Congress, and U.S. regulators to identify offensive and defensive market access interests in such negotiations for banking, securities and mutual funds.

At the conclusion of the Uruguay Round negotiations in 1993, WTO members, led by the United States, agreed to further rounds of negotiations in those services sectors in which insufficient progress had been made, including financial services. A second round of financial services negotiations concluded in June 1995 with only an "interim" agreement, because Secretary Rubin decided to holdout for a better agreement and was able to encourage other negotiators to do the same.

The United States remained a full participant in the 1995 interim arrangement, entitled to all market access and national treatment commitments scheduled by other participants. In its own schedule of commitments, in force from June 30, 1995, the U.S. agreed to protect the existing investments of foreign financial services providers in the United States. However, the U.S. stopped short of guaranteeing full market access, national treatment, or MFN treatment in its own market. It reserved the right to provide differential levels of treatment to both new foreign

entrants to the U.S. financial market and to existing foreign firms seeking to expand or undertake new activities.

The third round of financial services negotiations was successfully concluded on December 12, 1997. This agreement included improved commitments from 70 members in the areas of: 1) foreign firms' right to establish; 2) foreign firms' right to full majority ownership of financial institutions; 3) guarantees that the existing rights of foreign firms in these markets will be preserved ("grandfathering"); and 4) the right to participate fully in other nations' domestic markets on the basis of substantially full national treatment. Under the agreement, several WTO members, including the United States, also either narrowed or withdrew their broad MFN exemptions based on reciprocity.

This, together with the accession of three countries since 1997, brings the number of WTO members that have made financial services commitments to 107, more than virtually any other sector. It has been estimated that this group accounts for over 95 percent of world trade in financial services when measured by revenues.

As comprehensive as the agreement is, it is widely recognized that many WTO members, including the United States, did not commit to provide more liberal treatment to foreign service suppliers than was already their practice. Several countries, in fact, did not even bind their current levels of treatment. Much of the importance of the accord remained, therefore, in its making this treatment legally enforceable by means of the WTO's dispute settlement procedures and the enhanced stability which that engenders. It also provided a pushing off point for further progress.

The Treasury Department sought to build upon this base of binding financial services commitments in a variety of venues, including WTO accession talks (e.g., China), bilateral agreements (e.g., Vietnam, Jordan) and multilateral talks such as the Free Trade Area of the Americas. In December 2000, the United States submitted in the WTO a new financial services proposal, which included commitments for fundamental market access and regulatory transparency, making it the first country to make such a proposal as part of the General Agreement on Trade and Services (GATS) 2000 process.

WTO/Uruguay Round

Treasury played a lead role in the negotiations on trade-related investment measures (TRIMs), balance of payments provisions, policy coherence with the International Financial Institutions, and financial services. The TRIMS agreement disciplined investment-distorting measures such as local content and trade-balancing requirements, thereby promoting greater gains to host countries and foreign investors from their investments. Under the framework of the WTO GATS, then-Assistant Secretary Timothy Geithner completed the banking and securities negotiations for the global Financial Services Agreement in 1997. This agreement is the largest market-opening agreement by value ever concluded, covering nearly $60 trillion in banking, securities, and insurance assets.

NAFTA

Treasury led the negotiations and implementation of NAFTA investment and financial services chapters. The investment chapter provided comprehensive disciplines to ensure that foreign investors did not face discrimination vis-à-vis domestic investors, would be able to invest and repatriate capital, and would be protected from unwarranted expropriation without due process. NAFTA partners invested $189 billion in one another's economies, while total intra-NAFTA foreign direct investment reached $864 billion. The financial services chapter set out rules and principles governing investments of one NAFTA country in the financial institutions in another NAFTA country and trade in financial services between the three countries. It provided for significant, phased opening of the Mexican banking and insurance markets, as well as for party-to-party and investor-to-party dispute settlement mechanisms.

Related Trade Initiatives

In addition to the negotiation of free trade agreements, the Clinton-Gore Administration also pursued a number of other trade-related initiatives. Specifically:

Helsinki Tied Aid Disciplines in the OECD

In late 1991, the United States concluded an agreement (the "Helsinki Package) with other OECD participants to the Arrangement on Guidelines for Officially Supported Export Credits that curtailed the use of trade-distorting tied aid. Tied aid is concessional financing that is linked to the procurement of goods and services from the donor country. The agreement helped to ensure that tied aid was focused on bona fide aid projects that could not service financing terms at market rates, and not on subsidized export promotion. The agreement also protected U.S. exporters from trade-distorting tied aid. Treasury estimated that open competition for new products created additional exports of approximately $1 billion per year. And, the U.S. taxpayer saved more than $300 million per year in appropriations that would have been needed to support the same level of exports if competing with export subsidies -- $2.1 billion since 1993.

OECD Premia and Agriculture Agreements

The 1997 agreement on OECD premia, which became part of the Arrangement on Guidelines for Officially Supported Export Credits, reduced subsidies in the exposure fees charged by export credit agencies by establishing minimum risk premiums. The agreement saved U.S. Ex-Im Bank an estimated $20-30 million per year in budget subsidy appropriations.

OECD Agreement on Agricultural Export Credits

In late 2000, the Administration was also on the verge of finalizing an agreement on agricultural export credits in the OECD Participants Group. The OECD agreement would protect U.S. agricultural export credit programs and allow the United States to focus attention on reducing direct agricultural subsidies in next WTO round.

Bilateral Investment Treaties

During the Clinton-Gore Administration, 17 Bilateral Investment Treaties (BITs) entered into force, with another two pending entry into force as of January 2001. The Administration negotiated and signed 11 additional BITs; ten of these were recently approved by the U.S. Senate for Azerbaijan; Bahrain; Bolivia; Croatia; El Salvador; Honduras; Jordan; Lithuania; Mozambique; and Uzbekistan.

National Treatment Studies

Pursuant to the Financial Reports Act of 1988, the Administration submitted in December 1994, and again in December 1998, its "Report on Foreign Treatment of U.S. Financial Institutions." These reports, which updated previously mandated national treatment studies, described the presence and treatment of foreign financial services firms in the United States, reviewed U.S. government efforts to remove barriers to trade in financial services, and examined the degree of national treatment and market access afforded U.S. financial institutions in foreign banking and foreign securities markets.

II. Management of Emerging Market Financial Crises

During the 1990s, the United States was confronted with a series of financial crises in emerging market economies that at times seemed to pose major risks to U.S. and global financial stability. Between January 1995, when the Mexican peso crisis erupted, and the final year of the Clinton-Gore Administration, when a potential debt crisis in Argentina posed risks to broader emerging market stability, financial crises loomed large on the international landscape.

Working together with the U.S. Federal Reserve, the G7, and the IFIs, the Treasury Department helped lead global efforts to respond effectively to these crises, and to contain the broader effects. This section looks at each of the major crises in turn.

The Mexican Peso Crisis of January 1995

The sudden and dramatic devaluation of the Mexican peso in January 1995 posed a grave risk to global economic stability. The devaluation of Mexico's currency led to the threat of immediate default on Mexico's dollar-denominated, short-term bonds – or *tesobonos* – and the contagion looked likely to spread to other emerging market economies. As Mexico's largest neighbor and a fellow member of NAFTA, the United States was the only country capable of providing the necessary leadership to stave off a much broader international crisis. Yet it was by no means clear that the Clinton-Gore Administration could persuade a skeptical Congress to endorse the large-scale financial assistance that was needed. Acting on the advice of newly appointed Secretary Rubin, President Clinton on January 10, 1995 approved a U.S.-led package of emergency assistance that was to be decisive in restoring stability in Mexico and quelling the crisis. President Clinton made this historic decision despite public opinion polls showing that the overwhelming majority of Americans opposed such assistance.

The international support package provided up to $50 billion in emergency financial assistance, including up to $20 billion in U.S. loans through Treasury's Exchange Stabilization Fund (ESF). The resulting emergency support agreement signed by Secretary Rubin on February 21, 1995, was backed by Mexican oil export proceeds and was dependent on Mexican adherence to a rigorous economic adjustment program.

At the time, this decision was highly controversial, particularly since the use of the ESF, in contrast to more traditional forms of bilateral support, did not require congressional approval. By and large, however, the opposition grew more quiet when faced with Mexico's remarkably rapid recovery. Mexico had borrowed a total of $12.5 billion from the United States in emergency financial support. On January 15, 1997, Mexico made its final repayment on the borrowed funds – three years ahead of schedule – and Mexican interest payments resulted in a net gain of nearly $580 million for the American taxpayer. The program was a resounding success on all fronts: Mexico's economy recovered strongly; stability was preserved in emerging markets around the world; U.S. exports were protected; and Mexico returned to the international capital markets after only seven months. These developments in large part vindicated the decision to intervene in a situation that then-Under Secretary Summers dubbed the "first 21st century financial crisis." The episode also provided the policy makers concerned with some useful preparation for the more global financial crises of 1997-1999.

The Asian Financial Crisis of 1997-1998

Much like the Mexican crisis, the scale and speed of the Asian financial crisis took the world by surprise. Owing to its magnitude and severity, the U.S. was again the only country with the leadership and credibility to marshal an international response to the crisis. Led by Secretary Rubin and then-Deputy Secretary Summers, the Treasury Department took an active role in restoring financial stability by organizing record levels of multilateral and bilateral emergency financing to address the immediate liquidity crisis and by developing structural adjustment programs aimed at addressing the root causes of the crisis. Treasury also worked closely with the IMF, the World Bank, and the Asian Development Bank (ADB) to ensure that social safety net programs were augmented to address the rapid increase in unemployment in those countries most severely affected by the crisis. These initiatives, combined with the strong commitment by the Korean and Thai governments to undertake essential economic adjustment measures, restored confidence in the region and paved the way for a strong economic rebound in 1999.

Financial markets generally associate July 2, 1997, the day Thailand was forced to abandon its exchange rate peg, with the commencement of the Asian financial crisis. Initially the crisis was characterized by repeated unsettling news of the external and domestic finances of Thailand, including lower international reserve levels, higher external liabilities, and much weaker corporate balance sheets than markets had expected. Financial institutions reacted quickly by withdrawing corporate and interbank credit lines and selling off equities and bonds resulting in a rapid depreciation of the Thai baht and a liquidity crisis for the government, domestic banks, and private corporations. As similar unsettling news began to surface in neighboring countries, financial markets reacted, and the crisis quickly spread to Malaysia, Korea, and Indonesia, soon becoming a region-wide emergency.

- In Thailand, the Treasury Department coordinated efforts to develop an international financial support package ($17.2 billion) in 1997 and worked closely with multilateral agencies and the Thai government to stabilize the economy and address the major structural problems in the financial and corporate sectors. By early 1998 the balance of payment crisis had ended, and the economy began to recover in 1999.

- In Korea, the U.S. led a record emergency financial support package ($57 billion) including contingency financing of $5 billion from Treasury's ESF, which was ultimately not used.[1] This financial support, combined with economic stabilization measures, quickly arrested the balance of payments crisis and the economy bounced back in 1999 with real GDP growth of 10.7%.

- In Indonesia, the Treasury Department helped mobilize an initial financial support package in late 1997 of $36 billion including contingency financing from the ESF. However, Indonesia's economic program faltered in 1998 as the Suharto government failed to follow through on commitments to the IFIs. The economy continued to suffer from political uncertainty associated with the end of Suharto's rule and the slow transition to democracy.[2] With political stabilization, the economy stabilized in 1999 and was expected to grow by 5% in 2000.

The Russian GKO and LTCM Crisis

Within months after stability was restored in the wake of the Asian financial crisis, the world was once again faced with the threat of major contagion -- this time originating in Russia. Russia began to feel the fallout from the Asia crisis in late 1997. Spurred also by a sharp fall in the price of oil, Russia's major export, Russia faced significant fiscal and balance of payments problems in mid-1998. Then-Deputy Secretary Summers and Under Secretary Lipton led a major international effort, which mobilized up to $22 billion, to support Russia's efforts to stave off the crisis by pushing ahead with aggressive tax reforms and other needed policies. The reformist Russian government, however, was unable to push its program through the fractious Duma, leading the Russian government to devalue its currency and default on a large portion of its debt. Unlike the crises in Mexico and Asia, however, the defaulted debt in question was denominated largely in Russian rubles, rather than US dollars.

In the wake of the Russian default and devaluation, Treasury initiated steps to minimize the economic impact on Russia and on other countries in the region. Treasury encouraged the European Bank for Reconstruction and Development (EBRD) to set up trade credit lines to Russia and other countries to fill the gap caused by the widespread collapse of Russian banks. Treasury also supported a rescheduling of some of Russia's official debt in 1999.

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[1] The success of this package, which was announced on Christmas Eve 1997 as Korea was threatened by default, was made possible in part by the decision of U.S. financial institutions to roll over pending Korean debts, which had been strongly encouraged by Secretary Rubin and other U.S. officials. This was the first instance of significant private sector involvement in financial crisis resolution.

[2] In 1998, President Clinton dispatched then-Deputy Secretary Summers and former Vice President Mondale to Jakarta to meet with President Suharto and Indonesian financial officials in an effort to spur reform.

However, Russia's default on GKOs – or ruble-denominated government bonds – sparked a broader sell-off in emerging market debt instruments and in other "convergence plays" ranging from Italian government bonds to Danish mortgages. The widening of bond yields on the latter two in particular, led to severe and immediate solvency problems in some of the world's leading hedge funds, including Long-Term Capital Management (LTCM), once considered the "Rolls Royce" of leveraged institutions. Owing to their unexpectedly heavy exposure to LTCM, the crisis posed grave risks to the financial health of some of the world's leading investment banks, and thus threatened to undermine the stability of the global financial system. In this instance, the U.S. Federal Reserve played the lead role in dousing the crisis by persuading LTCM's major creditors to rollover their exposure to the hedge fund, and by rapidly cutting interest rates in three consecutive moves.

Latin American Crises in the Late 1990s and 2000

The Mexican, Asian, and Russian financial crises posed the broadest and most serious challenges to the American economy and to America's ability to contain international volatility in the 1990s. However, the Russian crisis, with its later effects on American hedge funds and other highly-leveraged institutions (HLIs), was not the last financial crisis of the Clinton years, even if it was almost certainly the gravest.

In the final two years of the Clinton-Gore Administration, Treasury was confronted by further crises. In each case, the U.S. helped to prevent the crisis from spilling over into serious international contagion:

- Brazil avoided default on its sovereign debts in 1998-99, when it was briefly but negatively impacted by the Asian financial crisis. The U.S. Treasury led international financial support efforts for Brazil that included a $5 billion ESF guarantee of a loan from the Bank for International Settlement (BIS), for which it earned a fee of approximately $140 million. Brazil's downturn was short-lived, and it was able to preserve its financial stability after floating its currency, the real. It also fully repaid all bilateral and most IMF support in little more than one year.

- As a result of international financial turbulence, El Nino, and poor macroeconomic management, Ecuador entered into crisis in 1999, defaulted on its Brady bond and Eurobond debt, and built up large arrears to the Paris Club. Through intensive engagement with the international community, including the U.S. Treasury, Ecuador put in place a credible economic reform program in 2000 that was backed by the IMF, and successfully concluded a bond exchange with nearly all of its private bond creditors. This program was centered on reducing interest rates in part by converting Ecuador's currency to the U.S. dollar. Ecuador also concluded negotiations to reschedule its Paris Club commitments. As of January 2001, Ecuador's economic and financial outlook was still cloudy.

- Argentina's currency board withstood the pressures of the Mexican, Asian and Russian crises, and the Brazilian devaluation. But, following a deep recession in 1999 and zero growth in 2000, Argentina faced acute financing difficulties. In December 2000, Under Secretary Geithner visited Buenos Aires to consult with Argentine officials regarding needed

economic and structural reform measures as well as potential IMF support. At the end of 2000, the Argentineans negotiated a $40 billion IMF-led support package designed to restore investor confidence and economic growth. Half of the package was financed by the official sector, but no direct U.S. support was envisaged.

III. Reform of the International Financial Architecture and International Financial Institutions

This section is divided into two parts. The first will discuss Administration efforts to reform the international financial architecture, and the second will discuss reforms of the international financial institutions.

Reform of the International Financial Architecture

Enormous demands were placed on the U.S. government, and especially the Treasury Department, in responding to the financial crises of the 1990s. As a result of the experience gained in managing these emergency demands, the U.S. led a comprehensive international effort to reduce the risk of *future* financial crises. This investment in reducing vulnerability to new financial crises was complemented by efforts to strengthen the international community's capacity to respond effectively to new kinds of crisis.

By the end of the Administration, there was widespread agreement that the financial crises of the 1990s were caused by a combination of two factors: weakness in economic fundamentals coupled with a reassessment of the country's capacity to safely absorb foreign capital; and an element of panic, whereby domestic and foreign investors quickly shifted focus from the economic health of the country to preserving their own capital.

This understanding of the crisis informed the Clinton-Gore Administration's approach to the reform of the international financial architecture, summarized by three major efforts.

- First, there was a strong focus on building more effective means to prevent crises. The United States urged the IMF and the international community to strengthen their surveillance of new kinds of risk and encourage countries not to adopt policies that increase the risk of financial panic.

- Second, there was a concerted drive to encourage safer policies in emerging market economies. Greater global understanding and surveillance of economic risks contributed to policy shifts that were likely to help reduce the underlying vulnerability of emerging market economies to future crises. There was growing international consensus behind eliminating perverse incentives and policy biases that encouraged particularly risky forms of private borrowing, and behind sovereign debt management practices that leave governments less vulnerable to liquidity, currency, and interest rate risk.

- Third, there was a growing consensus in favor of supporting an IMF that was better equipped for modern crisis response. With U.S. support, the IMF developed tools that were better

designed to meet new types of crises. These changes were accompanied by efforts to increase the IMF's knowledge of financial markets.

In promoting reforms to create a more robust and effective international financial architecture, the Clinton-Gore Administration worked on a number of fronts. The remainder of this section highlights the most important efforts. Specifically:

G7 Creation of the G22, G20

At the initiative of the United States, G7 leaders decided at the June 1999 Cologne Summit "to establish an informal mechanism for dialogue among systemically important countries within the framework of the Bretton Woods institutional system." The creation of the G20 fulfilled this commitment by opening a permanent forum for informal consultation between emerging market economies and industrialized economies with a view to promoting international financial stability. The G20 built on and institutionalized the successful G22 – an informal forum for discussion created by President Clinton, Secretary Rubin, and then-Deputy Secretary Summers during the Asian financial crisis – and has the potential to be an important vehicle for building consensus and promoting cooperation in future crises.

Transparency and Disclosure

The Clinton-Gore Administration worked to substantially increase the level of transparency and disclosure expected from emerging market economies, pushing for a revolution in transparency that would make financial market surprises less likely. This advocacy led to the development of a framework of international codes and standards to provide benchmarks for national policies in areas such as bank supervision and securities market regulation, and more systematic incorporation of indicators of liquidity and balance sheet risks in IMF surveillance reports.

Efforts to Reduce Financial Vulnerabilities in Emerging Market Economies

The Clinton-Gore Administration worked to refine international consensus on how best to manage risks associated with cross-border capital flows. Treasury helped to identify policies needed to capture the benefits of capital flows while limiting the risk of sharp and destabilizing reversals, including: the elimination of perverse incentives and policy biases that favor higher-risk, short-term debt flows to private firms; sound public debt management practices that leave governments less vulnerable to liquidity, currency and interest rate risk; and appropriate regulation of the foreign currency exposure and foreign currency liquidity of emerging market banking systems. Notably, the ratio of external debt to foreign reserves more than halved since 1996 in countries that experienced liquidity crises; short-term debt as a share of total external debt, among the same group of countries, fell from 34 percent in 1996 to 18 percent in 1999.

As part of this effort, the United States also helped to focus attention on the need to avoid risky "fixed but adjustable" exchange rate regimes, and helped to develop international support for moving towards "corner" exchange rate regimes: namely, free floating of the exchange rate or a highly institutionalized and widely supported fixed-rate regime, such as a currency board. To enhance the incentive for countries to move away from the middle ground, in 1999, led by

Secretary Summers, the U.S. won G7 agreement that in the vast majority of cases, the international community would no longer provide large-scale official support to unsustainable fixed exchange rate regimes. In part as a result of these efforts, in the latter years of the 1990s some fourteen countries moved away from fixed-but-adjustable exchange rate regimes.

Development of Financial Vulnerability Indicators

Building on the effort to reduce vulnerabilities, and to enhance the markets' own surveillance capacity with respect to such risks in the future, the Treasury worked with international colleagues to develop vulnerability indicators to focus attention on a set of indicators of balance sheet and liquidity risk that helped identify sources of vulnerability to capital account crises. The Treasury's leadership helped to bring about greater use of these indicators as a focus of international economic surveillance work.

Creation of the Financial Stability Forum

In the fall of 1998, then-Assistant Secretary Geithner urged the creation of a new forum for financial market regulators, supervisors, international financial institutions and national authorities with an interest in financial stability to promote international cooperation in the supervision of financial markets. The Financial Stability Forum (FSF) was subsequently inaugurated by the G7 in the spring of 1999 to promote international financial stability through information exchange and international cooperation in financial supervision and surveillance. The FSF has since been expanded to include Australia, Hong Kong, Singapore and the Netherlands; other emerging and industrial economies participate in the Forum's various working and study groups.

Three working groups were established following the Forum's first meeting: on Highly Leveraged Institutions (HLIs), Capital Flows, and Offshore Financial Centers (OFCs). The reports of these groups proved important contributions to strengthening the international financial architecture by recommending better risk management by HLIs and their counterparties, better disclosure practices among financial institutions, including HLIs, and improved oversight of creditor institutions. The Forum also worked to highlight the importance of managing risks, especially liquidity and foreign exchange risks, and of having the necessary building blocks for risk monitoring at the national level as well as in individual sectors. It also urged prompt development of guidelines for public debt management, and focused on the potential threat to financial stability posed by OFCs, encouraging priority assessments of compliance with key international standards in those centers interested in improving supervision and cooperation.

The Forum has also launched work in other areas consistent with Treasury's architecture reform agenda. The Task Force on the Implementation of Standards highlighted the leading role of the IMF in the assessment processes, in accord with its surveillance functions, and anticipates cooperation with the World Bank and national regulatory and supervisory authorities in the assessment and implementation of key economic and financial policy standards highlighted in the Forum's *Compendium*. A Follow-Up Group on Incentives to Foster Implementation of Standards continued to develop market and official incentives, including regulatory and

supervisory guidance, for countries to implement key standards. A separate group, formed at U.S. behest, was still to develop guidance on deposit insurance schemes at the close of the Administration.

Enhanced Disclosure for Hedge Funds

In an additional step to reduce international financial risk, Treasury staff contributed to international work on the potential systemic risk of highly leveraged institutions, and the impact of highly leveraged institutions (HLIs) (hedge funds) on market dynamics. The events in global financial markets in the summer and fall of 1998 demonstrated that excessive leverage could greatly magnify the negative effects of any event or series of events in the financial system as a whole. And the near collapse of Long Term Capital Management highlighted the possibility that problems at one financial institution could be transmitted to other institutions, and potentially pose risks to the financial system as a whole.

In response, Treasury staff -- including Under Secretaries Geithner and Gensler, Assistant Secretaries Edwin Truman and Lee Sachs, and Deputy Assistant Secretary Caroline Atkinson -- played a key role in developing a series of policy proposals with respect to hedge funds that were set forth in the President's Working Group report on Financial Markets. These included recommendations that more frequent and meaningful disclosure obligations be imposed on various financial institutions, better counterparty risk management techniques, and expanded risk assessment authority for unregulated affiliates of broker-dealers. At the same time, Treasury urged emerging market economies to focus their attention not on the impact of HLIs, but on the steps that emerging markets themselves need to take to make themselves more resilient and less vulnerable.

Developing a Framework for Involving the Private Sector in Crisis Resolution

To help establish clearer rules of the game for future crises and to minimize the risk that future investments would be made on a misplaced expectation of unlimited official assistance, Treasury drafted and won G7 and IMF support for a framework for private sector involvement in debt workouts which was formally agreed in the spring and summer of 1999. This framework allowed for appropriate differentiation among country cases, balancing the need for predictability and coherence with the need to maintain sufficient policy flexibility to respond most effectively to each individual case. The goal, strongly promoted by then-Deputy Secretary Summers, was to apply the same test of robustness to the international financial system that one would seek to apply to a national financial system: which is less that financial failures cannot take place than that failures in one sector or institution can occur without threatening the stability of the system as a whole.

Application of the G7 framework resulted in greater differentiation by credit quality in the level and pricing of flows to emerging markets. When needed to support a country's efforts to reestablish a viable debt profile in the context of a program of policy adjustment, the application of this framework made possible the restructuring of international sovereign bonds. In Ecuador and other cases, such restructurings demonstrated that bonds could be restructured relatively

quickly, without necessarily causing broad systemic disruption, and will lead more generally to a sounder international financial system.

Reform of the International Financial Institutions

In addition to its significant efforts to restructure and improve the international financial architecture, the Clinton-Gore Administration took the lead in pushing fundamental reforms in the International Financial Institutions (IFIs).

In the IMF, the Administration, through the Treasury Department, pushed for stronger standards regarding external debt reporting to encourage more open, better-working markets. As a result of U.S. policy pressure, the IMF became increasingly oriented toward the provision of short-term, emergency finance, priced to discourage casual use and encourage rapid repayment.

Among other things, in the multilateral development banks (MDBs), the Administration, through Treasury, pressed to put poverty reduction at the center of their formal mandate. As a result, there was a significant shift of MDB lending and priorities to investments in human and social capital, and the promotion of private sector development received much greater attention in the MDBs.

This section looks at each of the major IFI reforms in turn, with particular emphasis on the IMF.

Reform of the IMF

In December 1999, the Administration launched a major new initiative to reform the IMF. The steps proposed by Secretary Summers reflected experience gained in recent financial crises and Treasury's ongoing dialogue with Congress and other interested parties in academia, policy organizations, and civil society. Treasury made considerable progress in implementing the key components of this initiative, which included:

- A review of the IMF's lending mechanisms. In April 2000, four lending facilities were eliminated. In September 2000, the Board agreed to further revisions, which, among other things, shortened the effective maturity of IMF lending. These measures included a shortening of the expected repayment period for Stand-By and Extended Arrangements, more limited use of Extended Arrangements, surcharges for higher levels of access to discourage excessive reliance on IMF resources, stronger post-program monitoring, and enhancement of the Contingent Credit Line (CCL) to make it a more usable and effective instrument of crisis prevention.

- The creation and promotion of internationally accepted standards and codes in areas such as banking supervision, financial and monetary policy transparency, fiscal policy transparency, and data dissemination. In this last category, the IMF adopted stronger standards for external debt reporting requirements under the Special Data Dissemination Standard (SDDS), including maturity and sectoral breakdowns. In order to draw greater attention to the accuracy and quantity of data that countries disclose, the IMF began in July 2000 a new quarterly publication detailing country efforts to comply with the SDDS.

- At the urging of US Executive Director Karin Lissakers, the IMF began to develop and incorporate into its surveillance, indicators of financial sector soundness, national liquidity, and balance sheet risks. The G7 agreed that such indicators should be published regularly, together with explanatory material. In addition, the IMF and World Bank developed Draft Guidelines on sovereign debt management.

- The United States vigorously promoted stronger requirements for IMF borrowers to publish more detailed financial disclosures. In April 2000 the Executive Board adopted measures that include a new requirement for IMF borrowers to undertake and publish audited central bank financial statements and a new set of rules and guidelines to safeguard the use of Fund resources and to deal with cases of misreporting.

- At the urging of the United States, the IMF took steps to further improve transparency and accountability. The IMF established a permanent office to undertake ongoing independent evaluation of its operations. Among recent advances on transparency is the publication of the IMF's quarterly Financial Transactions Plan (formerly known as the "operational budget").

MDB Reform

Under the Clinton-Gore Administration, the U.S. redefined core thinking about development and development assistance. In 1993, then-Under Secretary Summers outlined in congressional testimony five broad areas in which the United States would seek improvements in the way that the development banks do business: project implementation; transparency and openness; sustainable development; support for strategic global interests; and development of business for U.S. firms.

In the succeeding years, the Administration made significant progress in a number of crucial areas, as highlighted below. It bears emphasis that these efforts were undertaken against a backdrop of sharp reductions in U.S. funding to the MDBs. Between 1994 and 1999, Treasury negotiated reduced U.S. funding to MDBs by 40 percent without loss in policy or lending leverage. Treasury also led and successfully achieved a replenishment of concessional resources in the Fund for Special Operations at the Inter-American Development Bank (IDB) that was expected to last until at least 2005 at no additional cost to donors.

- Enhanced Awareness of Environmental Issues and Priorities. Due largely to strong and persistent U.S. advocacy over more than a decade, the MDBs adopted an array of policies and guidelines in response to mainstream environmental considerations into their analytical work and operations. Over the last five years of the Clinton-Gore Administration, the World Bank became the world's largest financier of investments to reduce pollution, protect ecosystems, and build capacity for environmental management, with an active portfolio of environmental loans totaling $12 billion (not including IFC projects).

  An additional focus of Treasury's efforts on environment was the Global Environment Facility (GEF), which was created on a pilot basis in 1991 and restructured in 1994 in

response to growing concerns about global environment challenges. The Administration's support for this multilateral fund helped developing countries address biodiversity loss, pollution of international waters and overfishing, the phase-out of ozone-depleting substances, and the promotion of renewable energy sources and energy efficiency. Since the GEF's formal restructuring in 1994, the U.S. contributed $548.8 million. Under President Clinton's leadership, a portion of the U.S. arrears to the GEF were cleared leaving $203.7 million to clear at a later date. In 1998, the Treasury was successful in instituting a number of GEF reforms and operational adjustments to help ensure every dollar is effectively used and serves to support sustainable outcomes.

- Public Disclosure and Participation. As a result of consistent pressure by the Clinton-Gore Administration, the IMF and MDBs began to systematically disclose to the public a broader range of key operational documents. For example, program documents for nearly 90 percent of the IMF arrangements discussed by the IMF Executive Board since June of 1999 and 70 percent of World Bank country assistance strategies were publicly released. Public participation in IFI operations was a mainstay of the HIPC program and vastly increased in the review of draft MDB policies and country strategies.

- Labor. Under the Clinton-Gore Administration, priority was given to promotion of the internationally agreed core labor standards (CLS): freedom of association; right to organize and collective bargaining; a prohibition on forced labor; minimum age; and equality of opportunity and treatment. Core labor standards were seen an important development issue and adherence to CLS could contribute to economic efficiency and productivity. In addition, the right of free association had implications beyond the workplace and was seen as an important element of civil society, governance, and democracy. By the close of 2000, the World Bank and the Regional Development Banks, largely in response to U.S. efforts, all adopted, or were in the process of adopting, mechanisms for reviewing CLS in their planning and/or lending procedures.

- Governance. During the Clinton-Gore Administration, anti-corruption and good governance efforts were mainstreamed into the international development agenda. The Administration strongly supported enhanced IFI engagement in fighting bribery and corruption, and all MDBs introduced governance strategies to guide internal and external operations. The U.S regularly used its voice and vote in the IFIs to push for greater institutional accountability and transparency in project development, safeguards, and such things as inspection panels.[3]

- Selectivity. Consistent pressure from the Administration and from Congress helped achieve much greater selectivity in the allocation of MDB assistance – with greater support for stronger performance and reduced support for repeated non-performance. Treasury also

[3] On February 24, 1999, Vice President Gore convened, and Secretary Rubin addressed, an international conference on corruption with representatives from 80 countries. In his speech at the conference, Secretary Rubin stated: "In some countries, corruption has increased vulnerability to crisis. In others, corruption was a significant impediment to implementing the necessary response and a major obstacle to restoring the confidence that is so critical to countries' recovery and stability. In still some other countries, corruption is so pervasive it can be a threshold economic issue that undermines a country's ability to succeed in the global economy." Secretary Rubin pledged that the U.S. would continue to intensify its efforts to work with the IFI's and other countries to promote good governance and stamp out corruption.

helped to focus the IFIs' attention on key priorities such as investment in basic education and health care and combating corruption, and it is leading efforts to identify a more selective role of the MDBs in middle income countries. The IMF's Poverty Reduction and Growth Facility (PRGF) puts core social investments and poverty reduction at the heart of country economic programs.

- Financial Crime and Money Laundering. Financial abuse, including money laundering, has the potential to create serious macroeconomic distortions, and possibly undermine the stability and integrity of the international financial system. Recognizing these threats, the Clinton-Gore Administration, working with our G7 and OECD allies, sought changes in the rules of the financial game for countries. The Financial Action Task Force (FATF), the OECD, and the Financial Stability Forum have published lists of countries that are uncooperative in combating money laundering, maintain unfair tax practices, or have lax supervision of offshore financial centers.

  G7 Heads of State indicated at the Economic Summit in Okinawa that they were prepared to act together to implement coordinated counter-measures against jurisdictions on the FATF list that did not take steps to reform their systems appropriately. Similarly, it was agreed that defensive measures could be imposed against jurisdictions on the OECD's list of uncooperative tax havens, to be issued in mid-2001. (See Chapter 5 for a full discussion of Treasury's international and domestic efforts to combat money laundering.)

- Foreign Credit Reporting. The Clinton-Gore Administration initiated development of a comprehensive and timely system for reporting of USG foreign credit exposure. Without timely, accurate, and complete data, executive branch management and congressional oversight of and budgeting for international credit and debt reduction programs would be significantly impaired. Once fully implemented, the new Foreign Credit Reporting System is expected to greatly improve the efficiency of the government's international credit and debt reduction programs.

- A Second Wave of MDB Reforms. In the spring of 2000, the United States and its G7 partners launched a new MDB reform initiative to apply the lessons of preceding years and expand the process of reform. This focused on four core areas, highlighted in a speech given by Secretary Summers at the Council on Foreign Relations on March 20, 2000. These were: enhanced support for the poorest countries; a more focused and selective role in the emerging market economies; enhanced support for global public goods; and an improved division of labor across the global development "system" as a whole, particularly between the IMF and World Bank and the Regional Development Banks. Some elements of these reforms were already under way when President Clinton left office: most notably, the more human-centered approach to development assistance in the poorest countries, and the greater focus on global public goods. These are discussed more fully in the following section.

IV. Enhanced Support for the Poorest Countries

International Debt Reduction and the Heavily Indebted Poor Countries (HIPC) Initiative

As the 1990s began, it was clear that there was a large pool of extremely poor countries with unsustainable debt burdens. Through a series of increasingly extensive debt reduction agreements, the international community, in the form of the Paris Club of Official Creditors, significantly reduced the non-concessional debts of these countries. In 1994, the U.S. obtained legislative authority to take a fuller part in this effort, and in a G7 meeting in Naples, the international community agreed to forgive 67 percent of a country's eligible non-concessional debts: first on debt service, and then after three years of sustained economic performance, on the stock of debt.

It was, however, increasingly recognized that even with continued economic reform, this two-thirds reduction in bilateral debt would not be enough to put the poorest, most indebted countries on a sustainable path -- not least because these countries often had very large outstanding debts to the IFIs. In the fall of 1996, the G7 therefore launched a new initiative -- the Heavily Indebted Poor Countries (HIPC) initiative -- which increased the amount of bilateral debt forgiveness and, for the first time, provided debt relief on obligations to the IMF, the World Bank, and other regional development banks.

Under HIPC, a country that was implementing economic reforms would receive three years of Naples Terms debt relief, then it could reach a "decision point." If eligible, it would then receive 80 percent relief, or more if needed, from the Paris Club on payments falling due for the next three years. After another three years of acceptable economic policies and performance, a country would reach its "completion point" and receive debt stock reduction by bilateral creditors and a proportionate level of IFI relief.

By the standards of past efforts, HIPC was an important step forward. But while seven countries benefited from the HIPC initiative in its first three years (including four that reached their completion point), a growing global movement of NGOs, religious leaders, and others argued that the debt reduction was too slow and too shallow -- and that recipient countries were being made to undergo overly ambitious market reforms.

In response to these and other mounting concerns -- and the personal efforts of Secretary Summers and such public figures as the Pope, Pat Robertson, and the rockstar, Bono -- in 1999 and 2000, the U.S., supported by the UK, led a major global effort to expand HIPC to provide faster, broader, and deeper debt relief. This enhanced initiative not only addressed debt problems in a more comprehensive manner, but within a broader development context, in which the link between debt relief and poverty reduction was strengthened.

The new initiative provided debt relief to countries undertaking economic reforms and using the freed-up resources to invest in areas that promote broad-based growth and poverty reduction. As of the close of 2000, debt relief was committed to 22 countries under the enhanced HIPC initiative. It was expected that roughly 33 countries would eventually qualify for the initiative. As an integral part of the debt relief strategy, President Clinton announced in the fall of 1999 that

the U.S. would reduce by 100 percent the non-commercial debt that qualifying HIPC countries owed to the U.S. The majority of other major creditors later followed suit.

Global Public Goods

The World Bank, with U.S. encouragement, intensified its support for international efforts to promote environmental sustainability, reduce threats to biodiversity, combat infectious diseases, and encourage the proliferation of knowledge relevant to promoting development. As part of this effort, President Clinton called for the MDBs to dedicate a further $400 million to $900 million of their lending to the poorest countries each year for basic health care to immunize, prevent, and treat infectious diseases. In addition, the Administration's FY2000 budget authorized a $20 million U.S. contribution to international efforts to combat AIDS.

African Growth and Opportunity Act

The African Growth and Opportunity Act (AGOA), which was signed into law on May 18, 2000 after a nearly three-year legislative campaign, was the central realization of the Administration's effort to transform our economic relations with Africa to place much greater emphasis on traditional economic ties and the promotion of trade, and much less emphasis on aid. While less ambitious in scope than initially hoped, the enacted bill did open up important new opportunities for many African economies by significantly expanding their access to the U.S. market, especially in labor-intensive manufactured exports where many countries in Africa had a distinct competitive advantage.

The rationale for AGOA was to give sub-Saharan Africa an opportunity to make up for lost ground. Rapid labor-intensive growth was important for sub-Saharan Africa, as many countries there are trying to make the transition from agricultural-based economies to manufacturing-based economies. By significantly expanding access to the U.S. market, especially in textiles and labor-intensive manufactured exports, AGOA offered strong, new support for growth in private investment in the successful reforming African economies.

V. Promoting Coordinated Responses to Global Problems in a More Integrated World

In an increasingly borderless world, policy makers in the 1990s increasingly faced a broad class of so-called "global public goods," problems governments would need to confront collectively as well as nationally: everything from curbing the growth of international financial crime and money laundering, to combating global warming, to developing the right framework for supporting the global growth of e-commerce.

The Clinton-Gore Administration, often led by Treasury, helped craft the global response to many of these concerns. Of these, several, including the stepped-up efforts to combat money laundering and tax havens, are addressed in Chapter 5 along with other law enforcement initiatives. And Treasury's efforts to devise a coordinated global approach to the taxation of e-commerce are discussed in Chapter 6. However, a number of other international issues are

discussed briefly in this chapter: first, efforts to combat global climate change; second, global tax issues.

Climate Change

With regard to climate change, the Administration focused on finding an answer to the question that the UN Framework Convention on Climate Change, signed in Rio in 1992, had left unresolved. That was the issue of how, precisely, the desired global reduction in the emissions of greenhouse gases was to be achieved. In debating this question, Treasury consistently pressed for a clear-minded consideration of both the benefits and the costs, and advocated approaches that used market mechanisms to achieve the desired environmental result: most notably, an emissions trading regime that would give countries maximum flexibility in meeting their Rio Treaty obligations. It is fair to say that these efforts had only moderate success.

Kyoto Protocols, 1997

Leading up to the UN-sponsored negotiations at Kyoto in 1997, the major issue under discussion was how tightly to limit emissions of greenhouse gases. Some within the Administration argued that the U.S. government should agree to drastic cuts on greenhouse emissions, with little consideration of the costs and benefits of the different options. Working with the other economic agencies, Treasury insisted on a rigorous assessment of the costs and benefits of various options, and took the view that because climate change is a long-term problem, it could only be effectively addressed by considering the long-term effects of various policies.

In addition, Secretary Rubin and then-Deputy Secretary Summers consistently advocated an emissions trading regime that would give countries maximum flexibility in meeting their obligations under the Rio Treaty, consistent with maintaining the Treaty's environmental goals. Treasury strongly opposed prohibitions or caps on the trading of emissions allowances, and on the use of other economic instruments. Leading up to the negotiations at Kyoto, Treasury and the other economic agencies prevailed in this aspect of the debate within the Administration.

At Kyoto, the U.S. negotiating team was led by Vice President Gore and then-Under Secretary of State Stuart Eizenstat. The U.S.'s negotiating partners (including Japan, Canada, and Australia) shared our views on full flexibility. The countries of the European Union, however, took a more moralistic and less market-friendly view, insisting that countries achieve their targets of reducing greenhouse gases domestically. To this end, the EU countries supported caps on trading, and limitations on other economic mechanisms. In addition, the EU countries insisted on targets for reductions of greenhouse gas emissions that many economic observers believed were unrealistic.

The Kyoto Protocols adopted tight targets for all industrialized countries (Annex I countries) for emissions of carbon dioxide and other greenhouse gases, including methane and chlorofluorocarbons. On the question of flexibility in achieving these targets, the record at Kyoto was mixed. The Kyoto Protocols included a number of flexibility mechanisms, including emission trading, the inclusion of carbon sinks, and the Clean Development Mechanism. At the same time, the Protocols language was ambiguous enough that the dispute continued to simmer.

Negotiations at The Hague, 2000

Widely viewed as the deadline to implement the key elements of the Kyoto Protocols, the Sixth Conference of the Parties (COP-6), held at The Hague, Netherlands (Nov. 13-24, 2000) was meant to resolve several issues of disagreement among the parties. These included the mechanisms and structure of emissions trading, issues of concern to developing countries, the role of carbon sinks, and the rules for the Clean Development Mechanism. As the U.S. government, led by Under Secretary of State Frank Loy, prepared for the meeting, Treasury assisted in the formulation of the U.S. positions on establishing an emissions trading regime, penalties for non-compliance, what credit should be granted for carbon sinks, and how developing countries could participate in the treaty. Treasury provided analysis in support of full flexibility to make greenhouse gas reductions that maintained the environmental integrity of the agreement but at the same time held down the costs of compliance.

At The Hague, Treasury staff served on several contact groups whose charter was to agree on the text of a decision, including guidance to the financial mechanism and other key components of the Protocol. In the end, the COP-6 negotiations failed to reach agreement on these issues. At the close of the Clinton-Gore Administration, governments participating in the negotiations remained divided over how best to address the problem of global warming.

Harmful Tax Competition and Other Global Tax Issues

As a complement to the Administration's general policy of promoting facilitating globalization and the removal of barriers to capital flows, the Treasury Department argued for strong global efforts to combat the risk of a "race to the bottom": the risk that global capital mobility would allow capital to play jurisdictions against one another, undermining individual nation's capacity to raise taxes or impose the regulatory standards that their people demanded.

The Office of Tax Policy during this period took on an especially important aspect of this problem in its efforts to combat practices by other countries that facilitated tax evasion or abusive tax avoidance. Because these objectives are most effectively achieved at the multilateral level, the Office of Tax Policy directed its efforts in this area to supporting the work of the Organization for Economic Cooperation and Development (OECD).

The OECD's Harmful Tax Competition Project grew out of a failed effort in the mid-1990s to address the more general issue of tax incentive regimes in all sectors. The breadth of that effort resulted in a failure to reach the requisite international consensus. An OECD Ministerial Communiqué in May 1996, endorsed by a Communiqué issued by the G-7 Heads of State at their 1996 Lyon Summit, called upon the OECD to refocus its efforts toward combating tax incentive regimes aimed at attracting financial and other geographically mobile activities. The Office of Tax Policy played a significant role, under the direction of Deputy Assistant Secretary Joseph H. Guttentag, in developing a report, *Harmful Tax Competition: an Emerging Global Issue*, adopted by the OECD in April 1998.

At that time, the Forum on Harmful Tax Practices was established, with International Tax Counsel Philip R. West as a Co-chair, to implement the recommendations in the 1998 Report. Pursuant to these recommendations and under the leadership of ITC West, the Forum established

of a list of tax havens, evaluated preferential regimes in OECD member countries, and developed a dialogue with non-member countries to promote the recommendations of the 2000 Report. Along with ITC West, Attorney-Advisors Michael J. Caballero and Rocco Femia made significant contributions to the project. In June 2000, the OECD adopted a report of the Forum's progress to date, *Progress on Identifying and Eliminating Harmful Tax Practices*. The 2000 Report included a list of 47 preferential regimes within OECD member countries and 35 tax havens. While the two lists drew widespread attention, of more importance was the commitment of OECD members and six non-OECD members examined as possible tax havens to cooperate with each other and eliminate those aspects of their own tax systems that facilitate tax evasion or international tax arbitrage. More commitments from tax havens were anticipated as of the end of 2000.

Transfer Pricing Guidelines

The Treasury Department's Office of Tax Policy was instrumental in forging an international consensus in the area of intercompany transfer pricing that adopted many of the principles of United States regulatory policy. International consensus in the area of transfer pricing is critical to the international tax system because, without such consensus, the income of multinational enterprises may be taxed by more than one country. This consensus is embodied in the 1995 report by the OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. Barbara Rollinson, Director, Office of International Taxation in the Office of Tax Analysis, Warren Crowdus, Associate International Tax Counsel, and Scott Newlon, International Economist, were instrumental in developing the 1995 *Guidelines*.

Director Rollinson, Associate ITC Crowdus, and IE Newlon were also instrumental in finalizing comprehensive regulations in 1994 relating to intercompany transfer pricing under section 482 of the Internal Revenue Code. The principles of these regulations generally were developed concurrently with the work on the OECD's 1995 *Guidelines*, in which they ultimately were included.

Anti-Conduit Regulations

Although the United States has included anti-treaty-shopping rules in all of its modern tax treaties, those rules apply on an entity-by-entity basis, not with respect to individual transactions. Case law that would prevent abusive transactions was unclear at best, and unhelpful at worst. As an adjunct to the Administration's effort to modernize and expand the U.S. treaty network, its 1993 budget proposal included a provision granting broad regulatory authority to address abusive multi-party financing transactions. This broad grant of regulatory authority was enacted and first used in proposed withholding regulations issued in 1994, and finalized in 1995, that dealt with the abuse of tax treaties. The effect of these regulations is to address treaty-shopping at an individual transaction level. As a result, a company that satisfies the anti-treaty-shopping rules of tax treaties may nevertheless be denied benefits with respect to particular items of income.

History – Sub F Study

In December 2000, Treasury published a study on the deferral of income earned by U.S. controlled foreign corporations. Work on the study began following the publication of IRS Notice 98-11, which described certain transactions involving so-called "hybrid" entities (e.g., entities that are treated as corporations for foreign tax purposes but whose existence is disregarded for U.S. tax purposes). Although Treasury believed the Notice appropriately applied the existing U.S. "anti-deferral" rules to hybrid entities, some taxpayers believed that Treasury exceeded its authority in issuing the Notice. Other taxpayers argued that the existing U.S. anti-deferral regime had not kept pace with changes in the U.S. and world economy, and that these changes necessitated a significant relaxation of the current rules.

In response, Treasury took a fresh look at the U.S. anti-deferral regime in an effort to determine whether changes to the current rules were warranted. The study reexamined the history of the rules (to determine Congress' intent in enacting them), and also reconsidered the broader economic underpinnings of the rules (to determine what is the best way to tax foreign income to maximize economic efficiency). The study next examined the extent to which the existing rules were achieving their original policy goals and also discussed how the rules may be challenged by future changes to the U.S. and world economy. Finally, the study presented several possible options for reforming the rules. The primary drafter of the study was William Morris, Associate International Tax Counsel, although Morris departed the Treasury before the study was published. The economic analysis in the study was primarily the work of Donald Rousslang of the Office of Tax Analysis.

Tax Treaties

One of the Clinton-Gore Administration's earliest and highest priorities in the international tax arena was the modernization and expansion of the U.S. income tax treaty network. When President Clinton took office, the oldest U.S. income tax treaty in force dated from 1939, and many others were nearly half a century old. Assistant Secretary Leslie B. Samuels, with ITC Cynthia Beerbower, was the driving force behind the initial effort to update these older treaties in order to make them less susceptible to abuse, through the addition of anti-treaty-shopping rules and improved exchange of information provisions.

As a result of this focus, updates of six treaties dating from the 30's, 40's and 50's have entered into force. The United States also has traditionally had a much smaller treaty network than other industrialized countries. Major strides have been taken to correct this, as the United States also entered into 12 treaties with countries that were not already covered by its treaty network. Altogether, 22 new full income tax treaties (out of a total of 54) have entered into force since the beginning of 1993, in addition to 8 substantial protocols to existing income tax treaties.

The treaty negotiation process has been directed by DAS Joseph Guttentag and, following his departure from Treasury, by ITC West. Most of the international lawyers and economists have been involved in the treaty process, led by International Economists Marcia Field and Mordecai Feinberg and Associate ITCs Carol Dunahoo and Warren Crowdus and Deputy ITCs Norm

Richter, Daniel Berman and Patricia A. Brown. The Commissioner's office was most often represented in these negotiations by Carolyn Christensen.

VI. International Economic Engagement

In addition to these cross-cutting policy priorities, the United States under President Clinton continued to face the challenge of maintaining strong regional and bilateral relations with its allies and trading partners around the world. This kind of economic engagement, coupled with exchange rate policy, was the traditional mission of U.S. international economic policy. But it was a mission made more difficult and complex during the 1990s by historic new challenges: from the promotion of economic reform and transition in the formerly planned economies; to the economic reconstruction of the war-torn Balkan nations; to crafting a response to the creation of the euro; to responding to the growing popularity of dollarization.

The remainder of this chapter addresses the Treasury Department's economic engagement on both a regional and a bilateral level between 1993 and 2000 -- taking each country or region in turn.

Relations with the European Union

Although the Maastricht Treaty was signed in 1992, it was only in late 1996 that most observers began to confront seriously the treaty's stated aim of creating a single currency in Europe – European Monetary Union (EMU). Treasury analyzed this development closely, monitoring the effects of the project on American interests, and concluded that a decision to proceed with a common European currency would probably have little net direct impact on the U.S. economy. As the time for EMU's formal launch approached, Treasury made clear its policy of careful and impartial watchfulness, working to keep the United States from being drawn into intra-European policy controversies. The euro was launched in an orderly fashion at the beginning of 1999, but its weak exchange rate performance during its first two years surprised most observers. It was the object of one supportive currency invention, in the summer of 2000, which is discussed separately below.

Relations with Japan

Throughout the Clinton-Gore Administration, Japan continued to be hampered by economic difficulties that posed challenges for the United States.

After impressive growth in the 1980s, Japan suffered a prolonged period of weak economic growth during the 1990s, associated with serious financial system problems, and a general awareness that its economy needed major structural changes to adapt to new economic circumstances.

Treasury devoted substantial effort to analyzing Japan's economic problems and discussing policy issues with Japanese authorities, both bilaterally and in the context of meetings of G-7 finance ministers and central bank governors. The objective was to encourage stronger Japanese performance that would support global growth and the reduction of external imbalances.

Treasury urged Japanese authorities to consider a number of fiscal expansion packages. These led among other things to the 1996 upturn – the only year of strong growth since 1991 – and to fiscal support that prevented weaker performance. Against the views of international institutions, Secretary Rubin and then-Deputy Secretary Summers warned – both quietly with Japanese authorities and in restricted international discussions -- that a sharp 1997 fiscal contraction would prove deleterious to the Japanese economy, a view later proved correct. By the end of the Clinton-Gore Administration, Japan's economy appeared to be on the way up, although the situation remained fragile.

Treasury also conducted discussions with Japan to encourage the authorities to embrace financial sector reform and restructuring in the wake of the bursting of the asset-price bubble in 1991. The issue took on increasing importance with the collapse of several large Japanese financial institutions in the fall of 1997, and the ensuing severe strains on the banking system. Treasury urged the Japanese authorities to take quick and substantial action to resolve the problems. After a slow start, the Japanese government took effective measures in 1998 and 1999 to stabilize Japan's financial system, deal with weak banks, and institute an improved supervisory and regulatory structure.

Finally, Treasury, along with other Administration agencies, worked throughout both terms of the Clinton-Gore Administration to encourage structural reforms and market opening measures in Japan's economy, with considerable success in opening Japan's product and financial markets to competition from the United States and other countries. Specifically, as a result of consultations under the US-Japan Framework for a New Economic Partnership, on February 13, 1995, Secretary Rubin and Finance Minister Masayoshi Takemura signed an agreement entitled "Measures by the Government of the United States and the Government of Japan Regarding Financial Services." Implementation of this agreement was highly satisfactory, and liberalization measures implemented under the agreement substantially improved commercial opportunities for foreign financial services providers in the U.S. and Japan. The ongoing follow-up meetings brought together officials from a range of financial agencies on both sides, and provided an opportunity to discuss recent financial policy and supervisory developments in addition to the measures under the agreement.

Official Intervention in Foreign Exchange Markets

The Administration intervened on 20 days during the January 1993-January 2001 period. On 19 of these days, there were operations in yen; on 6 of these days there were operations in DM, and on one day there was an operation in euros. All of these operations were in conjunction with at least one other member of the G-7.

The overwhelming majority of these interventions took place in the first three years of the Administration (1993, 1994 and 1995) and involved sales of either DM or yen (or both) to combat excessive market volatility and, from March to May 1995, to strengthen market confidence in the dollar. The dollar reached historical lows vs. the DM and the yen in March and April 1995, respectively.

The May 1995 intervention was explicitly in reference to the April 25, 1995 G-7 statement, "The Ministers and Governors expressed concern about recent developments in exchange markets. They agreed that recent movements have gone beyond the levels justified by underlying economic conditions in the major countries. The also agreed that orderly reversal of those movements is desirable, would provide a better basis for a continued expansion of international trade and investment, and would contribute to our common objectives of sustained non-inflationary growth. They further agreed to strengthen their efforts in reducing internal and external imbalances and to continue to cooperate closely in exchange markets." The Administration subsequently made further sales of yen on three days in July and August 1995. On the last of these days (August 15, 1995), DM were also sold.

There was no further intervention in foreign exchange markets until mid-June 1998, when the Administration purchased yen in the context of Japan's plans to strengthen its economy. Finally, in September 2000, the Administration bought euros, in a coordinated intervention at the initiative of the ECB, on shared concern about the potential implications of euro weakness for the broader world economy.

Relations with Latin America

In addition to Treasury's extensive efforts to curb the risks and stem the effects of financial crises in Latin America, and its work in promoting free trade agreements in the region (discussed above), Treasury also undertook a number of other important initiatives in the region:

Creation of the North American Development Bank (NADB)

Under the leadership of then-Assistant Secretary Jeffrey Schafer, the North American Development Bank (NADB) was established in FY 1995 and funded jointly by the United States and Mexico. Chartered under the auspices of the North American Free Trade Agreement (NAFTA), the NADB was established to finance environmental infrastructure projects along the U.S./Mexico border, as well as community adjustment and investment in both nations. The NADB provides financing (loans, guaranties, and grants) for projects that have been certified by its sister institution, the Border Environment Cooperation Commission (BECC), principally in the areas of water and wastewater treatment and solid waste disposal within 100 km of either side of the border.

In the years 1995-2000, the NADB approved $273.26 million in financial assistance for 31 projects, 13 in Mexico and 18 in the United States, which represent a total investment of $865.82 million. Of this amount, $262.14 million was in grants authorized through the NADB's Border Environment Infrastructure Fund (BEIF), which is funded by the U.S. Environmental Protection Agency (EPA). NADB also approved $11.12 million in lending to seven of these projects using its own capital. Five of these projects had been completed by January 2001, with 13 more under construction.

In 1997, NADB made a concerted effort to make its financial assistance more affordable, in part by working with the EPA to establish the BEIF. This fund allows the NADB to couple its loans with grants to make financing packages for water and wastewater projects more affordable to

poor communities. By the end of FY2000, EPA had made $252 million in funding available to NADB for this facility. In 1999, to complement the BEIF program, the NADB also developed a new $5 million pilot grant program that would allow the Bank to assemble affordable financing packages for municipal solid waste projects and will target small border communities in particular.

Under the leadership of Deputy Assistant Secretary William Schuerch, in November 2000, the NADB board also agreed to establish a new $50 million lending facility to provide lower cost loans to poor border communities. The Board also agreed to allow the Bank to establish equity stakes in projects.

Creation of the North American Financial Group (NAFG)

In 1994, Secretary Bentsen and Fed Chairman Greenspan created the NAFG with their counterparts from the Central Banks and Finance Ministries of Mexico and Canada. The NAFG members met on an annual basis to discuss issues related to the economies of North America. In 1999, Under Secretary Geithner led efforts to create a NAFG deputies group that met regularly with the purpose of better informing the discussions of the NAFG members.

Creation of the Committee on Hemispheric Financial Issues (CHFI)

Secretary Bentsen led the move to create the CHFI in 1994. The CFHI became an important vehicle for exerting U.S. leadership and forging a common vision in the hemisphere on financial and macroeconomic policies, and for building deeper relations between finance officials throughout the region.

Response to the Growing Popularity of Dollarization

Following public discussion in early 1999 by a few Latin American countries about the possible dollarization of their economies, then-Deputy Secretary Summers testified before a subcommittee of the Senate Banking Committee on dollarization on April 22, 1999. Subsequent to Secretary Summers' testimony, Senator Connie Mack (R-Florida) proposed legislation to share seigniorage (the revenues from printing money) with officially dollarized countries, and public interest in dollarization continued. Treasury officials were invited to speak on the topic on a number of occasions. Most notably, in October 1999 Assistant Secretary Truman delivered remarks at Harvard University on dollarization, and in December 1999, he spoke at length on the issue in remarks before the Institute for International Monetary Affairs in Tokyo, Japan. In the wake of Ecuador's decision to dollarize in January 2000, Senator Mack invited Treasury to testify on his seigniorage sharing proposal, which Assistant Secretary Truman did before the Subcommittee on Economic Policy of the Senate Banking Committee on February 8, 2000.[4]

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[4] Secretary Summers and the Administration did not endorse Senator Mack's bill, indicating that the time was not ripe for such measures.

Emerging Asia

In addition to Treasury's integral role in helping to diffuse the Asian financial crisis and in encouraging financial reform in Japan, Treasury was involved in a number of other initiatives in Asia.

APEC Finance Ministers Forum

Created by President Clinton in 1993, the Asia Pacific Economic Cooperation forum became a key part of the Administration's multilateral engagement with Asian and Pacific Rim countries. Secretary Bentsen initiated the first meeting of APEC Finance Ministers in 1994 and played a lead role in the discussions of global economic and financial issues and in building consensus on sound macroeconomic policies and structural reforms to sustain strong economic growth. In November 1998, Secretary Rubin put forward a cooperative growth strategy – endorsed by APEC Leaders in Kuala Lumpur – to promote recovery from the Asian financial crisis. Treasury participated in a number of initiatives in the APEC Finance Ministers' process aimed at strengthening regional bank supervision, building strong and fiscally manageable social safety nets, improving corporate governance, and combating financial crime.

Manila Framework Group

The Manila Framework Group was established under the leadership of the U.S. Treasury in 1997 to help develop a coordinated regional effort towards mitigating the Asian financial crisis and as an alternative to Japanese efforts at the time to establish an Asian Monetary Fund. The Group consists of 14 members (Australia, Brunei, Canada, China, Hong Kong, Indonesia, Korea, Japan, Malaysia, New Zealand, Philippines, Singapore, Thailand, United States) and four observers from international financial institutions (ADB, BIS, IMF, World Bank). It became an important forum for deepening relations and dialogue between the U.S. and Asian finance ministries and central banks. Due to the smaller size and informality of the group, the discussions tended to be more frank. It also gave countries that are not members of the G7 or G20 an opportunity to discuss global issues with members of these more influential fora.

China

The Administration used the opportunities provided by meetings of APEC Finance Ministers, the Manila Framework Group, G20 Ministerials, annual meetings of the ADB, World Bank and IMF, and the US-China Joint Economic Committee to meet bilaterally with senior Chinese finance officials on a regular basis. The discussions focused on China's reform plans in the financial and state-owned enterprise sectors, monetary and exchange rate policy, and global economic developments, such as the Asian financial crisis and rising world oil prices.

Towards the end of the Clinton-Gore Administration, a US-China Financial Sector Dialogue, co-chaired by the Treasury, Federal Reserve, China's Ministry of Finance, and the People's Bank of China, was announced at the October 1999 session of the US-China Joint Economic Committee (JEC) in Beijing. The objective of the dialogue was to strengthen the financial and economic relationship between the US and China through regular contact among policymakers from each

country. The initial meeting of the dialogue on October 27, 2000 was co-chaired for the U.S. by Assistant Secretary Truman and Federal Reserve Governor Laurence Meyer, and for China by Jin Liqun, Vice Minister of Finance, and Li Ruogu, Assistant Governor of the People's Bank of China. Issues relating to the development of capital markets and banking sector developments were the focus of the initial meeting of the Dialogue.

Vietnam

In April of 1997, Secretary Rubin met with senior Vietnamese officials in Hanoi and Ho Chi Minh City to discuss ways to improve trade and investment relations between the two countries. At the same time, Secretary Rubin signed a bilateral debt agreement committing Vietnam to repay the U.S. some $145 million in debts incurred by the former government of South Vietnam. By committing to repay its debts to the U.S., Vietnam took a step towards improving its credit standing with the investor community at large. In 1999, USTR Barshefsky negotiated a bilateral trade agreement with Vietnam normalizing trade relations and committing Vietnam to sweeping economic reforms. In exchange for opening its markets to U.S. exports and investment, Vietnam was granted Permanent Normal Trade Relations status. And, in November 2000, President Clinton traveled to Vietnam to continue the Administration's push for economic reforms and expanded business opportunities.

Debt for Nature Swaps

With Bangladesh, the U.S. reached its first debt relief agreement under the Tropical Forest Conservation Act of 1998, which permits debt cancellation in return for the preservation of tropical forests. In September 2000, the U.S. and Bangladesh signed two separate agreements reducing a portion of Bangladesh's debt while creating a locally managed tropical forest fund.

The Former Soviet Union and Central and Eastern Europe

During the Clinton-Gore Administration, Treasury took the lead role in encouraging other countries and international financial institutions to develop creative solutions to support economic reform in transition economies. These efforts helped ensure that IFI and other donor country finance was largely conditioned on reform progress. Over time, these efforts also built consensus that, by the end of the Clinton-Gore Administration, was shared by most officials in transition economies on the kinds of stabilization, privatization, legal, regulatory, institutional, and other reforms needed to spur investment and growth.

Treasury took the lead in supporting the creation of the IMF's Systemic Transformation Facility, which supported transition economies in the mid-1990s. Treasury was also instrumental in pushing for more intensive use of IFI instruments for catalyzing private financing, such as IFC and IBRD guarantees. And Treasury is also largely responsible for an increased focus on IFI financial safeguards over use of IFI, reserve, and budgetary resources, and curbing money laundering.

Russia

Treasury worked on a number of fronts to provide assistance to Russia in its efforts to move from a command administrative economy to a free market economy based upon the rule of law.

In 1993, then-Under Secretary Summers helped put together a package of assistance from the G7 and IFIs, totaling some $43 billion, that was available to support Russian reform efforts. Due to Russia's inability to follow through on reform commitments, most of the conditional support from the IFIs was not disbursed. At this same time, Treasury gave privatization of Russia's state owned enterprises a prominent place in our policy dialogue with Russia, and the U.S. supported Russia's small-scale voucher program (but not the non-transparent 'loans-for-shares' program) with significant technical assistance. By 2000, after nine years of transition, over 70 percent of Russia's economy was in private hands.

In the mid-1990s, Treasury recognized that Russia needed particular help in improving its fiscal stability and developing its capital markets. Treasury provided significant technical assistance to Russia on both tax policy and tax administration, which laid the groundwork for Russia's new tax code, which has been largely enacted in the last two years. Treasury also helped create the U.S.-Russia Capital Markets Forum, co-chaired on the U.S. side by Secretary Rubin and SEC Chairman Levitt, which brought together leading Russian and U.S. experts on capital markets to discuss concrete recommendations covering market regulation and oversight, corporate governance, accounting and auditing standards, and regulation of investment funds and tax reform for use by the GOR and Russia's Federal Commission for Securities Market (FCSM).

After Russia reduced inflation to manageable levels in 1995-96, then-Deputy Secretary Summers pressed the World Bank to take a larger role in supporting Russian efforts to enact structural reforms in banking, demonopolization, legal reform, the social sector and other areas that were critical to building a stronger market economy based on the rule of law. The World Bank responded by developing lending programs to support coal sector restructuring, social sector reform, and banking sector reform.

Treasury also focused on developing new, small enterprises to boost competition in Russia. Then-Deputy Assistant Secretary David Lipton helped establish the Russia Small Business Fund (RSBF) at the EBRD to support bank lending to small and micro enterprises (SME). The RSBF has an excellent repayment history and has disbursed loans of more than $400M in Russia. Treasury used the lessons of the RSBF to help EBRD develop an SME fund for Southeast Europe. This fund adds a policy dialogue that for the first time links financing to action by government at all levels to remove specific impediments to SME viability and profitability.

After allegations surfaced in 1999 that Russia had misused funds from the IFIs and kept them in offshore corporations controlled by the Central Bank of Russia, then-Deputy Secretary Summers and the IMF required Russia to undertake and publish independent investigations of the Central Bank's offshore subsidiaries. These reports, performed by the accounting firm Price Waterhouse, did not provide evidence of misappropriation of IFI funds, but they did indicate that the Russian government had misled the IMF about the size of its budget deficit and reserves in 1996. As a result, Treasury and the IMF pushed Russia to follow through on a number of

financial safeguards designed to minimize the opportunity for misuse of IFI resources. For example, Russia's only IMF disbursement since the allegations was deposited at the IMF and only used to repay Russia's debt to the IMF. Secretary Summers has also taken the lead in encouraging the IFIs, G-7, and the Financial Action Task Force (FATF) to press Russia to enact money laundering legislation that is up to international standards. The USG has provided technical assistance to Russia on its efforts to draft such legislation.

Poland

Among other forms of continued economic support for Poland during this period, the U.S. and Treasury took the lead in the creation of the multilateral Polish Bank Privatization Fund that was instrumental in the successful privatization of major Polish banks. Most agree that Poland's healthy commercial banking system contributed significantly to its transformation and growth success.

Ukraine

Treasury took a lead role in the U.S. – Ukrainian Committee on Sustainable Economic Cooperation, where we have assisted the Ukrainian government in making progress on improving fiscal policy and maintaining macroeconomic stability in a difficult domestic and external environment. Treasury has also provided Ukraine with significant technical assistance (TA) in the areas of budget, tax, debt, and macroeconomic analysis.

International Technical Assistance Program

This program was established after the collapse of the Former Soviet Union and communism in Eastern Europe to offer financial advice on the transition to capitalism and in support of the free market system. The program, headed by Deputy Assistant Secretary James Fall, began in about ten countries in the early 1990s and had spread to more than 25 countries throughout the world by the end of the Administration. By the fall of 2000, Treasury deployed approximately forty-five resident financial advisors and more than one hundred short-term specialists in these countries.

South Eastern Europe

Throughout the Balkan conflicts in the former Yugoslavia, beginning in Croatia in late 1992 and continuing through to the conflict in Kosovo in 1999 and 2000, the United States played the leading role of mediator and peacemaker. A key element of this was the need to organize packages of assistance to reconstruct the war-torn region in which Treasury played a vital role:

Bosnia/Dayton

At the Dayton peace talks, led by then-Assistant Secretary of State Richard Holbrooke, the Bosnian parties had conflicting views of the monetary arrangements (powers and leadership of the central bank) under the new federal structure and even on whether Bosnia would have its own currency. To bridge these differences, Under Secretary Lipton proposed that Bosnia adopt a

currency board and make an international civil servant the head of the central bank. These arrangements made the central bank one of the most effective federal institutions in Bosnia, while giving Bosnia a single currency that now circulates throughout the country.

Kosovo

Following the conflict in spring 1999, Treasury framed the priorities for economic administration in Kosovo and described the structures that would be necessary for effective economic governance under the U.N. Mission in Kosovo (UNMIK). Development of the Central Fiscal Authority, which serves as the treasury for Kosovo's interim government, was one of UNMIK's most notable accomplishments.

Creation of the High Level Steering Group (HLSG) Process

The HLSG process (including G7 finance ministers, IFIs, the European Commission, and Stability Pact representatives) worked to coordinate economic strategies and assistance for Southeast Europe. This process, established in the wake of the Kosovo conflict, helped mobilize financing for regional infrastructure and other projects, assisted creation of effective economic administration of Kosovo, and approved a coordinated strategy for providing support to the FRY following Serbian President Kostunica's successful bid for power.

Montenegro

In the wake of Montenegro's adoption of the German mark as legal tender in 1999, Treasury played a key role in defining priorities for the U.S. technical assistance effort (including introduction of the dual currency arrangement), providing technical assistance in the budget area, coordinating with European financial and technical assistance, and encouraging participation in Montenegro by the European Investment Bank.

Serbia

Following President Milosovic's ouster in October 2000, Treasury played a major role in the development of a strategy to reintegrate Serbia (and the FRY) into international economic institutions. This included preparing a comprehensive "roadmap" for IFI membership, and working with the international donor community to develop a coordinated plan for assistance.

Sub-Saharan Africa

U.S. economic relations with Africa were elevated to a more prominent position than ever before under the Clinton-Gore Administration. Beginning in 1996, and partly in response to African trade legislation being proposed in the House Ways and Means Committee, Under Secretary Lipton began meeting with counterparts from the Department of State (then-Assistant Secretary for Economic Affairs Allen Larson) and USTR (Deputy USTR Jeffrey Lang) to brainstorm ways in which the United States might support broad-based and effective economic reform on the continent.

The approach they conceived was centered on expansion of bilateral trade opportunities, supported by: (1) creation of more favorable environments for foreign investment in sub-Saharan Africa; (2) stronger reform-oriented lending and technical assistance from the International Financial Institutions; (3) expanded debt relief; and (4) enhanced Cabinet-level dialogue on economic issues with reforming African countries. This agenda became the nucleus of the President's Partnership for Economic Opportunity and Growth in Africa. The passage into law of the African Growth and Opportunity Act (AGOA) in May 2000 was the culminating event of this effort.

Secretarial Visits

In furtherance of President Clinton's effort to enhance economic relations with Africa, Secretaries Rubin and Summers, respectively, were the first and second Secretaries of the Treasury ever to tour sub-Saharan Africa. Mr. Rubin's visit to Cote d'Ivoire, South Africa, Mozambique, Namibia, and Kenya in July 1998 focused on the need to improve governance and anti-corruption efforts, strengthen financial sectors (including micro-finance institutions), and integrate Africa more closely into the global economy. His speech in Nairobi on the economic costs of corruption in developing countries was surprisingly well received and one of the highlights of the trip.

Mr. Summers' June 2000 visit to Nigeria, Tanzania, South Africa, and Mozambique focused on the potential economic and social benefits to Africa of debt relief under the enhanced HIPC initiative, the importance of the AGOA to US-African economic relations, and the terrible economic threat posed to Africa by the AIDS epidemic. He also observed the flood damage in Mozambique. His visits to AIDS treatment centers in Tanzania and South Africa highlighted the emerging awareness of the threat in Africa and the need for comprehensive responses.

The Middle East

Following the signing of the Oslo Accords in 1994, the U.S. government coordinated pledges for the Palestinian Authority (PA) from donor countries. The first consultative meeting was held in Norway in 1994 under Treasury direction with organizational help from the World Bank, and ultimately led to the establishment of the Trust Fund for the West Bank and Gaza.

Donor assistance through the Trust Fund has played a key role in the economic development of the West Bank and Gaza by supporting the PA's current expenditures until a sustainable revenue base is built. Work focused on rehabilitating existing and building new infrastructure, and providing technical assistance to help strengthen Palestinian institution-building efforts. Loans through the Trust Fund are dispersed on concessional terms and have helped the PA establish a working relationship with the multilateral donor community. Total disbursements through the Trust Fund (projects administered by the IFC, MIGA, or World Bank) reached $281 million by the end of the Administration and there were 27 projects in five different sectors underway or completed. Deputy Secretary Eizenstat played a key leadership role in efforts to promote trade and economic reform in the region.

CHAPTER THREE

IMPROVING FINANCIAL SERVICES AND MARKETS AND THE FEDERAL GOVERNMENT'S FINANCIAL MANAGEMENT

Introduction

The years of the Clinton-Gore Administration featured some of the most dramatic developments in financial markets and the most dramatic improvement in the Federal government's fiscal position in a generation.

Key financial market developments included: the rapid globalization of financial markets, and the increased international competition that resulted; the periodic occurrence of financial crises, most dramatically, near-bankruptcy of LTCM in September 1998; the historic bull market in equity stocks throughout most of the Administration before the decline of high-tech stocks in 2000; and the emergence and integration of new technology into the financial services industry, most notably with the growth of online banking and online securities trading.

In the face of these often dramatic events, the Clinton-Gore Administration maintained its strong commitment to free market competition within an overarching framework of effective and consistent regulation. This policy of promoting market competition while strengthening the regulatory framework to minimize the risk of systemic financial failure, was aptly summarized by Secretary Summers in a speech to the Securities Industry Association on November 9, 2000, in which he said "we believe that our markets will not be fail-safe until they are safe for failure."

Throughout both terms of the Clinton-Gore Administration, the Treasury Department worked on many fronts to modernize the regulatory environment for the domestic financial services industry and financial markets with the objective of strengthening the effectiveness of competition to the benefit of American consumers and businesses alike. This chapter looks first at the financial services industry and then at financial markets.

In addition, one of the most dramatic accomplishments of the Clinton-Gore Administration was the transformation of the fiscal position of the Federal government. As covered in Chapter 1, the budget deficit in 1992 was $290 billion, the largest ever, and was projected to grow to $475 billion by century's end. By fiscal year 2000, however, there was a surplus of $237 billion, the third consecutive surplus and the largest ever. Between 1998 and 2000, the publicly held debt was reduced by $363 billion. This had far-reaching implications for the management of publicly held debt, one of the key functions of the Treasury Department.

This chapter will also look at how Treasury adapted to a world of declining debt while seeking to maintain the liquidity of the Treasury benchmark and continue to finance the government at the lowest cost to taxpayers. The chapter will further look at broader issues of financial management, including innovations in Treasury debt management, improvements to government financial accountability; the improvement of Federal debt collection procedures; and Treasury's role in Federal privatizations during the Clinton-Gore Administration.

I. Financial Services

This section looks at the key changes to the financial services industry under the Clinton-Gore Administration including: the Interstate Banking and Efficiency Act of 1994; the repeal of the Glass-Steagal Act; improvements to the Federal safety net following the thrift crisis of the early 1990s; strengthening protection for consumers in the financial services industry; and issues that arose from the growing prominence of Government Sponsored Enterprises (GSEs).

Financial Services Regulatory Reform

In 1993, the bank and thrift industries began to emerge from the crises and failures that marked the 1980s and early 1990s. The Treasury, working with Congress, oversaw enactment of several significant initiatives that accelerated the recovery of the industry, modernized U.S. financial markets, and substantially eased regulatory burdens on financial institutions.

In early 1993, Secretary Bentsen announced the Administration's support for a basic approach to financial institutions legislation in a speech before the Center for National Policy. The Secretary indicated that the Treasury would focus on specific pieces of legislation, like interstate banking, one at a time.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994[1] was the first achievement of that process. U.S. geographic restrictions on commercial banks were unique among the nations of the industrialized world and clearly one of the least defensible of our banking laws. The Interstate Banking and Branching Efficiency Act, which President Clinton signed in Treasury's historic Cash Room on September 29, 1994, permitted a bank holding company to acquire a bank located in any state, beginning one year after enactment. It also permitted a bank holding company that owned banks in different states to turn them into branches beginning June 1, 1997, or earlier if a state permitted it. This groundbreaking legislative initiative enhanced the competitiveness of, and reduced risk in, the U.S. financial system, authorizing national banks to operate on a nationwide basis and permitting states to authorize state banks to branch across state lines. For the first time, these changes permitted the creation of a truly national market in bank products and services.

Another early legislative achievement was the Riegle Community Development and Regulatory Improvement Act of 1994,[2] which established the Community Development Financial Institutions Fund (CDFI). (The CDFI is described in detail in Chapter 4.) This legislation also provided important new consumer protections in the home mortgage arena, and eliminated dozens of burdensome paperwork and reporting requirements for financial institutions.

In addition, the Administration proposed legislation in 1994 to rationalize the regulation of depository institutions and consolidate the many far-flung and sometimes overlapping functions of the numerous U.S. bank and thrift regulatory agencies. This initiative did not result in

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[1] Pub. L. No. 103-328, 108 Stat. 2338 (Sept. 29, 1994).
[2] Pub. L. No. 103-325, 108 Stat. 2160 (Sept. 23, 1994).

legislation, largely because the Federal regulatory agencies with jurisdiction over financial institutions were unable to agree upon a restructuring of their responsibilities.

The Economic Growth and Regulatory Paperwork Reduction Act,[3] which was enacted in 1996, reduced regulatory burdens imposed on depository institutions by repealing outdated reporting requirements and streamlining regulatory and approval processes.

On November 17, 1997, Secretary Rubin released a study entitled "American Finance for the 21st Century." This study set forth an analytic framework for considering issues confronting the financial services system of the 21st Century.[4] This document informed the debate over financial modernization legislation and reform to the regulatory structure of the financial services industry.

Working from this report, Treasury developed a major legislative proposal to repeal the provisions of the Glass-Steagall Act that had restricted affiliations between commercial banks and securities underwriting firms since the 1930s. The proposed legislation also sought to remove restrictions on affiliations between banks and insurance underwriters. For the first time, this proposal would permit the creation of holding companies that could offer banking, insurance, securities, and other financial products under one roof. The principal architects of this proposal were Secretary Rubin, then-Under Secretary for Domestic Finance John D. Hawke, Assistant Secretary for Financial Institutions Richard Carnell, Assistant General Counsel Roberta McInerney, and Director of Financial Institutions Policy Joan Affleck-Smith.

On October 14, 1999, after almost two years of contentious negotiations between the Treasury Department and the Federal Reserve Board, Secretary Summers and Chairman Greenspan agreed upon two corporate structures from which banking organizations wishing to affiliate with insurance companies and investment banks could choose – namely, national banks with insurance or securities subsidiaries, or financial service holding companies with subsidiaries in banking, securities or insurance. These structures were designed to enhance the safety and soundness of the financial system, prevent expansion of the safety net, and maintain the existing balance between the Fed and the Treasury/OCC regarding regulatory authority.

A few days later, Secretary Summers and Senate Banking Committee Chairman Gramm reached agreement on what had become one of the most divisive issues: application of the Community Reinvestment Act (CRA) to organizations engaging in the newly permitted affiliations. While Chairman Gramm had sought to restrict the applicability of CRA in connection with newly authorized activities, an agreement was ultimately reached on provisions that preserved the applicability of CRA to the new financial holding companies.

Enactment of the final bill followed months of difficult negotiations led by Secretary Summers, Under Secretary Gary Gensler, and Assistant Secretary Greg Baer, along with Assistant Secretary Linda Robertson and Deputy Assistant Secretary Marne Levine of Legislative Affairs. Many others at Treasury, including Deputy Assistant Secretary for Community Development

[3] Pub. L. No. 104-208, 110 Stat. 3009-394 (Sept. 30, 1996).

[4] United States, Department of the Treasury, American Finance for the 21st Century, by Robert E. Litan with Jonathan Rauch.

Policy Michael Barr, Director Affleck-Smith, and John D. Hawke, as Comptroller of the Currency, played critical roles in the final legislation.

The agreements reached as a result of these negotiations paved the way for passage of the most sweeping financial services legislation enacted in nearly six decades, which President Clinton signed on November 12, 1999. The Gramm-Leach-Bliley Act,[5] named after the chairmen of the House and Senate committees of jurisdiction, repealed provisions of the Glass-Steagall Act that had, since the 1930s, restricted affiliations between commercial banks and securities underwriting firms. The Act also amended the Bank Holding Company Act of 1956 to remove restrictions on affiliations between banks and insurance underwriters. The Act permitted the creation of new financial holding companies, which could offer banking, insurance, securities, and other financial products. It also provided companies with a choice of corporate structures for undertaking many of these activities.

The legislation was designed to benefit consumers, businesses, and communities in three clear ways:

- By repealing outmoded activity and affiliation restrictions, it opened the way to increased competition among providers of financial services and in the capital markets. This was expected to result in lower prices and a greater array of choices for individual consumers, small businesses, farmers, and local governments, as financial services providers adapt their product offerings to meet the changing demands of their customers in a truly national market.

- The Act also was designed to improve access to financial services for underserved consumers by encouraging new competitors to seek profitable opportunities in overlooked markets.

- Finally, the Act was designed to enhance consumer protections in the financial sector, particularly in the area of data privacy, where new rules give consumers much greater control over financial institutions' collection and use of sensitive financial information.

Upon signing the bill on November 12, 1999, President Clinton stated that: "This historic legislation will modernize our financial services laws, stimulating greater innovation and competition in the financial services industry. America's consumers, our communities, and the economy will reap the benefits of this Act. Beginning with the introduction of an Administration-sponsored bill in 1997, my Administration has worked vigorously to produce financial services legislation that would not only spur greater competition, but also protect the rights of consumers and guarantee that expanded financial services firms would meet the needs of America's underserved communities. Passage of this legislation by an overwhelming, bipartisan majority of the Congress suggests that we have met that goal."

During 1999 and 2000, led by Under Secretary Gensler and Assistant Secretary Baer, the Treasury Department played an active role in the implementation of the Act. For example, it participated in the six-month interagency process for drafting rules requiring financial institutions to disclose to their customers how they protect the privacy of their customers'

[5] Pub. L. No. 106-102, 113 Stat. 1338.

financial information. It developed a joint rule with the Federal Reserve Board concerning the newly authorized merchant banking activities of financial holding companies. It also drafted a rule setting out procedures for determining whether additional activities are financial in nature. As required by the Act, the Department also issued a joint study with the Federal Reserve on the feasibility and appropriateness of mandating that large banking institutions issue subordinated debt to enhance market discipline. In 2000, the Department issued a baseline study on the benefits of the Community Reinvestment Act (CRA). (The CRA is discussed in greater detail in Chapter 4.)

Deposit Insurance/Federal Safety Net

In addition to the repeal of Glass-Steagall, the Administration made a concerted effort to rectify the inadequacies that had been brought to light by the thrift debacle of the late 1980s and early 1990s. Treasury worked with Congress to enact several bills between 1993 and 1998 that finally put an end to the thrift crisis while working to minimize the fall-out from any subsequent crises:

- The Resolution Trust Corporation Completion Act of 1993,[6] which provided the funds needed to close and dispose of the remaining failed thrifts and to protect their depositors.

- The Deposit Insurance Funds Act of 1996,[7] which strengthened the Savings Association Insurance Fund by recapitalizing it and establishing a more viable mechanism for the payment of interest on Financing Corporation bonds.

- Finally, the Homeowners Protection Act of 1998,[8] which abolished the Thrift Depositor Protection Oversight Board established to oversee the Resolution Trust Corporation's handling of the savings and loan failures. That Act transferred the Board's remaining functions to the Treasury.

As part of its drive to strengthen the regulatory environment governing thrifts, Treasury, led by Assistant Secretary Carnell, undertook a comprehensive review of credit unions and credit union regulation, leading to a December 1997 report to Congress.[9] In this report, Treasury made more than 20 recommendations to Congress and to the National Credit Union Administration. Nearly all of Treasury's legislative recommendations were enacted in the Credit Union Membership Access Act of 1998.[10] These included establishing net worth requirements for all credit unions and risk-based net worth requirements for complex credit unions, and strengthening credit unions' Federal deposit insurance fund. The Act also strengthened credit union oversight by directing the National Credit Union Administration to develop a system of prompt corrective action to deal with a credit union's financial difficulties before those difficulties lead to an institution's failure. After enactment, the Treasury continued to work with the National Credit Union Administration as it implemented the new net worth requirements and the system of prompt corrective action.

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[6] Pub. L. No. 103-204, 107 Stat. 2369 (Dec. 17, 1993).
[7] Pub. L. No. 104-208, 110 Stat. 3009-479 (Sept. 30, 1996).
[8] Pub. L. No. 105-216, 112 Stat. 897 (Jul. 29, 1998).
[9] United States, Department of the Treasury, Credit Unions.
[10] Pub. L. No. 105-219, 112 Stat. 913 (Aug. 7, 1998).

Consumer Protection

During the Clinton-Gore years, extraordinary advances in technology and competition among institutions presented Americans with more complex financial choices than ever before. While these innovations usually lead to better products and lower prices, they also brought new risks and new opportunities for abusive practices.

In response to these developments, then-Deputy Assistant Secretary Baer and Director Affleck-Smith worked with Sarah Rosen of the National Economic Council to develop a proposal that would update consumer protection laws to provide consumers with the power, information, and protection they needed to profit from America's increasingly sophisticated financial system. President Clinton unveiled this detailed proposal on May 4, 1999.[11]

Perhaps the most critical component of the President's proposal involved strengthening consumer financial privacy. Protecting the privacy of personal information was seen as crucial to maintaining consumer confidence in the financial system, and in turn to the growth of electronic commerce and finance. The Treasury Department ensured that the Gramm-Leach-Bliley Act included stringent new financial privacy protections. The privacy provisions of the Act required financial institutions to disclose clearly and conspicuously their privacy policies and practices, including policies on sharing information with both affiliated and unaffiliated third parties.

In addition, by requiring financial institutions to consult consumers first, it gave consumers a veto over financial institutions' ability to share consumers' financial information with unaffiliated institutions. Treasury played a leadership role in the interagency development of regulations implementing the statute's privacy title.

Nevertheless, President Clinton indicated when signing the Gramm-Leach-Bliley Act that its privacy protections did not go far enough. Subsequently, Under Secretary Gensler and Assistant Secretary Baer led an effort by Treasury and other agencies to develop a proposal to further enhance financial privacy. On April 30, 2000, the President announced a legislative proposal for additional financial privacy provisions designed to close loopholes in the Gramm-Leach-Bliley Act protections. The proposal included further restrictions on the sharing of medical and other highly sensitive data, new rights for consumers to access and correct information held by financial institutions, and new rights for consumers to restrict the sharing of information among affiliates within a single corporate entity. It was expected that this proposal would serve as a framework for discussions in the 107th Congress.

Another critical component of the May 1999 proposal involved actions to curb abusive practices in the subprime mortgage market. The subprime market emerged in the 1990s as a rapidly growing source of funds for credit impaired households. While generally a positive development, the market has also seen a disproportionate share of abusive, or predatory, lending practices involving brokers and lenders preying on unsophisticated households that have few credit options. Together with Housing and Urban Development Secretary Cuomo, Secretary

[11] "The Clinton-Gore Plan for Financial Privacy and Consumer Protection in the 21st Century," May 4, 1999.

Summers established a HUD-Treasury National Predatory Lending Task Force. This Task Force drew a wide range of members interested in and affected by predatory lending practices, from the private sector, government, and activist communities. The Task Force held public forums throughout the country to gather information on predatory lending practices. Treasury and HUD concluded their research on this topic by issuing a joint report on June 20, 2000 that detailed the Departments' findings and recommendations for legislative, regulatory, and other steps to curb predatory and abusive home mortgage lending practices.[12]

Government Sponsored Enterprise Policy

In the 1990s, government sponsored enterprises, or GSEs, emerged as a significant force in the U.S. financial system. Established by Congress decades ago to facilitate the flow of credit to agriculture, housing, and education, the GSEs emerged as central players in financial markets, responsible for more than $1.5 trillion in debt and $1.2 trillion in mortgage-backed securities. Known best by their nicknames, the housing GSEs are Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System, the agricultural GSEs are the Farm Credit System and Farmer Mac, and the education GSE is Sallie Mae.

GSEs are privately owned but Federally chartered companies. Congress created the GSEs to meet specified public purposes – facilitating the flow of credit to the particular sector in which the GSE operates – and gave each GSE a series of benefits that subsidize its operations. The idea behind this arrangement was to marry a limited charter and Federal subsidies aimed at a public purpose with the financial incentives and operating flexibility associated with privately owned companies. As a group, the GSEs had become quite successful. The 1990s, however, saw the maturation of many of the markets served by the GSEs and the growing incentive for the GSEs to use their subsidies to both dominate their markets and expand into new markets.

As the GSEs continued to grow and to play an increasingly central role in the capital markets, issues of potential systemic risk and market competition became more relevant. The Administration took a number of steps to redress these concerns:

- Treasury worked to reform the Federal Home Loan Bank System. In 1995, the Administration submitted to Congress the "Federal Home Loan Bank System Restructuring and Modernization Act." Congress failed to pass this bill, but eventually enacted limited Federal Home Loan Bank reforms as part of the Gramm-Leach-Bliley Act. Regrettably, this portion of the bill fell well short of the Administration's goals. In particular, the provisions failed to curb the System's arbitrage activities and short-term lending, which do not advance the System's public purpose.

- Congress directed the Treasury to consider the desirability and feasibility of privatizing the other two housing GSEs, Fannie Mae and Freddie Mac. In response to that mandate, Deputy Secretary Summers submitted a report to Congress in July 1996.[13] The study found that firm

[12] United States, Departments of the Treasury and of Housing and Urban Development, Curbing Predatory Home Mortgage Lending: A Joint Report, June 2000.
[13] United States, Department of the Treasury, Government Sponsorship of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, July 11, 1996.

conclusions regarding the desirability of ending or modifying the government's sponsorship of these two companies were premature. The study also found that the two GSEs retain a substantial portion of the benefits of their government subsidy.

- In 1996, Congress, with Administration and Treasury support, passed the Student Loan Marketing Association Reorganization Act,[14] providing for the privatization of Sallie Mae. The Act required Sallie Mae to propose to shareholders a plan of reorganization under which their shares would convert to share ownership in a state-chartered holding company. Subsequently, in August 1997, Sallie Mae was reorganized into a subsidiary of SLM Holding Corporation (SLM), a Delaware corporation. The holding company structure allows SLM to enter new lines of business through its non-Sallie Mae subsidiaries. The Reorganization Act, required Sallie Mae to transfer its business to SLM, and it must liquidate and dissolve before September 30, 2008. During the period prior to the dissolution, Sallie Mae is subject to various limitations on its business and activities, although it may continue to purchase student loans, subject to certain conditions, until September 30, 2007. Treasury officials were integrally involved with and closely monitored the privatization process.

- The 1996 Reorganization Act also expanded Treasury's oversight of Sallie Mae. In 1997, Secretary Rubin established an Office of Sallie Mae Oversight. This office developed and implemented an examination plan to monitor Sallie Mae's safety and soundness and its compliance with statutory provisions, including its progress toward its statutorily required privatization. The Office issued its first examination report in March 2000, and will prepare annual exams going forward until Sallie Mae has been dissolved.

- In 1997, Secretary Rubin established an Office of GSE Policy in order to monitor ongoing GSE issues. In every year except 1993 and 1997, Treasury officials (including Secretary Rubin, Deputy Secretary Summers, Under Secretaries Newman and Gensler, and Assistant Secretaries Carnell and Baer) testified before Congress on GSE matters. Most importantly, in congressional testimony by Under Secretary Gensler on March 22, 2000, Treasury made recommendations on behalf of the Administration to promote private market discipline of GSEs, increase transparency of GSE credit worthiness, and promote market competition between GSEs and other private financial institutions.[15] This testimony provoked widespread debate on the appropriate relationship between the GSEs and the Federal government.

- At the request of Fannie Mae and Freddie Mac, officials of those two institutions provided a series of joint briefings for Treasury and Federal Reserve Board officials, including briefings for Secretary Summers and Chairman Greenspan. These briefings were held over a period of months before and after Under Secretary Gensler's March 2000 testimony and primarily covered subjects related to risk management and systemic risk. On October 19, 2000, Fannie Mae and Freddie Mac announced a series of measures intended to enhance transparency and market discipline. In response, Assistant Secretary Michelle Smith released the following statement: "Treasury monitors the Government Sponsored Enterprises (GSEs) on an ongoing basis and has discussed its concerns about a variety of issues with a number of interested parties, including the housing GSEs themselves. The measures announced today

[14] Pub. L. No. 104-208, 110 Stat. 3009-275 (Sept. 30, 1996).

[15] United States, Department of the Treasury, "Statement of the Honorable Gary Gensler" March 22, 2000.

by Fannie Mae and Freddie Mac, if fully implemented, are useful ones that have the potential to promote market discipline and increase transparency. Of course, there remains a range of issues with respect to GSEs that warrant continuing attention from financial authorities, the Congress and their regulators."

II. Financial Markets

The rapid growth in both size and sophistication of the financial markets posed a series of challenges to the Clinton-Gore Administration as the boundaries between national markets, different types of traded securities, and regulatory jurisdictions, started to blur or even disappear. Treasury worked on a number of fronts to manage the consequences of these developments, taking significant steps toward making our financial markets more competitive, efficient, and transparent, as well as safer for customers by improving the regulatory framework. The Administration also took measures designed to reduce systemic risk and enhance the underlying integrity of our markets.

This section looks at the key initiatives undertaken during the Clinton years in the context of its work through the President's Working Group on Financial Markets. These included: legislation to improve foreign currency and financial contract netting; improvements to mechanisms designed to curb extreme market volatility; the response to the near bankruptcy of LTCM; and reforms to the regulatory scope affecting over-the-counter derivatives trading. In addition this section discusses improvements to the regulation of government securities.

The President's Working Group on Financial Markets

Overview

The President's Working Group on Financial Markets (the "Working Group") was created by Executive Order in March 1988 in reaction to the stock market crash in October 1987. The Working Group provided a coordinated response to several significant market events, leading to the introduction of "circuit breakers" and "speed bumps" in the stock markets and related futures markets. From 1991 through 1993, the Working Group was relatively inactive.

Secretary Bentsen reactivated the Working Group with a broader mandate in 1994. In a letter to the other principals of the Working Group dated January 3, 1994, Secretary Bentsen suggested that the Working Group could achieve its goals of "enhancing the integrity, efficiency, orderliness and competitiveness of our Nation's financial markets and maintaining investor confidence" (Executive Order No. 12631, March 18, 1988) by coordinating the policies and actions of the various government agencies "in response to significant new developments in financial markets and to market problems and emergencies."

The chairman of the Working Group is the Secretary of the Treasury, and the other members are the chairmen of the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission, and the Commodity Futures Trading Commission. Subsequent to its reactivation by Secretary Bentsen, the Working Group served effectively as a means for the Treasury and financial regulatory agencies to exchange information and coordinate policy.

Participation in Working Group activities was expanded to include the heads of the National Economic Council, the Council of Economic Advisers, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve Bank of New York. Senior staff from the Working Group agencies composed a Steering Committee, which met every two weeks and was often in daily contact during periods of intense activity. These meetings were chaired by the Treasury Assistant Secretary for Financial Markets, who took an active role in leading Working Group activities.

Following is a summary of the five most significant actions resulting from the Working Group's recommendations:

Proposed Legislation on Netting of Foreign Currency Transactions

One of the first concrete acts of the Working Group after its reactivation in January 1994 was to formulate and transmit to Congress a proposed amendment to Section 101(55) of the Bankruptcy Code, which served to clarify the validity of netting spot foreign currency transactions under the Code. On October 22, 1994, President Clinton signed a substantially similar provision into law as part of the Bankruptcy Reform Act of 1994.

Legislative Proposals on Financial Contract Netting (Bankruptcy Code and Bank Insolvency Law)

The Working Group recognized the importance of improving the U.S. legal regime governing netting in order to enhance market stability, limit counterparty exposure, and preserve market stability in the event of a failure of a financial institution. Improvements in this area would help to reduce systemic risk in financial markets. As a result, staff of the Working Group began an intensive effort, lasting over two years in 1996-1998, to craft a legislative proposal. The goals were to eliminate uncertainty in the interpretation of certain provisions of the law; to harmonize, where appropriate, provisions under the Bankruptcy Code and the bank insolvency laws; and, to update laws to reflect changes in the market.

On March 16, 1998, Secretary Rubin, as Chairman of the Working Group, transmitted the agencies' legislative proposal to Congress, urging its prompt passage. On October 20, 2000, Secretary Summers and Federal Reserve Chairman Alan Greenspan wrote to Congress to urge passage of this important legislation, and the Administration issued a Statement of Administration Policy on October 24, 2000 in strong support if it. While the Working Group's financial contract netting proposals are not controversial and enjoy bipartisan support, they have been linked legislatively with other Bankruptcy Code amendments that have given rise to substantial controversy. A stand-alone bill introduced by Chairman Leach in 1999 was similarly embroiled in the politics of the larger bankruptcy legislation. The legislative proposal was not enacted in 1998, 1999, or 2000, but was expected to be taken up quickly by the 107th Congress.

Circuit Breakers Study

On October 27, 1997, the trading-halt procedures of U.S. securities, options, and futures exchanges --- commonly known as "circuit breakers" --- were triggered for the first time. A 350 point drop in the Dow Jones Industrial Average ("DJIA") triggered a 30-minute trading halt at 2:26 p.m. ET. A second-level circuit breaker was tripped at 3:30 p.m. as the DJIA dropped to 554 points below the previous day's closing level, effectively ending the trading session 30 minutes prior to the normal stock market close. After the markets closed, Secretary Rubin issued a statement that Treasury would continue to monitor developments in the U.S. and abroad, emphasizing that "[i]t is important to remember that the fundamentals of the U.S. economy are strong and have been for the last several years, and the prospects for growth with low inflation and low unemployment continue to be strong." The markets stabilized in subsequent days and the DJIA soon rose above its October 27 level.

In a letter dated October 29, 1997, Senators Phil Gramm and Christopher Dodd asked the Working Group to undertake a comprehensive study examining how well circuit breakers functioned in their first market application and whether they accomplished the objectives for which they were established. On January 29, 1998, Representatives of the Working Group --- including then-Under Secretary John D. Hawke, Jr.--- testified before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs concerning the shortcomings of the circuit breakers then in place.

In a report released on August 18, 1998, the Working Group unanimously concluded that the trigger levels for the DJIA circuit breakers in effect on October 27 were too low for current market levels and no longer reflected their original purpose of temporarily halting trading at significant percentage level declines. Accordingly, the report recommended, among other things, that the circuit breaker trigger levels should be increased; that the circuit breaker procedures should not force a premature closing of the market, except in extreme circumstances; and, that circuit breaker levels and procedures must be reviewed periodically.

In April 1998, the NYSE and CME had adopted revised trading-halt procedures and trigger levels, which were endorsed by the Working Group's report. The revised procedures also committed all of the exchanges to coordinate and re-set the trigger levels on a quarterly basis. As of the end of the Clinton-Gore Administration, these new trading halt procedures had not been triggered.

Long-Term Capital Management and Its Aftermath

In 1998, Long-Term Capital Management ("LTCM"), a hedge fund, suffered heavy financial losses that brought the fund to the brink of collapse. LTCM's size and use of leverage, among other things, rendered the fund vulnerable to the volatile financial market conditions that developed following Russia's devaluation of the ruble and declaration of a debt moratorium in August 1998. As the fund's losses mounted through August and September, it ultimately faced a severe liquidity crisis. Fearing that a collapse was imminent and could have broad systemic implications, a small group of LTCM's counterparties began to consider alternatives that could forestall a default. On September 23, fourteen of LTCM's counterparties met in facilities

provided by the Federal Reserve Bank of New York and agreed to participate in a $3.6 billion recapitalization of the fund. In return, these firms received a 90 percent equity stake in LTCM's remaining portfolio, plus the assumption of operational control. The episode created grave concern regarding systemic risk and the impact of the failure of any one institution on the system more broadly. (See also Chapter 2 for more on Treasury's efforts to reform the international financial architecture in the wake of the near-collapse of LTCM.)

In the aftermath of LTCM, Secretary Rubin asked the Working Group to prepare a report on the crisis. In order to arrive at a consensus on the underlying causes of the crisis and a unanimous set of recommendations to address such causes, the Working Group Steering Committee members and staff conducted extensive examinations, discussions, and negotiations. Then-Assistant Secretary Gensler, then-Deputy Assistant Secretary Lee Sachs, and Deputy Assistant Secretary Roger Anderson coordinated these efforts. The Working Group completed its report, *Hedge Funds, Leverage, and the Lessons of Long-Term Capital Management*, on April 29, 1999. The report concluded that the central public policy issue raised by the near-collapse of LTCM was how to constrain excessive leverage more effectively, not only in the case of hedge funds but for financial institutions in general.

To address these issues, the report presented a comprehensive set of recommendations intended to create an environment in which market discipline can work effectively, strengthen credit risk management practices, promote the maximum degree of transparency, maintain competitiveness of the system as a whole, and reduce systemic risk.

- The Working Group recommended that more frequent and meaningful information on hedge funds should be made public; that financial institutions should enhance their practices for counterparty risk management; and that regulators should encourage improvements in the risk-management systems of regulated entities.

- The Working Group also reiterated its recommendation that Congress should enact its provisions relating to financial contract netting.

- Finally, the report noted that additional steps, including direct regulation of hedge funds, could be considered if other indirect measures proved ineffective at constraining leverage. Representatives of the Working Group, including Assistant Secretary Sachs, promoted these recommendations in follow-up testimony before Congress.

Several of the Working Group's recommendations related to issues or areas that fell fully within the purview of U.S. regulators, legislators, or policy makers, and each such recommendation had either been implemented or had been initiated and remained in progress at the end of the Administration. Several other recommendations related to issues or jurisdictions with an international reach, and thus U.S. policy makers had not been able to implement them unilaterally. The member agencies of the Working Group, however, worked closely with their foreign counterparts to pursue advances in these areas.

In addition, Congressman Richard Baker, Chairman of the Capital Markets Subcommittee of the House Banking Committee, and Ranking Member Paul E. Kanjorski introduced in September

1999 the *Hedge Fund Disclosure Act* (H.R. 2924), which was designed to require "unregulated hedge funds" to disclose publicly certain information about their financial and risk management activities. Treasury Assistant Secretary Lee Sachs testified on behalf of the Working Group, and the Working Group helped to improve the legislation. The full committee did not vote on the bill in 1999 or 2000.

Over-the-Counter Derivatives Markets, Legal Uncertainty, and the Commodity Exchange Act

During the Clinton-Gore Administration, Treasury acted on its long-running concern about the uncertain legal status of swaps and hybrid financial instruments. This uncertainty stemmed from ambiguities about the scope of the Commodity Exchange Act ("CEA"). Treasury, among others, was concerned that this legal uncertainty had an unnecessarily negative impact on the over-the-counter ("OTC") derivatives markets in the U.S. and, in times of substantial market volatility, could contribute to systemic risk.

In 1993, the CFTC exercised the authority granted to it by the Futures Trading Practices Act of 1992 and approved exemptions from the CEA and CFTC rules and regulations (except for anti-fraud and anti-manipulation provisions) for certain swap agreements, hybrid instruments, and contracts on specified energy products. Despite these changes, legal uncertainty remained.

On May 7, 1998, CFTC Chairwoman Brooksley Born announced a controversial concept release on regulation of OTC derivatives. This release heightened concerns among market participants regarding the CFTC's jurisdiction and the implication that some swaps could be considered illegal off-exchange futures contracts and hence voidable.

The response from the other Working Group members, who had requested that the CTFC refrain from such an action, was swift and decisive. The same day the concept release was issued, Secretary Rubin, Chairman Greenspan, and Chairman Levitt issued a joint press release noting their "grave concerns" about the CFTC's action and its possible implications. Subsequently, they urged Congress to issue a legislative moratorium on CFTC action regarding OTC markets. Under Secretary Hawke and Deputy Secretary Summers testified on Treasury's concerns during congressional hearings in June and July 1998. On October 21, 1998, as part of the omnibus appropriations bill, President Clinton signed legislation imposing the moratorium.

Key members of Congress requested orally and in report language that the Working Group conduct a study on the OTC derivatives markets and the CEA. The study was begun in the fall of 1998. Given the controversial issues and jurisdictional concerns involved in the study, extensive discussion and negotiation was required to reach unprecedented unanimous recommendations. Secretary Summers and Assistant Secretary Sachs led the efforts to build consensus. Additionally, the principals met several times through the course of the study to resolve differences. Chairwoman Born announced on January 19, 1999 that she would not seek reappointment at the end of her term in April 1999, and President Clinton replaced her with William Rainier.

On November 9, 1999, the Working Group released its report, *Over-the-Counter Derivatives Markets and the Commodity Exchange Act*. The Working Group unanimously recommended

changes to the CEA to ensure legal certainty and to promote innovation, competition, efficiency, liquidity, and transparency in OTC markets. Treasury Secretary Summers and Assistant Secretary Sachs later promoted Treasury's support of the Working Group's recommendations in testimony before Congress.

The Working Group worked closely with Congress in an effort to turn its recommendations into legislation. Secretary Summers and Assistant Secretary Sachs played pivotal roles in negotiating the agreement between the SEC and the CFTC on a regulatory regime for single stock and narrow-based stock index futures, which allowed for the repeal of the eighteen-year ban on their trading. Resolution of this issue was vital to passage of the legislation.

On October 19, 2000, the House voted 377 to 4 to pass H.R. 4541, the Commodity Futures Modernization Act of 2000. Negotiations initially bogged down in the Senate, however, as Senator Gramm raised issues concerning the treatment of OTC derivatives under securities and banking laws. After Congress reconvened in post-election session, however, Secretary Summers, Under Secretary Gensler, and Assistant Secretary Sachs successfully negotiated provisions to address these issues. On December 15, the House and Senate each passed the consensus legislation as part of the final year-end spending bill. President Clinton signed the bill on December 21, 2000.

The final derivatives bill reflected a balanced approach to resolving troublesome and longstanding problems with the CEA that had been of concern to the markets for derivative products. The bills not only provided legal certainty to OTC derivatives markets and clarified the Treasury Amendment, but also granted regulatory relief to the futures exchanges and intermediaries and repealed the eighteen year old prohibition of single stock and narrow-based stock index futures that resulted from a jurisdictional dispute between the CFTC and SEC.

Government Securities Market Regulation

Another important area of improvement for financial markets was government securities regulation. Congress passed the Government Securities Act of 1986 ("GSA") to close then-existing gaps in the regulation of market participants. Prior to the enactment of the GSA, some government securities brokers and dealers were not registered with or regulated by any Federal government agency, resulting in a number of problems. The GSA required this group of brokers and dealers to register with the SEC. In addition, the GSA granted to the Treasury limited rulemaking authority over all government securities brokers and dealers, including financial institutions. The Treasury rules are enforced by appropriate regulatory agencies -- the Federal banking regulators fill that role for commercial banks, and the SEC for all other government securities firms.

Treasury's rulemaking authority under the GSA expired on October 1, 1991. Prior to congressional renewal of that authority, the primary dealer firm of Salomon Brothers was charged with auction irregularities, including an attempted "short-squeeze" in the government securities market. The scandal triggered intense scrutiny of the market for government securities. This was the situation when the Clinton-Gore Administration entered office on January 20, 1993.

Treasury staff, led by Under Secretary Frank Newman and Deputy Assistant Secretary Darcy Bradbury worked intensively during 1993 to renew Treasury's authority under the GSA. As a result, the Government Securities Act Amendments of 1993 ("GSAA") was signed by President Clinton on December 17, 1993. It permanently reauthorized Treasury's rulemaking authority under the GSA. In addition, the GSAA granted the Treasury new authority to prescribe large position recordkeeping and reporting rules, and authorized the National Association of Securities Dealers ("NASD") and bank regulatory agencies to develop sales practice rules for the government securities market. It also removed the limitations in the GSA on the type of rules the NASD can adopt and made it an explicit violation of securities law to provide the Treasury with false information in connection with an auction bid for Treasury securities.

The GSAA also directed the Secretary of the Treasury, the SEC, and the Board of Governors of the Federal Reserve to jointly study and report to Congress by March 31, 1998 on the effectiveness of the regulatory system for government securities. Pursuant to the directive of the GSAA, the Treasury, the SEC and the Board submitted the *Joint Study of the Regulatory System for Government Securities* to Congress on March 26, 1998. The study concluded that the government securities market functions smoothly, is not flawed in any fundamental sense, and that no additional rulemaking authority under the GSA, as amended, was currently needed.

III. Debt Management

This section looks at key debt management issues that arose during the Clinton-Gore years.

New Instruments and Initiatives

In an effort to address the changing needs of markets and market participants, Treasury's debt managers continually reviewed offerings and processes, updating practices and introducing new instruments when necessary to meet new needs. Three significant changes are highlighted below.

Introduction of Uniform-Price Auctions

In the wake of the Salomon Brothers auction violations in the summer of 1991, the Treasury Department, the Federal Reserve, and the Securities and Exchange Commission published *The Joint Report on the Government Securities Market*, issued in January 1992.[16] One of the recommendations of the report was that the Treasury consider alternatives to the sealed-bid, multiple-price auction technique it was then using to auction marketable securities.

After an extensive review of the issues, the Treasury announced on September 3, 1992, that it would conduct a uniform-price auction experiment for all auctions of 2-year and 5-year notes.

Treasury studied uniform-price auctions for the next three years under the leadership of Assistant Secretary for Financial Markets Darcy Bradbury and Deputy Assistant Secretary for Federal Finance Roger Anderson. In October 1995, the results of Treasury's uniform-price auction

[16] United States, Department of the Treasury, Securities and Exchange Commission, and the Board of Governors of the Federal Reserve System, Joint Report on the Government Securities Market. (Washington: GPO, 1992).

experiment were published in a report entitled, *Uniform-Price Auctions: Evaluation of the Treasury Experience.*[17] The report concluded that under a uniform-price auction format the concentration of awards was reduced, and participants bid more aggressively, resulting in reduced financing costs. In October 1998, an update to the 1995 study was released.[18] The conclusions of the update reinforced and confirmed those reached in 1995. The findings indicated that uniform-price auctions have allowed the Treasury to make improvements in the efficiency of market operations and reduce the costs of financing the Federal debt.

On October 28, 1998, Treasury extended the use of uniform-price auctions to all marketable Treasury securities. This change included bills (including cash management bills), notes, and bonds, bringing consistency to Treasury auction procedures and techniques.

Introduction of Marketable Inflation-Indexed Securities and Inflation-Indexed Savings Bonds

In 1995, then-Deputy Secretary Summers and other Administration officials began to look seriously at the merits of issuing inflation-indexed securities. Proponents of inflation-indexed bonds argued that such instruments would broaden investor demand by appealing to retail investors who did not ordinarily invest in conventional Treasury securities. By offering investors an asset class that would provide a guaranteed real rate of return over inflation, it would encourage a higher level of personal saving. (For more on Treasury's efforts to encourage personal savings, see Chapter 4.) In addition, inflation-indexed bonds would provide benefits to the Treasury Department, saving the Treasury money by capturing, over time, the inflation risk premium built into nominal securities, and reducing and making more stable the government's funding costs. Finally, it was believed that they would spur development of the capital markets.

Treasury first sought comments in *The Federal Register* and held extensive meetings with investors, dealers, and other interested parties across the country. On January 21, 1997, Secretary Rubin announced that Treasury would begin offering marketable inflation-indexed securities, beginning with the auction on January 29, 1997 of $7.0 billion of 10-year inflation-indexed notes.

On September 1, 1998, as part of its over-all, inflation-indexed securities program, and to provide inflation protection to small savers, Treasury announced that it was offering for sale new inflation-indexed savings bonds, called I-bonds.

Modernization of State and Local Government Program

In 1996, Treasury also implemented new regulations to make it easier for states and local government to manage tax-exempt bonds. State and Local Government Series (SLGS) securities are non-marketable U.S Treasury securities offered for sale to issuers of state and local government tax-exempt debt to assist with compliance of yield restriction or arbitrage rebate provisions of the Internal Revenue Code. After meeting with municipal market participants in

[17] United States, Department of the Treasury, Uniform-Price Auctions: Evaluation of the Treasury Experience, (Washington: 1995).

[18] United States, Department of the Treasury, Uniform-Price Auctions: Update of the Treasury Experience, (Washington: 1998).

December 1995, the Treasury, under the direction of Assistant Secretary Bradbury and Deputy Assistant Secretary Anderson, undertook a study of the SLGS program. On October 28, 1996, Treasury implemented new regulations for the SLGS program that were designed to make it easier and less costly for state and local governments to refinance and invest proceeds of tax-exempt bonds.

Debt Limit Impasse: November 15, 1995 – March 29, 1996

As discussed in Chapter 1, the Administration and Congress became embroiled in a fierce standoff over the Republican budget reconciliation plan at the start of fiscal year 1996. At the same time, Congress refused to increase to the statutory public debt limit in the absence of a resolution to the budget debate. Beginning in October 1995, Treasury took a series of extraordinary actions to avoid default before Congress finally voted to increase the debt limit.

Debt Paydown

In fiscal year 1998, the United States government recorded its first budget surplus since fiscal year 1969. Budget surpluses continued to grow during fiscal years 1999 and 2000, totaling $430.6 billion over the combined three-year period. Debt held by the public, which had peaked at $3.8 trillion in March 1997, declined steadily as a result of these surpluses. [19] By the end of fiscal year 2000 the debt held by the public had declined by $363 billion, or by 9.4 percent from its 1997 peak. Indeed, on December 28, 2000, President Clinton put forward a concrete proposal founded on realistic economic assumptions that would eliminate the Federal debt held by the public by 2010.

The Government's improved fiscal position, combined with forecasts of additional surpluses going forward, posed significant but welcome challenges for the Treasury's debt managers. Led by Under Secretary Gensler and Assistant Secretary Sachs, Treasury sought to develop ways to manage the Federal government's reduced borrowing needs while maintaining the liquidity of the markets for Treasury securities and continuing to finance at the lowest cost to taxpayers. Initially, the paydown of debt was accomplished by issuing less new debt than the amount of debt maturing. This entailed a broad reduction in the amount of securities issued, less frequent issuance of certain securities, and the outright elimination of some securities from Treasury's debt issuance schedule. Additionally, two other debt management tools were developed to facilitate the process of paying down the debt: debt buybacks and regular reopenings. As a result of these combined policies, during the period from fiscal year 1997 to fiscal year 2000, gross bill issuance declined by $87.1 billion and gross coupon issuance declined by $262.3 billion.

The four most significant changes to Treasury debt management resulting from debt paydown are highlighted:

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[19] Gross Federal Debt consists of debt held by the public and debt held by Government accounts. Borrowing from the public has a significant impact on the economy and is a good approximation of the Federal demand on the credit markets. Federal borrowing competes with the borrowing of other sectors for funds in the credit markets.

Changes to Treasury Auction Schedule

In adjusting to a world of debt repayment, Treasury sought to distribute the required reductions in borrowing across various maturities and sectors of the Federal debt in an effort to maintain liquidity in benchmark issues. In May 1998, the Treasury discontinued auctions of quarterly 3-year notes, and adjusted the frequency of 5-year note auctions. In August 1999, Under Secretary Gensler announced a reduction in the number of 30-year bond auctions. On February 2, 2000, Under Secretary Gensler announced a reduction in frequency of 52-week bill auctions and the elimination of the April 30-year inflation-indexed securities.

Introducing Debt Buybacks

In order to increase the tools at its disposal to manage the repayment of publicly held debt, and at the recommendation of the Treasury Borrowing Advisory Committee, Treasury sought regulatory changes that would allow it to buy back outstanding Treasury debt before its final maturity date. Under Secretary Gensler and Assistant Secretary Sachs led the effort to develop a buyback program. Fiscal Assistant Secretary Donald Hammond and Deputy Assistant Secretary Michael Paulus played critical roles in the implementation of the program.

On January 13, 2000, Secretary Summers announced that Treasury had released final regulations allowing it to conduct buybacks of outstanding Treasury securities and announced intentions to conduct up to $30 billion in buyback operations in calendar 2000. On March 9, Treasury conducted the government's first buyback operation in 70 years, using the Federal Reserve Bank of New York's Open Market operations system. In August of 2000, the buyback program was extended to include callable securities.

Reopening Treasury Securities

Treasury also sought to adjust to the new environment by creating greater flexibility in the way it managed government bonds, most notably by conducting reopenings of Treasury securities without creating concern under the original issue discount (OID) tax rules. In a re-opening, the new securities auctioned are part of an existing securities issue, creating a larger and more liquid issue. On November 3, 1999, Treasury announced a change to allow for the reopening of its benchmark securities within one year of issuance, thereby allowing more flexibility in conducting reopenings, promoting greater liquidity and efficiency in the markets for the Treasury securities and reducing borrowing costs. With the new OID rule in place, Treasury announced on February 2, 2000 a regular reopening schedule for longer-term securities (5- and 10-year notes and 30-year bonds) with smaller reopenings than initial issuance.

Revising the Auction Rules for Foreign and International Monetary Accounts

Against the backdrop of Treasury's declining borrowing needs, a review was begun in 2000 of the treatment of Foreign and International Monetary Authority (FIMA) accounts bidding in Treasury auctions. Treasury's policy had permitted FIMA accounts to bid non-competitively and without size limitation in Treasury bill, note, and bond auctions. FIMA non-competitive purchases of coupon securities, and portions of FIMA non-competitive purchases of bills, were

treated as "add-ons" to Treasury's public auction amounts. This resulted in significant issuance of Treasury securities above the publicly announced auction amounts.

Treasury's study of this matter and the work of Under Secretary Gensler, Assistant Secretary Sachs, and Deputy Assistant Secretary Paulus, in close coordination with Under Secretary Geithner, Assistant Secretary Truman, Assistant Secretary Hammond and Deputy Assistant Secretary Lebryk, resulted in a decision to limit competitive awards to individual FIMA accounts, and to limit total non-competitive bids from all FIMA accounts, thereby eliminating "add-ons" to auction sizes. These decisions were made in conjunction with the Federal Reserve Bank of New York, which worked with the largest foreign accounts to ensure minimal disruption due to the changes. Deputy Assistant Secretary Paulus led the implementation efforts for these changes. On November 15, 2000, Treasury announced proposed changes that were to become effective on February 1, 2001. These changes were designed to facilitate the continued participation of FIMA accounts in the auction process, improve the liquidity and efficiency of the Treasury market, and allow the Treasury to better control the amount of funds raised at auction.

IV. Government Financial Accountability

One of the key priorities of the Clinton-Gore Administration was to improve the performance and accountability of Federal agencies and thereby raise the level of public confidence in Federal government. Called "reinventing government," Vice President Gore led the Administration's efforts to improve the performance and accountability of Federal agencies. Treasury was integral to the effort to ensure improved accounting, auditing, performance evaluation, and financial management across government. Three of the key changes were:

Measuring Government Performance

The Government Performance and Results Act of 1993 provided for the establishment of strategic planning and performance measurement in the Federal government. The purpose of the Act was to improve the American people's confidence in the government by holding Federal agencies accountable for achieving program results, initiating program performance reform, improving Federal program effectiveness and public accountability, helping Federal managers improve service delivery, improving congressional decision making, and improving internal management. The Act required each agency to prepare an annual performance plan covering each program activity set forth in their budget. In addition, it required each agency to prepare a report on program performance no later than March 31 for the previous fiscal year. Treasury fully supported and participated in the development and enactment of this legislation.

Improving Government Accounting and Reporting

Government Management Reform Act of 1994

The Government Management Reform Act of 1994 created the requirement for audited consolidated financial statements for the Federal government. Starting on March 1 of 1997 and each year thereafter, the Act required 24 major executive agencies to prepare and submit an

audited financial statement to the Office of Management and Budget (OMB) for the preceding fiscal year. OMB was delegated the task of prescribing the form and content for these financial statements. Furthermore, the Act granted authority to OMB to identify other components of executive agencies required to prepare audited financial statements. This Act also required the Secretary of the Treasury, in coordination with the Director of the OMB, to prepare and submit governmentwide financial statements, starting no later than March 31, 1998, and each year thereafter, to the President and the Congress. The Act required these statements to be prepared in accordance with the form and content requirements set forth by OMB and audited by the Comptroller General of the United States. Treasury was a strong supporter of this Act and has successfully completed and submitted the governmentwide financial statements within the prescribed due dates for the three years 1998-2000.

Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act of 1996 requires each agency to implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the United States Standard General Ledger at the transaction level. The Act also requires audit reports on system compliance. In cases of non-compliance, the report is required to include the name of the entity or organization responsible for the financial management system, the nature and extent of the noncompliance, the cause of the noncompliance, the responsible party, relevant comments from responsible officers or employees, and remedial actions and timeframes to implement such actions. An agency had three years to bring their financial management system into substantial compliance once a determination is made that they are not in compliance. Treasury strongly supported this legislation and has been an active participant with the Joint Financial Management Improvement Program, as well as the CFO Council, in improving Federal financial management systems and requirements.

Joint Financial Management Improvement Program

The Joint Financial Management Improvement Program (JFMIP) was established in 1948 to increase the effectiveness and efficiency of Federal financial systems. The eight years of the Clinton-Gore Administration witnessed a dramatic transformation of JFMIP into the central player in Federal financial software. The Treasury Department has been a major contributor to JFMIP since its inception, and in 1999 and 2000 the Treasury Fiscal Assistant Secretary served as its chairman. With the 1998 issuance of system requirements covering many major functional areas together with revised core system requirements, JFMIP provided a solid framework for financial systems for the start of the twenty-first century. JFMIP has also taken responsibility for certifying commercial, off-the-shelf systems for use by Federal agencies. To date, nine packages by eight vendors have become eligible for purchase by agencies through JFMIP's certification process. Moreover, companies selling financial market software to government agencies were required to meet JFMIP's core requirements. This was a major step forward in the standardization of Federal financial management and the reduction of risk in systems acquisition.

New DAS for Accounting

Recognizing the increasing policy importance of accounting expertise, the Office of the Fiscal Assistant Secretary was reorganized in 1998 to create the position of the Deputy Assistant Secretary for Accounting Operations. This position was responsible for representing Treasury in the Federal accounting standards organization, the Federal Accounting Standards Advisory Board, and for providing accounting expertise and policy direction to the operations of Federal accounting and reporting, including the governmentwide consolidated financial statements. The first DAS for Accounting Operations, Robert Reid, was appointed in June 1999.

Federal Accounting Standards

The Financial Accounting Standards Advisory Board (FASAB) issued its first concept statement and first accounting standard in 1993. Treasury, as one of three principal members of the board, provides funding and leadership to FASAB's. In 2000, standards covering both credit reform and social insurance joined the sixteen previous standards to provide a comprehensive base for Federal government accounting. The Administration's accomplishments in this area were recognized by the AICPA in 1999 when it designated FASAB standards as Generally Accepted Accounting Principles for Federal entities.

Managing Government Trust Funds and Deposits

In November 1999, in recognition that careful and effective administration of trust funds and other Government accounts with investment authority (or investment funds) is an important and growing Treasury function, Secretary Summers directed the Department to complete a study of Treasury's duties and responsibilities in the administration of investment funds. The study, conducted over a period of twelve months, was led by Fiscal Assistant Secretary Hammond and involved Treasury's Offices of Domestic Finance, General Counsel, Tax Policy, Economic Policy, as well as the IRS, the Financial Management Service, and the Bureau of the Public Debt. The goals of the effort were to conduct a comprehensive review of the investment funds within Treasury, document Treasury's role in the administration of these funds, evaluate that role on the basis of appropriateness and efficiency, and develop recommendations for improvement. The final report was completed in November 2000.

The report concluded that Treasury has exercised appropriate diligence in the performance of its duties as currently defined. The review recognized, however, that there was a need for more focused and comprehensive attention on Treasury's overall responsibilities, and recommended a number of administrative improvements to enhance on-going operations and strengthen Treasury's control and oversight of investment funds. Secretary Summers approved the recommendations of the review and tasked the Under Secretary for Domestic Finance and the Fiscal Assistant Secretary with implementing the recommendations.

V. Improvements in Federal Debt Collection

In addition to Treasury's actions to improve the efficiency of Federal agencies, the Department was also deeply involved in efforts to improve the collection of Federal debts.

Both the National Performance Review in September 1993 and the President's Council on Integrity and Efficiency in March 1995 reported on the need for improvements in the tools and systems for the collection of delinquent Federal debt. As a result, the Debt Collection Improvement Act of 1995 was introduced into the House of Representatives in August 1995. The proposed legislation enjoyed strong bipartisan support and was championed through the legislative process by Representatives Horn (R) and Maloney (D). Along with other members of the Administration, Assistant Secretary for Management and Chief Financial Officer George Muñoz testified in strong support of the legislation, describing Treasury's plans to expand the use of existing tools and to establish a centralized offset program. On April 26, 1996, President Clinton signed into law the Debt Collection Improvement Act of 1996 (DCIA) as part of the Omnibus Consolidated Recessions and Appropriations Act of 1996, Public Law 104-134.

Under the guidance of Under Secretary for Domestic Finance Hawke and Fiscal Assistant Secretary Hammond, the Department centralized debt collection at the Financial Management Service (FMS), a Treasury bureau that had experience in setting debt collection/credit management standards and in assisting agencies in implementing debt collection procedures. FMS, under the leadership of Commissioner Gregg, used offset of federal payments, cross-serving, private collection agencies, and referral of delinquent debt to the Department of Justice for collection. In addition, FMS began collecting state income tax debt and has initiated the continuous tax levy program.

From the enactment of the DCIA in 1996 to the end of the Administration, Treasury collected $9.1 billion in delinquent debt. While the primary purpose of the DCIA was to increase the collections of non-tax debts owed to the Federal government, the Act also contained important provisions that could be used to assist families in collecting past-due child support obligations. Since 1998, child support collections have totaled $3.8 billion. Secretary Summers was a strong advocate of the child support initiative, and the collection of $1.3 billion in over due child support payments in fiscal year 2000 reflects that commitment.

VI. Privatizations

As the Federal government's principal financial and economic department, Treasury also played a leading role in managing the privatizations that occurred during the Clinton years. Here, the two main privatizations are highlighted:

Elk Hills Naval Petroleum Reserve

Treasury played an important role in one of the largest privatizations in the history of the Federal government -- the February 1998 sale of the Federal government's interest in the Naval Petroleum Reserve at Elk Hills ("NPR-1"), California to the Occidental Petroleum Corporation for $3.65 billion in cash. The February 1996 legislation authorizing this sale required the

Secretary of the Treasury, along with the OMB Director and the Secretary of Energy, to review and approve, or disapprove, the draft agreements relating to the sale. Secretary Rubin delegated this authority to Under Secretary Hawke. Principal Deputy Assistant Secretary Mozelle Thompson and his staff worked with OMB, the Department of Energy and its financial advisors and outside counsel, to ensure that: (1) the sale was conducted in a sound manner that satisfied Federal financial policies, and (2) the sale was consistent with commercial practices and maximized sales proceeds to the Federal Government, as required under authorizing legislation. NPR-1 was transferred to the Occidental Petroleum Corporation on February 5, 1998.

United States Enrichment Corporation

Congress began the process of privatizing the United States Enrichment Corporation (USEC) in 1992 with passage of the Energy Policy Act (the 1992 Act). That legislation established USEC as a government corporation and gave it a mandate to develop a strategic plan for privatization. The 1992 Act required that the plan be approved by the President. In 1995, USEC submitted its privatization plan to the President and Congress. The plan accomplished the statutory requirement to evaluate alternative means of privatization by establishing a "dual-path" process, in which USEC simultaneously prepared for an initial public stock offering and a negotiated third-party sale.

Before President Clinton approved USEC's privatization plan, however, Congress passed the USEC Privatization Act of 1996 (the 1996 Act). While directing USEC to privatize, with the approval of the Secretary of the Treasury, the 1996 Act imposed additional statutory criteria concerning the long-term viability of USEC, continued operation of the gaseous diffusion plants, and maintenance of domestic sources of uranium enrichment and conversion. The 1996 Act directed that the sale seek to maximize proceeds for the United States, consistent with statutory criteria.

Treasury coordinated the inter-agency process for the privatization, and, from 1992 until late 1997, Treasury's efforts were headed by Deputy Assistant Secretary Thompson. Following DAS Thompson's departure, then-Assistant Secretary Gensler assumed responsibility for the USEC privatization.

In July 1997, Secretary Rubin and President Clinton approved the privatization plan. In June 1998, the USEC Board unanimously approved the public stock offering proposal. At that point, pursuant to statutory guidelines, the government reviewed the USEC Board's decision to approve the stock offering. After extensive interagency consultation, the Government endorsed the stock offering as the best means of achieving the statutory requirements of the privatization. Although not required by statute, Treasury entered into a separate agreement with USEC a few days before privatization that placed some additional limitations on the corporation's conduct after privatization. Treasury believed this was the best way to address special areas of concern identified in the privatization. The net proceeds to the government from the sale were approximately $1.4 billion.

CHAPTER FOUR

WORKING TO BRING ALL AMERICANS INTO THE ECONOMIC MAINSTREAM

Introduction

Since the beginning of the Clinton-Gore Administration, one of the critical goals of the Treasury Department has been to ensure that all Americans share in the benefits of the strong and growing economy. The foundation for this effort has been to help build a strong national economy by investing in people, opening markets, and adhering to the fiscal discipline necessary to restore market confidence and free up capital for private investment.

As Treasury Secretaries Bentsen, Rubin, and Summers emphasized repeatedly throughout their tenures, bringing all Americans into the economic mainstream is an economic imperative as well as a moral imperative. Even when unemployment was at its lowest in a generation, the Administration recognized the importance of engaging more Americans in the workforce to prevent inflationary pressures from arising in the labor market. The Administration also recognized the need to bring low-income communities into the mainstream economy to improve productivity and ease social costs. As Secretary Rubin often said, "this country will fall far short of its full economic potential for all Americans, unless the least well off have a real opportunity to join the economic mainstream. Providing this opportunity is an economic issue of fundamental importance to all of us."

By maintaining fiscal discipline, by supporting free markets both at home and internationally, and by implementing policies and programs to support economic development in all communities, the Clinton-Gore Administration helped to achieve a level of economic prosperity in America unlike any before. Indeed, a strong and growing economy over the period of the Administration led to a reduction in unemployment to the lowest level in 30 years and a decline in poverty rates to 20- and 30-year lows for all ethnic groups.

However, in spite of the strength of the economy, too many Americans remained outside the economic and financial mainstream. For example, in 1999, in the midst of the longest period of economic growth in America's history, one in ten American families and one in five African American families still lacked a bank account. More than one-third of Americans were without personal savings. And although homeownership rates for minorities were on the rise, they continued to lag behind those of whites.

Throughout the Clinton-Gore Administration, the Treasury Department focused intensively on providing the most effective policies to stimulate business investment in low- and moderate-income communities and to encourage low- and moderate-income Americans to participate in the broader economy. As a testament to the will and determination of the Administration, one of the largest federal programs ever to focus on investment in low- and moderate-income communities was passed on December 21, 2000. As part of a broader package focused on low- and moderate-income communities, the New Markets Tax Credit – a credit for investors who

make equity investments in low-income communities – was created, and was designed to stimulate over *$15 billion* in investments in these communities.

The Administration and the Treasury Department also demonstrated their commitment to revitalizing distressed communities by consistently supporting the Community Reinvestment Act (CRA). From 1993 to 1999, banks and thrifts subject to the CRA made *$800 billion* in home mortgage, small business, and community development loans to low- and moderate-income borrowers and communities.

This chapter looks at the five main areas where Treasury took significant steps to broaden economic opportunity for all Americans: first, by providing communities with access to capital and investments; second, by increasing access to financial services; third, by providing enhanced retirement security; fourth, by targeting tax incentives at low-income individuals and communities (most of these tax measures are discussed in Chapter One, Section II); and finally, by increasing access to health security for working Americans.

I. Providing Communities with Access to Capital and Investments

First Lady Hillary Clinton often said that "it takes a village to raise a child." Secretary Summers agreed but often added that "it takes capital to build a village." As part of its effort to broaden economic opportunity, Treasury believed it was critical to encourage more capital to flow into economically disadvantaged areas to provide them with the investments that were needed to broaden their economic opportunities.

CDFI Fund

In his 1992 Presidential campaign, then-Governor Bill Clinton stated that the country had an economic and moral responsibility to ensure that all citizens were able to participate in the nation's economic growth. He called for the establishment of hundreds of "development banks" throughout the country to provide critical loans and investments that more conventional lenders perceived as too risky for their portfolios.

With the strong support of the Administration, Congress passed the Riegle Community Development and Regulatory Improvement Act in 1994. The Act established the Community Development Financial Institutions (CDFI) Fund to promote revitalization and development in economically distressed communities. The Fund would help to catalyze private market activity in areas that had often been ignored by conventional market forces. Congress initially created the Fund as an independent Federal agency, and then moved it into the Treasury Department in June 1995. From 1995 through the end of the Clinton-Gore Administration, the CDFI Fund had the following three directors: Kirsten Moy; Ellen Lazar; and Maurice Jones.

Since making its first awards in 1996, the Fund, as of 2000, awarded CDFIs $294.3 million for efforts to improve conditions in places as diverse as the Hopi Indian Reservation, the Mississippi River Delta, the west side of Chicago, and the south Bronx. The Fund's monies assisted the financing of affordable housing developments, mortgages for low-income people, day care centers, and health and educational facilities. Many of the Fund's awardees provided basic

financial services to individuals and organizations that otherwise would not have been able to access them.

The Fund also awarded over $135.6 million to banks and thrifts through the Bank Enterprise Award Program. These monies helped generate more than $2.4 billion in new loans, investments, and services in economically distressed communities and $683 million in bank and thrift investment in CDFIs. In addition to its financial awards, the Fund in early 2000 initiated a training program to enhance the capacity of local CDFI personnel and others in the development finance field.

In 1997, with the support of Secretary Rubin and First Lady Hillary Clinton, the Fund established the Presidential Awards for Excellence in Microenterprise Development. By the end of the Administration, twelve organizations had been nationally recognized for their work in helping low-income entrepreneurs develop their own businesses. The Fund also co-sponsored with the Small Business Administration the Interagency Working Group on Microenterprise.

President's New Markets Initiative

" Thousands -- literally thousands and thousands of entrepreneurs in this country just need a little capital and a little guidance to expand their businesses and to create new jobs. All told, this New Markets Tax Credit will bring $15 billion in new private sector investment, our most significant opportunity in years to break the cycle of poverty and joblessness in the neighborhoods where unemployment is still too high."

President William J. Clinton

On December 21, 2000, President Clinton signed into law the New Markets and Community Renewal legislation to encourage private sector investments in economically distressed communities. Passage of this $25 billion initiative came to fruition as a result of and as a testament to the Clinton-Gore Administration's commitment to empower low- and moderate-income communities throughout the country.

President Clinton unveiled the New Markets Initiative on January 15, 1999, to encourage private sector equity investment in underserved communities throughout the country. Throughout 1999 and 2000, President Clinton, Treasury Secretaries Summers and Rubin, and others in the Clinton-Gore Administration highlighted the economic potential of the nation's New Markets with trips to underserved inner city and rural communities, including Newark, Harlem, Hartford, the Mississippi Delta, Appalachia, rural Arkansas, and the Pine Ridge Indian Reservation.

On May 23, 2000, President Clinton, joined by House Speaker Dennis Hastert, announced a bipartisan agreement on the New Markets and Community Renewal proposals to promote economic growth in low-and moderate-income communities. The agreement was a result of the commitment President Clinton and Speaker Hastert made in November 1999 to develop a bipartisan legislative initiative to revitalize impoverished communities.

President Clinton signed the historic bipartisan New Markets and Community Renewal initiative on December 21, 2000. The legislation included a New Markets Tax Credit designed to spur

$15 billion in private investment in underserved communities; the creation of New Markets Venture Capital Firms to enhance the flow of debt and equity capital to small businesses in these communities; the creation of nine new Empowerment Zones and extension of existing Empowerment Zones through 2009; $200 million in discretionary investment in 2001 for Empowerment Zones; and the designation of new Renewal Communities. The legislation also expanded the Low Income Housing Tax Credit to create 180,000 additional housing units over the next 5 years, and it provides $7 million for local BusinessLINC coalitions. The New Markets Tax Credit alone was one of the largest community development programs ever created. For more on the New Markets Tax Credit, see Chapter One.

Establishment of the Office of Community Development Policy

In April 1997, Secretary Rubin created the Office of Community Development Policy (CDP) to bring increased energy and focus to the Department's efforts to bring economic growth and opportunity to America's economically distressed communities. Creation of the Office put Treasury in a unique position to advance community development policy Administration-wide.

Headed by Deputy Assistant Secretary Michael Barr, CDP was responsible for developing, enacting, and implementing a broad range of community development initiatives, including: the New Markets Initiative; the Community Reinvestment Act; the Low Income Housing Tax Credit; Empowerment Zones and Enterprise Communities; tax incentives and economic development in the District of Columbia; BusinessLINC; affordable housing policy; community development financial and tax policies; micro-enterprise development; improved access to financial services, including First Accounts; brownfields redevelopment; predatory lending and fair lending policies; low-income savings strategies; financial literacy; small business development; welfare-to-work; and policy development, legislative strategy, and liaison with the CDFI Fund. CDP also provided occasional assistance with respect to international access to capital issues, including work in South Africa, Great Britain, and Northern Ireland.

The Community Reinvestment Act

The Community Reinvestment Act (CRA) was enacted in 1977 to encourage federally insured financial institutions to provide banking and credit services to all segments of the communities in which they operate. Under the CRA, the bank regulatory agencies – the OCC, OTS, the Federal Reserve, and the FDIC – review how well each financial institution provides lending, investment, and banking services to low- and moderate-income groups in the areas served by the institution. These CRA ratings are used by the regulatory agencies in their consideration of certain applications, including those for proposed mergers and acquisitions.

In 1993, at the request of President Clinton, banking regulators began reforming the regulations implementing CRA by replacing criteria that had been viewed as subjective and process oriented with objective performance criteria. Institutions were also given authority to elect to be examined based on a CRA strategic plan that they develop. Revised regulations issued in 1995 effectively streamlined the CRA review process to assure consistency in regulatory oversight.

Over the course of the Clinton-Gore Administration, community reinvestment lending grew dramatically. From 1993 to 1999, banks and thrifts subject to CRA made a staggering $800 billion in home mortgage, small business, and community development loans to low- and moderate-income borrowers and communities. A Treasury report issued in April 2000 demonstrated that the CRA has significantly contributed to improved performance by financial institutions in meeting the lending and service needs of low- and moderate-income communities, as well as minorities. It showed that between 1993 and 1998, CRA-covered lenders and their affiliates increased their mortgage lending to low- and moderate-income borrowers and communities at more than twice the rate of increase for other borrowers. In those same years, depository institutions and their affiliates covered by the CRA made a total of $467 billion in mortgage loans to low- and moderate-income borrowers, and borrowers in low- and moderate-income neighborhoods. In 1998 alone, these institutions originated $135 billion in mortgage loans to lower-income borrowers and areas, an 80 percent increase over similar lending in 1993.

The growth in lending to small businesses and community development projects has also been significant. From 1996 to 1998, the three years for which this data has been collected, lending by CRA-covered institutions to small businesses located in low- and moderate-income communities averaged $33 billion annually. In the same period, community development lending by these institutions averaged $17 billion annually.[1]

Maintaining the CRA in the 1999 Financial Modernization Act

Maintaining the strength of CRA was a top priority throughout the Administration. Some in Congress repeatedly attempted to eviscerate CRA during legislative deliberations, spanning a number of years, over regulatory reform, financial modernization, and other matters. CRA became a central element in the negotiations over the 1999 Financial Modernization Act. Senator Gramm, the Chairman of the Senate Banking Committee, sought to exempt all banks with assets under $250 million from the CRA, and to exempt banks with satisfactory records on their last CRA examination; the Chairman also insisted that financial modernization not expand the reach of the CRA. The Administration stood firm, and successfully defended CRA. The proposed exemptions were defeated, and the Act extended CRA by providing that a bank must have and maintain a satisfactory CRA rating in order for it or its holding company to commence, or to acquire or merge with a company engaged in, a newly authorized line of business, such as securities, insurance, and merchant banking. (See also Financial Services discussion in Chapter 3.)

Community Adjustment and Investment Program (CAIP)

The North American Free Trade Agreement Implementation Act, which President Clinton signed on January 1, 1994, created the Community Adjustment and Investment Program (CAIP) to help create and preserve private sector jobs for workers in communities affected by changing trade patterns with Canada or Mexico. It was created in conjunction and was affiliated with the North American Development Bank (NADBank), also created by the NAFTA Implementation Act.

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[1] United States, Department of Treasury, "The Community Reinvestment Act After Financial Modernization: A Baseline Report," (Washington: 2000)

Pursuant to a 1994 Executive Order, the Treasury Secretary chairs an inter-agency Finance Committee that administers the program (Exec. Order No. 12916). Deputy Assistant Secretary Mozelle Thompson oversaw the establishment of program, the development of eligibility guidelines, and the launch of assistance. In 1996, the program began providing assistance to eligible communities by subsidizing loan costs for Federal loan guarantee programs. The CAIP made its first direct loan in 1997. Beginning in 1998, then-Deputy Assistant Secretary Sachs undertook an effort to make the CAIP more effective in meeting community needs. In 1999, then-Deputy Assistant Secretary Sachs led the development of the CAIP grant program. Subsequently, Deputy Assistant Secretary Harry Haigood undertook the implementation of this program, and the first grants were awarded in October 2000.

Until 1999, the CAIP was funded solely from a one-time ($22.5 million) set-aside of capital in the NADBank. In FY 1999 and FY 2000, in an effort to preserve the paid-in capital while continuing the federal loan guarantee programs and implementing the grant program, the CAIP received appropriations of $10 million per year. As of December 2000, the CAIP had worked to create or preserve over 16,000 jobs in 27 states affected by changing trade patterns.

Partnership in Education Initiative

In 1995, Secretary Rubin created the Partnership in Education (PIE) program, under the leadership of then-Executive Secretary Benjamin Nye and PIE Executive Director James Coleman. Under the PIE program, Treasury hired inner city high school students for summer internships and provided support to career academies (career oriented schools-within-schools). Sol Hurwitz, the retired President of the Committee for Economic Development, and consultant to Secretaries Rubin and Summers on educational matters, was instrumental in conceiving and implementing the PIE program and its efforts in New York City.

Between 1995 and 2000, Treasury offices provided more than 800 internships to Washington, DC and New York City high school students through the PIE program. In 1998, Secretary Rubin made the PIE program a permanent organization within Treasury. On March 8, 1999, Secretary Rubin and Citigroup CEO Sandy Weill signed a partnership agreement between Treasury and the National Academy Foundation (NAF), under which Treasury and NAF worked together around the country to place high school students in Treasury offices and support career academies.

By 2000, PIE, under the leadership of Executive Secretary Neal Comstock and PIE Executive Director Rodney Spinks, sponsored career academies in business and finance, law and legal services, law and justice, and security at three DC high schools. On March 24, 2000, Secretary Summers launched Treasury's sponsorship of an international finance and business academy at George Washington High School in New York City, the alma mater of Federal Reserve Board Chairman Alan Greenspan and Anita Summers.

BusinessLINC

In July 1998, at the request of Vice President Gore, Secretary Rubin and Small Business Administrator Alvarez began the BusinessLINC initiative. BusinessLINC, which stands for

Business Learning, Investment, Networking, and Collaboration, is a public-private partnership that encourages large businesses to work with and mentor small business owners and entrepreneurs, especially those in America's underserved areas. In the summer of 1998, Treasury, SBA, and other agencies convened a series of meetings across the country to learn about cutting-edge private sector mentoring practices. In December 1998, Secretary Rubin released "BusinessLINC: Business-to-Business Relationships that Improve the Economic Competitiveness of Firms," which documented the key findings from the regional meetings. The report describes the critical factors for business-to-business mentoring success and provides examples, case studies, and lists available resources.

In 1999, the Business Roundtable and Texaco Chairman Peter Bijur took the helm of the BusinessLINC initiative at the request of Secretary Rubin. The Business Roundtable, with the support and guidance of Peter Bijur, serves as a national resource, advisory committee, and clearinghouse of best practices for local BusinessLINC coalitions throughout the country. As of January 2001, local BusinessLINC coalitions existed in Boston, Chicago, Dallas, New York City, Washington, DC, Houston, and the Mississippi Delta. Additional local BusinessLINC coalitions were being formed at the end of the Clinton-Gore Administration.

With the passage of the bipartisan New Markets and Community Renewal initiative in December, 2000, $7 million was made available to fund existing and new local BusinessLINC coalitions.

Fair Lending

In July 1998, the Department of Housing and Urban Development (HUD) and the Federal Reserve Board reported to Congress on recommended reforms to the Truth in Lending Act (TILA), the Real Estate Settlement Procedures Act (RESPA) and the Home Ownership and Equity Protection Act (HOEPA). Among other things, the report described abuses in the subprime lending market and recommended changes to HOEPA to combat those abuses. In May 1999, Treasury joined with the White House to endorse those recommendations and to propose additional protections for subprime borrowers in the Clinton-Gore Plan for Financial Privacy and Consumer Protection.

In 1998 and 1999, Treasury led interagency efforts to recommend that the Federal Reserve Board improve reporting under the Home Mortgage Disclosure Act (HMDA) and the Equal Credit Opportunity Act. In May 1998, Treasury joined with the Departments of Justice and HUD and the Federal Trade Commission (FTC) to submit joint agency comments to the Board asking it to amend Regulation C to improve the quality and utility of HMDA data in a few important areas. The data have proved to be an invaluable resource for Congress and federal agencies in shaping fair mortgage lending policy and enforcement. In November 2000, the Board issued a proposed rule on Regulation C acting on many of the recommendations in the agencies' letter.

In 1999, Treasury led an interagency group in submitting joint comments regarding the Board's proposal to amend Regulation B, which implements the Equal Credit Opportunity Act. The agencies, including Treasury, Justice, HUD, the FTC and the Small Business Administration, expressed their support for a proposal to allow lenders to voluntarily collect information about

the race and gender of applicants for non-mortgage credit. By 2000, the Board was expected to act on these comments by issuing a final rule in 2001 implementing this important change.

Joint Treasury-HUD Report on Curbing Predatory Home Mortgage Lending

The Clinton-Gore Plan for Financial Privacy and Consumer Protection in the 21st Century, announced by President Clinton on May 4, 1999, included a call for action against subprime lending abuses. Growth in subprime mortgage lending throughout the 1990s expanded the availability of credit for individuals with imperfect or limited credit histories, but fueled simultaneous growth in consumer abuses in that marketplace, one subject to less regulation than the prime mortgage market. The President's agenda called for expanded protections in the subprime home equity lending market, expanded enforcement tools, improved home mortgage lending reporting and improved regulatory guidance on subprime lending.

In July 1999, HUD Secretary Andrew Cuomo and Secretary Summers co-convened a National Task Force on Predatory Lending in response to a request by Senator Barbara Mikulski. The Task Force included representatives of consumer advocacy groups, industry trade associations, local officials and academics. The Task Force convened six forums around the country in April and May of 2000 to gather input from borrowers, industry and consumer representatives on local and national aspects of the predatory lending problem.

Treasury and HUD staff worked with staff from the Department of Justice, the Federal Trade Commission, and the White House to analyze the problem and to propose effective solutions. The Departments' work culminated in a report to Congress issued on June 20, 2000, *Curbing Predatory Home Mortgage Lending: A Joint Report*. In the Report, Treasury and HUD made recommendations to strengthen consumer financial literacy, prohibit creditor and broker sales practices that harm borrowers, limit potentially abusive loan terms and conditions, and promote healthier structure in the subprime markets. In December 2000, the Federal Reserve Board acted on a number of recommendations in the report in issuing a proposed regulation tightening lending restrictions in the high-cost loan market. Other Federal banking regulators, including the OCC and OTS, continued to adapt their examination procedures and use their specific authorities to root out predatory lending and encourage greater competition in the mortgage marketplace.

Improving Fair Access to Housing: Joint MOU with Treasury, HUD and Justice

In August 2000, Secretary Summers, with Attorney General Reno and HUD Secretary Cuomo, signed a Memorandum of Agreement to ensure that low-income housing tax credit projects were in compliance with the Fair Housing Act. Under the agreement, the Departments of the Treasury, Justice, and HUD agreed to establish a monitoring and compliance process to ensure that low-income housing tax credit properties meet the requirements of the Fair Housing Act. Justice and HUD agreed to provide notice to the IRS and state housing finance agencies of enforcement actions brought under the Fair Housing Act involving tax-credit property owners. The IRS, in turn, will notify involved property owners that a finding of discrimination could result in the loss of tax credits. Working together and with the private sector, the agencies sought to ensure that properties benefiting from low-income housing tax credits were built and operated in a manner consistent with the Fair Housing Act.

II. Increasing Access to Financial Services

Another key obstacle to economic opportunity in America was lack of access to mainstream financial institutions, including possession of a simple bank account. Treasury recognized that this was both a result of difficulties in getting a mainstream account in many low-income communities, and of poor dissemination of information about the benefits of possessing an account. During the Clinton-Gore Administration, Treasury took three clear steps to help "bank the unbanked."

Electronic Transfer Account (ETA)

The Debt Collection Improvement Act of 1996 required Treasury to ensure that individuals who must have an account to obtain Federal payments be able to obtain access to an account at reasonable cost and with appropriate consumer protections. Accordingly, Treasury designed the Electronic Transfer Account (ETA), which was formally announced by Vice President Gore and Secretary Rubin in June of 1999. It was specifically developed to provide the estimated five to six million Federal benefit recipients who lack bank accounts a means of receiving their benefits electronically.

Any individual receiving a Federal payment was eligible to open an ETA, and any Federally insured financial institution could become an ETA provider. ETAs were a voluntary program for both individuals and financial institutions, and an Internet site was developed to provide users the capability to search by ZIP code, city, or state for the addresses of nearby branches of financial institutions certified to offer the ETA. As of December 2000, the ETA was being offered by more than 600 financial institutions in 7100 locations, and Treasury was marketing the program to banks and to Federal benefit recipients.

The First Accounts Initiative

Treasury's EFT '99 initiative and the rollout of the ETA established Treasury as an institutional leader in understanding and addressing the needs of America's "unbanked" population - individuals and families who do not hold an account at a financial institution. The design and marketing of the ETA was driven by research completed in 1998 and 1999 on the preferences of unbanked Federal check recipients and the costs to financial institutions of different account features.

In November 1999, Under Secretary Gary Gensler and Senator Paul Sarbanes (MD), in cooperation with the U.S. Postal Service, unveiled ATMs in 6 post office lobbies in locations in inner-city Baltimore, Maryland and outside Tallahassee, Florida. The pilot program sought to test the demand for ATM transactions among residents of communities that lack access to conventional banking services, and to test the economic viability of providing such services through the US Post Office.

In the Fall of 1999, Secretary Summers promoted the idea of extending the benefits of Treasury's EFT '99 expertise to individuals and families who could benefit from account ownership, but do not receive Federal payments. On January 13, 2000, President Clinton unveiled Treasury's First Accounts initiative in a speech before the Reverend Jesse Jackson's Wall Street Project in New

York. In his FY 2001 budget, the President included $30 million for the Treasury Department to pilot strategies to expand access to the financial services mainstream for low- and moderate-income Americans, especially those who do not receive federal benefits.

In May 2000, Representatives LaFalce and Leach, and Senators Sarbanes and Daschle, introduced the First Accounts Act of 2000 in the House and Senate. At the same time, the Treasury-Postal Appropriations subcommittees in both chambers included funding and authorization for First Accounts in their respective bills. In December 2000, President Clinton signed an omnibus budget package that authorized First Accounts and made $10 million available for this important initiative. At the close of the Administration, Treasury was working to design and provide support to 2-3 pilots in urban areas and rural Native American reservations that promote access to the financial services mainstream for underserved consumers.

Improving Financial Literacy – The National Partnership for Financial Empowerment

As a result of increasing concern about the level of personal bankruptcies, President Clinton charged his National Economic Council on May 4, 1999 with launching an interagency Working Group to broaden the opportunities for individuals to improve their financial management skills. The Working Group recommended the creation of an intensive, nationwide, public-private effort to encourage comprehensive financial management skills and ensure that Americans have access to the tools and institutional support to help them plan and save for their futures.

On April 4, 2000, Secretary Summers joined with leading public and private organizations to launch the National Partners for Financial Empowerment (NPFE). Its mission was to help Americans improve their personal financial skills, especially in the areas of money management, saving, investing and credit. Secretary Summers stated, "Each of us has an important responsibility to manage our personal finances in a sound and prudent manner. Proper personal financial management can help improve our ability to meet life's needs and aspirations, including a financially secure retirement, a good education for our children, and the purchase of a home."

NPFE worked to increase public awareness of the importance of financial literacy; to encourage better personal financial education for our nation's young people, workers and families; and to bring greater focus and visibility to existing financial literacy projects.

Following the April 2000 launch of NPFE, national leaders, including senior officials at the Department of the Treasury, the Department of Labor, the Social Security Administration, the Federal Reserve System, and the Securities and Exchange Commission led a nationwide campaign to promote financial literacy by emphasizing it in numerous speeches and public events. As part of the public campaign, NPFE created a website that served as a portal to financial planning and saving resources. On July 25, 2000, NPFE launched a national television awareness campaign on the issue of savings with public service announcements aired nationally through the end of 2000. Treasury, working with NPFE members, also served as a catalyst to bring together groups to create and implement action plans to promote financial skills and expertise within particular target areas or groups.

III. Increasing Economic Opportunity Through Enhanced Retirement Security

During the 1990s, too many Americans continued to rely excessively on Social Security to provide for their retirement. Indeed, although the level of national savings almost doubled to 6.8 percent of GDP during the Clinton-Gore Administration -- largely due to the shift from budget deficits to surpluses that resulted in more than $350 billion in debt reduction -- the level of personal savings has dropped.

The low (and declining) level of personal saving raised two key concerns: first, it exposed many low- and mid-income individuals and their families to the vagaries of the economic and business cycle; and second, it created a weak link in America's strong economic position by constraining the rate of investment that was achievable without leading to a widening of the current account deficit.

Over the eight years of the Clinton-Gore Administration, pensions and retirement savings continued to be the largest tax expenditure in the federal budget -- growing from about $61 billion a year to about $116 billion a year -- and retirement plans are currently estimated to hold nearly $5 trillion of assets.

Treasury spearheaded the Clinton-Gore Administration's efforts to strengthen retirement security by enhancing pension security; simplifying the pension law, and expanding pension coverage and retirement savings.

Enhancing Pension Security

In March 1993, the Administration identified the need to improve the funding status of underfunded defined benefit pension plans and the financial state of the Pension Benefit Guaranty Corporation (PBGC), the government agency that insures those plans. Representative Jake Pickle (D-Texas) held a hearing on the issue in April 1993. Marty Slate, Executive Director of the PBGC and Randy Hardock, Treasury Benefits Tax Counsel, testified that an interagency task force had been established to analyze the issue, consisting of officials from the Departments of the Treasury, Labor and Commerce, the NEC, and OMB. The Task Force developed proposals to close loopholes in the funding rules, to eliminate the cap on variable rate PBGC premiums, and to eliminate the legally mandated subsidy for lump sum pension distributions. After its proposals were vetted through the relevant agencies and the NEC, the Task Force was authorized to draft legislation.

On October 28, 1993, the legislation proposed by the Administration, known as the Retirement Protection Act, was introduced by Chairmen Moynihan, Kennedy, Rostenkowski and Ford of the Senate and House tax writing and labor committees. The Ways and Means Committee marked up the legislation in April 1994, revising the new funding rules to respond to business concerns that they were too tight. The House Education and Labor Committee made further changes in their mark-up that occurred in July 1994.

The Administration's original proposal had been relatively revenue neutral, as the revenue loss attributable to tightening the funding rules was approximately offset by higher PBGC premiums. However, when the House Committees relaxed some of the proposed funding rules, the effect of which was to turn the legislation into a net revenue raiser. In the fall of 1994, this revised legislation served as the ideal candidate to offset the cost of the GATT agreements. Further changes in the package were negotiated with the Senate Finance Committee and the modified package was agreed upon in the mock conference that was part of the Fast Track procedure used to enact the GATT agreements in December 1994. President Clinton signed this legislation into law on December 8, 1994. Since 1994, the financial health of the PBGC has improved considerably, due primarily to the robust economy during the past 6 years. The PBGC reforms enacted in 1994 will help protect the PBGC finances in the event of a future downturn in the economy.

Treasury's Office of Tax Policy initiated a number of other significant actions to improve the security of pensions.

One key initiative was to accelerate the vesting of retirement benefits to reduce the risk that workers would lose their benefits when leaving their job. Both the Administration's NEST proposal, enacted as the SIMPLE plan in 1996, and the 401(k) safe harbor, which the Administration supported and helped enact in the same year, provide for full and immediate vesting of employer contributions (see next section). Also in the 1996 pension simplification package, the Administration proposed acceleration of vesting for multiemployer (industry-wide collectively bargained) pension plans from ten to five years. Finally, at the suggestion of the Treasury, the Administration proposed in its final budget to accelerate vesting under all tax-qualified retirement plans from five years to three years.

In addition, the Administration lent its weight to another key pension security provision that was enacted as part of the 1996 pension simplification legislation. This provision required deferred compensation (section 457) plans sponsored by state and local governments to hold their assets in trust so that employees would not lose their savings if the government declared bankruptcy (as did Orange County, California not long before the legislation was proposed).

Simplifying Pensions

Following the enactment of the Retirement Protection Act, Joseph Stiglitz of President Clinton's Council of Economic Advisors proposed, as a part of the Vice President's reinventing government initiative, simplifying the process of maintaining a pension plan. In particular, small business owners often felt overwhelmed by the number of rules they had to follow in maintaining a pension plan. In March 1993, an interagency working group was formed to pursue this objective, drawing on members from the PBGC task force and other Treasury and Labor Department personnel. The working group was chaired by Ellen Seidman, the NEC staffer who had been involved in the PBGC task force.

The Working Group began by reviewing the simplification proposals that had previously been passed by Congress but vetoed by President Bush in 1992. The Working Group determined that the simplification ideas were fundamentally sound, but needed to be modified to better protect moderate- and lower-income workers. At the same time, the Working Group decided to go

significantly further in developing a number of new simplifications. These included raising the dollar threshold for defining highly compensated employees (from $70,000 to $80,000); repealing the combined limit on defined benefit and defined contribution plans, and tweaking the nondiscrimination rules to make it easier for employers to allow newly hired employees to participate in their 401(k) plans immediately upon being hired (as opposed to waiting a year or more).

The most significant single element of the package was a simplified 401(k)-type "starter" plan for small businesses that would require no lengthy plan documents, no quantitative testing, and no IRS approval, and that would combine attractive features of the 401(k) plan and the IRA. This simplified 401(k) concept was primarily developed by Benefits Tax Counsel Mark Iwry and approved by Secretary Bentsen in March of 1995. Benefits Tax Counsel staff collaborated with Labor Department staff and consulted with private-sector financial institutions and small business representatives to flesh out detailed specifications. The resulting proposal (then called the "NEST") was approved by Vice President Gore, and announced by President Clinton in connection with the June 1995 White House Conference on Small Business as the centerpiece of the Administration's pension simplification legislative package. As originally conceived, the proposals were also included in Vice President Gore's reinventing government initiative.
In September 1995, Benefits Tax Counsel Iwry testified before the House and Senate Small Business Committees regarding the Administration's pension simplification proposals and those advanced by others. With the support of the National Federation of Independent Businesses, the Small Business Administration, and other small business representatives, Majority Leader Dole endorsed pension simplification and adopted the NEST proposal with certain modifications (renaming it the "SIMPLE" plan).

The "SIMPLE" proposal, as well as several other of the pension simplification proposals, passed as part of the Small Business Job Protection Act of 1996, which President Clinton signed into law on August 20, 1996. As evidence of the simplification provided by the SIMPLE plan, Treasury soon published administrative guidance in this area, which featured a two-page model form that small businesses could use to adopt a SIMPLE plan (instead of the 50 to 100 pages that previously comprised a typical qualified plan document). In the four years following the enactment of the SIMPLE, more than a million American workers have been covered by these plans, accumulating more than $6 billion of savings, and coverage is continuing to expand

During the Clinton-Gore Administration, Treasury's Office of Tax Policy, working with the IRS and drawing heavily on input from the private sector, also developed a significant number of regulatory guidance projects that were designed to simplify the pension and benefits system and make it more flexible and workable. These regulations and rulings have resolved, in a manner helpful both for the tax and retirement system and for the regulated community, numerous significant pension problems that have been of concern to plan sponsors and benefits professionals for many years.

Examples of projects that provided significant simplification of the pension laws include: (i) regulations to simplify the anticutback rules under section 411(d)(6) by, among other things, permitting plan sponsors to eliminate many optional forms of payment; (ii) guidance repealing (to a considerable extent) of the "same desk" rule restricting rollover of 401(k) balances after

corporate spinoffs; (iii) regulations resolving longstanding questions relating to loans from plans to employees under legislation enacted in 1982; (iv) rules governing 401(k) safe harbor plans to make those plans more flexible and easier to adopt and operate; (v) regulations allowing plans to be administered using "paperless" (electronic) technologies and prescribing appropriate standards; (vi) regulations that resolve numerous difficult questions regarding the imposition, calculation and timing of Social Security taxes on nonqualified deferred compensation; (vii) regulations interpreting 1986 statutory requirements for advance notice to employees if a pension plan is amended to reduce future benefit accruals; (viii) regulations repealing the administratively difficult "lookback" rule applicable to involuntary cashouts of small account balances; (ix) regulations clarifying and rationalizing the rules (enacted in 1986) governing employer-provided health care continuation coverage under COBRA; and (x) regulations clarifying and rationalizing the rules governing mid-year changes in health and dependent care elections under flexible spending and cafeteria plans.

Expanding Pension Coverage and Retirement Savings

The Clinton-Gore Administration, led by Treasury, also took a number of legislative and regulatory steps to encourage retirement security and saving, especially for lower- and moderate-income workers. Probably the most notable of these were efforts in the President's last two budgets to provide a progressive tax incentive to promote retirement saving, first through "Universal Savings Accounts" and subsequently through "Retirement Savings Accounts." Other initiatives included efforts to increase pension portability, facilitate automatic enrollment in 401(k) type plans, promote pension coverage for women, and provide automatic rollovers to prevent leakage.

USAs and RSAs

The Administration's strong commitment to enhancing retirement security was further reflected in the development of two major progressive savings proposals in 1999-2000, known as Universal Savings Accounts (USAs) and Retirement Savings Accounts (RSAs). The Administration was strongly committed to maintaining the solvency of Social Security while increasing the retirement savings for those needing it the most. The progressive savings proposals relied on income tax incentives (i.e., tax credits and deductions and tax deferred accumulation of retirement savings) and existing private retirement savings accounts to supplement individuals' social security benefits and other retirement savings and enhance the retirement security for all workers. (See Chapter 1 for a discussion of Social Security reforms.)

USAs and RSAs emerged in part from the debate over Social Security individual accounts. A key point of contention in that debate was whether individual accounts should substitute for a portion of the existing Social Security program or should be added only as a supplement on top of the existing program. As noted earlier, the Administration generally was not receptive to

[7] In fact, partly in recognition of this project, the Small Business Council of America informed Benefits Tax Counsel Mark Iwry that he had been selected to receive the SBCA's annual Special Appreciation Award, together with Senators Baucus and Domenici and Rep. Kasich. In a letter to Iwry, the SBCA stated that it "believes you have made a significant difference in our Federal tax system. We believe that you have made the Nation's Retirement System more accessible and more fair for small business."

proposals along the former lines, but was more open to individual account concepts that would provide a fair, progressive means for all working Americans to improve their financial security in retirement, separate from Social Security.

In this context, then-Deputy Secretary Summers met in December 1998 with Assistant Secretaries Don Lubick and David Wilcox, Deputy Assistant Secretaries Jon Talisman and Len Burman, and Benefits Tax Counsel Iwry to discuss the development of a possible "universal pensions" initiative. Based on Deputy Secretary Summers' direction and working with the NEC, Treasury staff formulated a progressive, universal retirement savings proposal unrelated to Social Security.

The proposal was announced by President Clinton in his January 1999 State of the Union address: "I propose that we use a little over 11 percent of the surplus to establish Universal Savings Accounts – USA Accounts – to give all Americans the means to save. With these new accounts, Americans can invest as they choose, and receive funds to match a portion of their savings, with extra help for those least able to save."

The USA initiative was a comprehensive plan designed to help working Americans achieve retirement security, largely by providing retirement savings for the 75 million workers and their spouses who currently lack pension coverage. USAs would have set aside some $534 billion of the then-projected budget surplus over 15 years to provide savings accounts for retirement.

The proposal, which President Clinton outlined in greater detail in a Rose Garden ceremony on April 14, 1999, combined an automatic government contribution to all workers earning less than a specified amount with a matching government contribution in the form of a refundable tax credit. Workers and nonwage-earning spouses with family incomes below a specified level would be given the opportunity to earn the match, deposited directly to their individual account, by contributing to the account on a tax-favored basis. One of the most important elements -- and perhaps the most unique element – of the proposal was the linkage of USAs with 401(k) and other private retirement savings plans. This pension coordination provided that the government matching tax credit would apply also to individuals' contributions to 401(k) plans. The proposal was included in President Clinton's FY' 2000 budget, but never received serious consideration in Congress, largely because it was viewed by many Congressional Republicans as a spending program, as opposed to a tax cut.

In his January 2000 State of the Union Address, President Clinton announced a revised proposal for a progressive individual retirement account, known as Retirement Savings Accounts (RSAs). Developed by Treasury's Office of Tax Policy, and detailed in President Clinton's FY 2001 budget, RSAs were designed to address a number of concerns that had affected the reception accorded the USA proposal in Congress. RSAs provided for additional tax benefits for contributions by moderate- and lower-income workers to employer 401(k) type plans and to IRAs. The participant's voluntary contributions would be matched by the employer sponsoring the 401(k) plan or the financial institution maintaining the IRA. The employer or IRA provider, in turn, would be made whole via an income tax credit. Unlike USAs, there would be no automatic contribution from the government, which significantly reduced the cost of the program.

Like USAs, RSAs were designed to expand pension coverage and improve the current income distribution of tax benefits associated with retirement savings by promoting retirement saving by lower- and moderate-income families. The substantial government matching contribution would provide a powerful incentive for saving, while providing the greatest tax benefit for those with the lowest incomes.

Treasury staff conducted extensive briefings of the USA and RSA proposals on Capitol Hill, with numerous corporate, financial and other interest groups, and with the press. In part based on feedback received in those briefings, the RSA proposal was recast, at the urging of the financial services industry and congressional staff, as an individual tax credit provided directly to individuals instead of credits for employers or financial institutions. RSAs were also revised to use existing forms of IRAs instead of a special new type of account to reduce their cost.

A modified version of the RSA proposal developed by Treasury's Office of Tax Policy was incorporated in the House Democratic pension bill in July 2000. A "low and moderate income savers tax credit" modeled on the RSAs was then included in Senate Finance Committee Chairman Roth's Mark and in legislation reported out by the Committee in September 2000.

In connection with RSAs, the Office of Tax Policy developed another major progressive saving initiative: a tax credit for small employers of up to 50% of the pension contributions they make for non-highly compensated employees. To qualify, the contributions must be subject to accelerated vesting and restrictions on withdrawal, and would have to be made to a plan that meets specified nondiscrimination standards. This proposal was included in the President's FY2001 budget. A somewhat similar tax credit, but lacking similar quality standards regarding vesting, withdrawal, coverage and nondiscrimination in benefits, was proposed by Senator Max Baucus. With his support, the Administration's small business tax credit proposal was also included in the legislation reported out by the Senate Finance Committee in September 2000.

Ultimately, however, owing to controversy over the size and composition of any tax package, the RSAs and the progressive tax credit for small business, as well as other retirement savings proposals, were never taken up by the full Senate.

USAs and RSAs represent the most significant retirement savings proposals advanced since the enactment of ERISA in 1974. RSAs or their predecessor, USAs, would have gone far toward providing retirement coverage to the 75 million Americans presently without coverage.

Pension Portability

By the mid-1990s, the potential adverse impact of job changes on workers' accumulation of retirement savings had become a salient issue. In 1996, Treasury undertook a review of possible guidance projects that could encourage "pension portability" – the ability to carry and continue retirement savings from job to job and between jobs without reduction or gaps in saving. This led to three regulatory projects: an IRS revenue ruling making clear that newly hired employees can be covered by a retirement plan immediately without adversely affecting other participants; another ruling protecting former employees who elect to keep their retirement benefits in their

former employer's plan for some period of time; and a regulation assuring employers who take appropriate precautions that their plan will not be adversely affected by receiving direct rollovers from another plan. On September 17, 1996, in the Oval Office, President Clinton, Secretary Rubin and the President's other senior economic advisers, held a ceremony focusing on these pension portability regulations and rulings.

Pension portability was also a focus of legislative action. Treasury's 1996 legislative pension simplification proposal facilitating immediate participation in 401(k) plans became effective in January 1999, and was a major factor leading to an increase in the proportion of those and similar plans providing for immediate participation from 32 % in 1998 to 52% in 2000.

The Administration's final two budgets included several new portability proposals. These proposals would have encouraged workers who are changing or losing jobs to retain retirement funds in plans or IRAs by making it easier to consolidate retirement savings through tax-free rollovers between plans of various types. The proposals would also have (1) permitted eligible distributions from a qualified retirement plan to be rolled over to a section 403(b) tax-sheltered annuity and vice versa; (2) allowed benefits from deferred compensation plans of state or local governments (457 plans) to be rolled over to an IRA; (3) permitted rollovers of IRAs to workplace retirement plans; (4) allowed rollovers of after-tax contributions to a new employer's defined contribution plan or to an IRA; and (5) allowed the Federal employees' Thrift Savings Plan to accept rollovers from private-sector plans. These proposals were not enacted in the 106th Congress.

Promoting Pension Coverage for Women

Largely at the recommendation of Office of Tax Policy, the Administration's FY98 and FY99 budgets included a number of legislative proposals designed to encourage pension coverage for women. One such proposal was the USA and RSA initiative (which provided for separate accounts for spouses based on family wages, whether or not they earned wages of their own). Other proposals included accelerated vesting and improved disclosure to women regarding their rights to survivor pensions. In addition, at a White House event in October 1998, President Clinton announced additional Administration pension proposals designed especially to assist women – vesting credit for FMLA leave and a 75% joint and survivor pension option for qualified plans.

Automatic Enrollment

In 1998-2000, Treasury sought to encourage retirement saving, especially by lower- and moderate-income workers who disproportionately fail to participate in 401(k) plans, by harnessing the power of inertia on behalf of savings. This process began with a revenue ruling developed by Tax Policy staff in 1998, which permitted 401(k) plans to enroll new employees automatically at a specified level of savings (unless the employee declines). The ruling was highlighted by President Clinton in his speech to the national SAVER Summit on June 4, 1998:

> [I]n an effort to encourage more workers to enroll in the 401(k)s that are already available to them, we've made it clear that employers can automatically enroll

> workers in 401(k) plans unless the workers themselves choose to opt out.... It sounds like a small thing, but [it] can really affect a very large number of people in getting them into the business of saving for their own retirement.

Secretary Summers highlighted the importance of automatic enrollment in many forums, including the April 4, 2000 national American Savings Education Council "Choose to Save" conference. He noted that surveys and studies suggest that automatic enrollment has increased participation in many companies from roughly 75% of eligible employees to about 95% and in some cases has doubled the rate of participation. Some at the conference expressed the view that automatic 401(k) enrollment will prove to be one of the most important pension coverage initiatives of the 1990s. The popularity of automatic enrollment was growing, from an estimated 4% of plans in 1998 to an estimated 11% in 2000, with more than a quarter of the other plan sponsors considering adoption of this arrangement. Automatic enrollment has been especially attractive to larger plans, which may further increase the percentage of workers covered.

On July 18, 2000, Secretary Summers announced the release of a series of revenue rulings and notices that extended similar automatic savings approaches to existing employees, to 403(b) annuity arrangements, to section 457 state and local government plans, and to small business prototype plans. In a joint statement with Labor Secretary Herman, Secretary Summers said

> We see automatic enrollment as a promising method of encouraging participation by those who have disproportionately been missing the benefits of a regular, disciplined approach to retirement savings. Automatic enrollment is fully consistent with Labor and Treasury policies, and we encourage employers to consider adopting automatic enrollment.

Automatic Rollover to Preserve Retirement Savings

Part of Treasury's long-term integrated strategy of encouraging retirement security focused not only on promoting additional contributions but also on preserving retirement assets in the tax-qualified system once assets have begun to accumulate. In furtherance of this strategy of reducing the "leakage" of retirement savings prior to retirement, the FY 2001 budget included a legislative proposal to provide for the automatic rollover to IRAs of retirement benefits that would otherwise be paid to those who have not explicitly requested distributions. In July 2000, Treasury and the IRS issued a ruling facilitating automatic rollover of small distributions to IRAs set up on behalf of distributees. The legislative proposal and the ruling already have spurred serious discussion regarding the importance of encouraging the preservation of retirement savings.

IV. Providing Tax Incentives to Promote Community Renewal and Individual Empowerment

The Clinton-Gore Administration took clear steps to bring capital and investments into low-income communities, to broaden access to the mainstream financial system, and to increase retirement security. In addition to these actions, the Administration also undertook a number of specific tax initiatives to stimulate both public and private sector investments in low-income

communities. These focused on the core objective of providing Americans with the skills, incentives, capital, and opportunities to participate in the mainstream economy. For more on tax incentives to work (e.g., the EITC, Targeted Jobs Tax Credit, and welfare to work tax credit), education and training tax initiatives, Empowerment and Enterprise Zones, the Low Income Housing Tax Credit, the Brownfields initiative, and the New Markets Tax Credit, see Chapter One, Section II. For more on the New Markets initiative more broadly, see Section I of this chapter. Below is a description of two additional tax initiatives aimed at lower income Americans.

Tax Proposals to Bridge the Digital Divide

During the 1990s, access to computers and the Internet and the ability to use this technology became increasingly important to enable workers and their families to fully participate in the expanding economy. Furthermore, inequalities in access to technology threatened to reinforce existing inequalities in wealth along ethnic, geographic and educational lines. As a result, the Administration was committed to expanding access to the Internet and computers for all Americans.

President Clinton's FY 2001 Budget included a series of tax incentives to ensure that residents of disadvantaged communities were able to develop the skills that would be essential for achieving success in the workplace in the New Economy. This initiative, to help "bridge the digital divide," consisted of three components: First, offering a credit to employers who provided training in literacy, basic education, and basic computer skills to educationally disadvantaged workers. Second, encouraging corporate donations of computer equipment, that would build upon and extend a similar provision of the Taxpayer Relief Act of 1997. Under the 1997 legislation, a taxpayer was allowed an enhanced deduction, equal to the taxpayer's basis in the donated property plus one-half of the amount of ordinary income that would have been realized if the property had been sold. The Administration proposed to enhance and extend this incentive. Third, providing a 50 percent tax credit for corporate sponsorship payments made to a qualified zone academy, public library, or community technology center located in an Empowerment Zone or Enterprise Community. The proposed tax credit would provide a substantial incentive that would encourage corporations to sponsor such institutions.

These proposed initiatives, which were not enacted by December 2000, were designed to help ensure that low-skilled workers received the training they needed to improve their job skills, and that disadvantaged communities had access to innovative educational programs and computer technology.

Native American Wage Credit

The Indian Wage Credit proposed by President Clinton provided a powerful incentive for job growth Native American communities, many of which continued to struggle economically in spite of the strong economy. Employers could claim an Indian employment credit equal to 20 percent of the qualified wages and employee health insurance costs paid to an enrolled member of an Indian tribe in compensation for services performed on or near a reservation. The

aggregate amount of qualified wages and health insurance costs could not exceed $20,000 per person per year. This incentive was made available through 2003.

V. Strengthening Health Security for Working Americans

Health care reform was a central priority of President Clinton and Vice President Gore when they came into office, and it remained a central priority for eight years. Although the comprehensive reform proposed by the Administration in late 1993 was not enacted, the Administration pressed hard in ensuing years for incremental reform – and, thanks to this leadership, important steps were taken. The last several years of the President Clinton's term saw increased attention to the need for Medicare reform, and the Administration's reform plan took center stage in the public discussion.

In all of these efforts, the Treasury Department played a key role. Under the leadership of Secretaries Bentsen, Rubin and Summers, the Treasury Offices of Economic Policy, Tax Policy, and the Fiscal Assistant Secretary, and the Internal Revenue Service, worked together with other Executive Branch agencies in developing Administration health proposals and explaining them to Congress and the American people. Throughout the Clinton-Gore Administration, health care and long-term care continued to be the second largest tax expenditure in the federal budget (second only to pensions and retirement savings) -- growing from about $53 billion to about $90 billion a year over this period. This section reviews the most important moments for the Treasury Department in the Administration's fight for better health care.

Comprehensive Reform Effort

In 1993, the Administration identified three interrelated failings of the American health care system. First, the system did not provide health security for Americans. Tens of millions of Americans were uninsured, and even those who were insured faced the risk of losing coverage if they left their jobs or their employers decided to stop offering coverage. People who were sick often found insurance outside the employer market unavailable or unaffordable. Second, the system did not foster effective competition, which made it very difficult for both providers and consumers to make informed, cost-conscious decisions. Third, the system placed an undue burden on both public and private budgets, with medical care representing one of the largest and fastest-growing categories of expenditures.

The Health Security Act

To address these problems, the Administration launched a Health Care Reform Task Force, chaired by First Lady Hillary Rodham Clinton and directed by Ira Magaziner. The Treasury Department played an integral role in this effort. Under the leadership of Secretary Bentsen and Deputy Secretary Altman, Treasury was represented on the Task Force by Deputy Assistant Secretary for Economic Policy Marina Weiss (who coordinated much of Treasury's activity on the Task Force), Alan Cohen, Jim Duggan, Randy Hardock, Janet Holtzblatt, Gillian Hunter, Mark Iwry, Kurt Lawson, and Alicia Munnell.

Treasury's involvement was particularly focused on the following issues:

- The design of an employer mandate to help achieve universal coverage, with temporary tax credits to ease the transition for small businesses and the self-employed.
- The role of the IRS in administering the employer mandate and tax credits, including strategies for preventing the possible widespread employer misclassification of employees as independent contractors in order to avoid the employer mandate.
- The financing of health care reform, including revenue estimates and methods to limit excessive increases in health care costs.
- The administration of premium-based versus payroll-tax-based health care systems.
- The formulation of a tax cap on health plans that were especially costly.
- The impact of reform on existing employer-sponsored health plans and cafeteria plans for workers and retirees.
- Provision for long-term care.

In September 1993, the Administration introduced the Health Security Act in Congress. First and foremost, the proposed legislation guaranteed all Americans a health insurance package with a comprehensive set of benefits. These benefits included acute care by hospitals and doctors, prescription drugs, mental health services, and long-term care. Individuals and families would have received this coverage through regional or corporate "health alliances," pools of individuals who purchase from a set of health plans. This pooling of health risks – with insurers prohibited from restricting coverage based on health status or pre-existing conditions – would have made insurance affordable for everyone. This approach essentially applied the principles underlying the existing employer-based insurance system to the entire population.

To encourage cost-conscious decisions, the Health Security Act would have allowed consumers a choice among several plans, providing them information about the quality of competing plans and their customers' satisfaction. The Act also would have set a limit on the growth of premiums in the alliances, in case private incentives to control spending did not have the anticipated effect.

The Administration projected that the Health Security Act would reduce national health expenditures over time relative to a no-reform baseline, as the savings from improved incentives and reduced administrative costs more than offset the cost of extending coverage to the uninsured. The Administration also projected that the Act would have trimmed the Federal budget deficit. Government spending would rise by providing discounts on the cost of insurance to businesses with low average wages and to families with low incomes. At the same time, spending on Medicare and Medicaid would decline, and revenue would increase through a tobacco tax and other provisions.

Health Reform Discussions in Congress

Treasury participated closely in the drafting of the Health Security Act, and in the subsequent Congressional deliberations of comprehensive health care reform.

President Clinton submitted the Health Security Act to the Congress on September 22, 1993. Secretary Bentsen traveled to Pennsylvania to join Senator Harris Wofford for tours of businesses and hospitals in Philadelphia and Pittsburgh in support of the plan. Deputy Secretary Altman and Treasury staff made numerous appearances and conducted numerous briefings in the private sector and on Capitol Hill to explain and advocate the plan.

As the legislation worked its way through the Senate Finance Committee and the House Ways and Means Committee, and as similar legislation was considered by the Senate Labor and Human Resources Committee, the House Education and Labor Committee, and the House Commerce Committee, Treasury's involvement, and especially that of the Office of Tax Policy, expanded. Treasury representatives worked closely with staff of the Ways and Means and Finance Committees, the Joint Committee on Taxation (JCT), as well as the staff of Speaker Foley and Majority Leader Mitchell. Treasury staff also coordinated closely with OMB Deputy Director Jack Lew and White House Health Care advisor Chris Jennings, the Administration's point persons for guiding the legislation through the House and Senate, respectively.

The following account of the 1993-1994 health care debate in Congress was contained in the Administration's FY 1996 Budget proposal[8]

> The President's bill spurred an unprecedented debate as Americans began to widely discuss the problems facing the health care system....
>
> The debate produced a consensus on several key points. Almost all of the health reform proposals introduced last year included insurance market reforms, such as provisions to prevent insurers from denying coverage to people who have been sick. Many bills recognized the importance of providing health coverage to low- and middle-income Americans, especially children.
>
> Also, the Nation began to examine and test various solutions to the escalating growth in health care costs.

Congressional committees held nearly 200 hearings on such issues as insurance market reforms, coverage, malpractice, and long-term care. After several months of debate, and for the first time in history, a congressional committee approved comprehensive health reform legislation – in fact, four committees did so. And for the first time in history, the Senate brought comprehensive health reform legislation to the floor for debate in August 1994. In the end, however, Congress could not agree on a bill. In the summer of 1994, First Lady Hillary Clinton came to Treasury to thank Treasury staff who worked on the health care reform effort and held a ceremony in Treasury's historic Cash Room.

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[8] Budget of the United States Government, Fiscal Year 1996, p. 103.

Incremental Reform

The failure to achieve consensus on the ambitious Health Security Act led to efforts to bring about incremental health care reform, and build on aspects of the 1993-94 effort that had bipartisan support. The Kennedy-Kassebaum legislation (the Health Insurance Portability and Accountability Act of 1996, or HIPAA), which President Clinton signed into law on August 21, 1996, contained several HSA proposals relating to health coverage, including modification of the tax treatment of the costs of long-term care and increased deductibility of health insurance for the self-employed. The bill adopted a number of basic health insurance reforms, including limits on the period for which an insurance policy or health plan can impose an exclusion for a preexisting condition, prohibition of exclusions based on covered individuals' health status, limits on insurers' ability to deny group coverage to small employers, and the right of an individual to obtain an individual health policy in the event of loss of group coverage. In addition, the bill made changes to prevent fraud and abuse in Federal health programs, including Medicare and Medicaid.

Implementing Kennedy-Kassebaum

Because of the multifaceted nature of health coverage, the portability and nondiscrimination provisions enacted in HIPAA were reflected in similar amendments to three separate statutes: ERISA (which allow participant lawsuits against employers and issuers), the Public Health Service Act (which mandates state regulation of insurance), and the Internal Revenue Code (which imposes an excise tax on an employer if its plan fails to comply). In a departure from customary practice, HIPAA required extensive regulations to be issued jointly by three Departments: HHS, Labor and Treasury.

The regulation project actually required forging a consensus on the regulations among five separate organizations -- HHS, the Health Care Financing Administration, the Labor Department, Treasury, and the IRS -- with divergent institutional viewpoints, jurisdictions, organizational interests, and professional backgrounds. Moreover, the agencies had essentially no experience or precedents for writing rules that would reflect a precise consensus among them all. Contrary to the expectations of most knowledgeable observers, the five organizations forged an agreement on an identical set of regulations, which were issued on April 1, 1997. The regulations were very well received by both Congressional Democrats and Republicans in Congress and won acceptance from a wide range of affected interest groups and praise from private sector experts. The rules reflected approaches that were viewed by the regulated community as substantially more faithful to the statute, and far simpler, more flexible, more workable, and more sophisticated than many of the rules that the individual agencies had promulgated on other occasions. Treasury's efforts in this area were led by Benefits Tax Counsel Iwry.

Medical Savings Accounts

Kennedy-Kassebaum also provided for a four-year demonstration project relating to a proposal to allow individuals covered by catastrophic health insurance to establish tax-favored medical savings accounts (MSAs). Treasury Tax Policy staff, working with White House and HHS officials, led the Administration's effort to analyze the MSA proposal. The Administration

concluded that MSAs raised serious health policy and tax policy concerns: MSAs could harm the health care market by encouraging adverse selection, would constitute a tax shelter for the healthy and affluent, would have a questionable effect on cost containment, would be ineffective in expanding coverage, and would be inconsistent with tax simplification.

Accordingly, Treasury Tax Policy staff worked to develop versions of MSAs or an MSA demonstration project that would minimize the substantial drawbacks of MSAs for both tax policy and health policy. This extensive work involved exploring ways to design an MSA experiment that would be meaningful, administrable, and appropriately limited (to minimize the risks that MSAs would lead to reduced coverage for less healthy and for moderate- or lower-income workers). The work was carried out in coordination with Senator Kennedy and his staff. In addition, Senate Finance Committee Chief Minority Tax Counsel Jon Talisman and Ways and Means Chief Minority Tax Counsel John Buckley played key roles behind the scenes.

Between April and July 1996, Treasury Tax Policy personnel were among the handful of Administration representatives who took part in negotiations on MSAs and other key health care issues with JCT Chief of Staff Ken Kies and representatives of the Republican leadership. The negotiations covered, among other things, possible designs of an experimental MSA program, including possible administration by HHS or IRS, the duration of the pilot program, establishment of a numerical cap on the permitted number of MSAs, special exceptions for MSAs that are associated with new health coverage, and criteria for defining the catastrophic coverage that would qualify for MSA treatment.

On April 23, 1996, in preparation for the Senate floor debate on MSAs, Treasury staff briefed Senator Kennedy, who was leading the opposition to MSAs as undesirable health and tax policy. Treasury's briefing focused especially on the threat of adverse selection – the risk that the healthier and more affluent would be more likely to opt for high-deductible catastrophic coverage associated with a tax-favored account that provides disproportionately valuable benefits to high-income individuals who can afford to allow contributions and earnings to accumulate in the account over the long term. Senator Kennedy was receptive and was vigorous in advocating against MSAs. Later that day, Senator Kennedy led a heated Senate debate and an upset victory against MSAs.

Ultimately, a compromise in the form of an MSA pilot project was signed into law by President Clinton as part of the Kennedy-Kassebaum legislation. Over the next several months, Treasury and IRS issued regulatory interpretations of the MSA law. Although these included rules cutting off widespread, inappropriate industry practices, the regulatory guidance was widely perceived to be fair, objective, and free of politics. Ultimately, by 2000, the number of MSAs actually adopted proved to be only in the tens of thousands -- far below the numerical limits (in the hundreds of thousands) that the law imposed each year.

Medicare Reform

During his second term, President Clinton determined to make fundamental reform of the major entitlement programs – Social Security and Medicare – a priority of the Administration. Social Security reform was discussed earlier in this chapter; Medicare reform is discussed below.

The Medicare Commission

The Balanced Budget Act of 1997 created the National Bipartisan Commission on the Future of Medicare, with a mandate to make recommendations about the program's long-term financial condition. The Medicare Commission consisted of 8 Republican appointees and 8 Democratic appointees (4 from the Administration), plus its Chairman, Senator John Breaux. An 11-vote super-majority was required for the Commission to make a formal recommendation.

Between March 1998 and March 1999, Chairman Breaux worked with Commission member Congressman Bill Thomas to develop a reform proposal. To spur competition between managed care plans and traditional fee-for-service Medicare, and to reduce Medicare spending over time, the Breaux-Thomas plan adopted a version of the "premium support" system formulated by Henry Aaron and Robert Reischauer of the Brookings Institution. Government payments for Medicare services would be tied to the average cost of all health plans participating in Medicare, encouraging competition among health care providers on the basis of price and quality. The Breaux-Thomas plan would also allow for prescription drug coverage, but limit premium subsidies to those seniors below 135 percent of poverty (about 40 percent of 1999 enrollees).

The Breaux-Thomas proposal raised several concerns within the Administration and among many of the Democrats on the Commission. One problem was a lack of additional funding for Medicare, because few analysts believed that structural reform alone could solve Medicare's long-term financing shortfall. A second problem was the lack of premium subsidies for drug coverage of the elderly with incomes above 135 percent of poverty. More than three in five Medicare beneficiaries do not have dependable drug coverage, and lack of drug coverage is not correlated very strongly with income. A third concern was that the Breaux-Thomas plan would raise premiums for enrollees in traditional Medicare relative to current law, because the traditional program would likely have higher cost than the average health plan in Medicare.

When the Breaux-Thomas plan was put to a vote in March 1999, Administration appointees Laura Tyson and Stuart Altman joined with five of the other Democratic appointees in opposing it -- leaving the plan one vote short of the super-majority needed to adopt a recommendation.

The Administration Proposal

Following the March 17, 1999, failure of the Medicare Commission to issue a final report, President Clinton announced that he would convene his advisers to develop an alternative proposal. The Treasury Department, led by its Office of Economic Policy, played a key role in policy-development effort that followed. Treasury staff helped to design a prescription drug benefit that balanced the needs of seniors, principles of insurance design, and fiscal constraints. Treasury supported an overall reform package that included sufficient expenditure savings to cover a significant share of the government cost for the drug benefit. Most importantly, Deputy Assistant Secretary for Economic Policy Mark McClellan designed a mechanism for competition that provides strong incentives for efficiency while addressing Democratic concerns about the "premium support" system.

The key insight behind the alternative competition mechanism was to tie the level of government support to the cost of the traditional fee-for-service program rather than the *average* premium of all health plans in an area. With this simple modification, the resulting system would provide the same incentive for beneficiaries to choose private plans that are more efficient, while ensuring that beneficiaries who chose to remain in the traditional fee-for-service plan would pay no more in premiums than under current law. Eventually, this approach was called the Competitive Defined Benefit. As the Clinton-Gore Administration developed its reform plan, a consensus developed that the incorporation of market mechanisms was necessary for the plan's credibility, and HHS threw its support behind this proposal.

The prescription drug benefit developed by the Clinton-Gore Administration would have covered 50 percent of the cost of each prescription up to a benefit cap. This cap started at $1,000 in the first year, rose to $2,500 by the eighth year (corresponding to $5,000 in drug spending), and increased more slowly after that. Enrollees would face no deductible, and Medicare would pay half of the cost of premiums. The proposal also included a special subsidy, developed by the Treasury Department, to encourage employers to continue offering drug coverage to their retirees.

President Clinton, along with Secretary Rubin and then-Deputy Secretary Summers announced the Administration's comprehensive Medicare reform proposal on June 29, 1999. In addition to the features already discussed, this proposal transferred $700 billion to the Medicare Part A Trust Fund over 15 years, which would extend the program's solvency for a quarter century.

Public Debate

Discussions between the Administration and Congress about alternative approaches to Medicare reform did not reach consensus by the end of 1999. The Administration revised its proposal over time and sent draft legislation to Congress in March 2000. While many of the revisions related to provider payments in traditional Medicare, the Administration also set aside $35 billion over 10 years from the budget surplus to add protection for seniors against "catastrophic" drug costs.

On June 20, 2000, President Clinton released the Administration's new specification for a Medicare drug benefit that included catastrophic protection. Under this specification, seniors with incomes below 135 percent of poverty would have been fully subsidized, and those with incomes above 150 percent of poverty would have receive a subsidy greater than 50 percent, with a sliding-scale subsidy in between. In traditional Medicare, private benefit managers would have bid to be the sole provider region-by-region, and the program would be overseen by the Health Care Financing Administration (HCFA), the arm of the Health and Human Services Department that runs Medicare.

On Capitol Hill, various alternative proposals competed for attention. Senator Bob Graham (D-FL) and others developed a proposal that was similar to the Administration's proposal in many respects, but it allowed for multiple benefit managers in each region. House Republicans developed a drug proposal that was narrowly passed by the House on June 28, 2000, but was not acted on by the Senate. The House bill would provide only small, indirect subsidies for drug coverage for seniors above low income, and it would rely on private insurers to offer these

policies, with the Federal government contracting directly with benefit managers as a last resort. Senators Breaux and Frist included a similar drug benefit design in their most recent Medicare reform proposal.

The Clinton-Gore Administration rejected the House Republican and Breaux-Frist proposals because they would not meet the needs of America's seniors. The subsidies for seniors above low income were too small to generate the near-universal take-up rates seen in Medicare, and opting-out by healthier seniors would raise premiums unacceptably for those remaining in the program. Moreover, many insurers expressed reservations about offering drugs-only policies – whereas private sector health plans take the Administration's approach of having one drug benefit and allowing choice among plans as a package.

By the end of the Clinton-Gore Administration, consensus had clearly developed that comprehensive Medicare reform was needed, and that a prescription drug benefit and competition among health plans must be central elements of that reform. Unfortunately, no agreement could be reached with 106th Congress on the specific construction of the drug benefit or system of competition.

CHAPTER FIVE

CREATING A SAFER AND MORE SECURE SOCIETY FOR AMERICA'S CITIZENS

Introduction

During the Clinton-Gore years, crime rates in the United States plummeted to the lowest levels in a generation, with homicides falling to a 30-year low. The Clinton-Gore Administration took a number of important steps that contributed significantly to this improvement. The Treasury Department, as the agency responsible for the Customs Service, the Bureau of Alcohol, Tobacco and Firearms, the Office of Foreign Assets Control, the Financial Crimes Enforcement Network, and the Secret Service, played a leading role in the Administration's efforts to combat violent and financial crime between 1993 and 2001. The Department's efforts fell into four broad areas: first, measures to combat firearms violence, including the 1993 Brady law and 1994 assault weapons ban; second, measures to fight financial crime, most notably money laundering; third, measures to fight terrorism and improve the interdiction of drug smuggling across U.S. borders; and fourth, re-organizing, modernizing, and reinvigorating Treasury's law enforcement agencies. This chapter focuses on these four categories.

I. Combating Firearms Violence

Treasury's Bureau of Alcohol, Tobacco and Firearms (ATF) is the lead agency responsible for enforcing and administering the Federal firearms laws. Between 1993 and 2001, by ensuring that the Brady law and other critical firearms laws were enforced, and by undertaking numerous other initiatives to tighten restrictions on gun sales and fight the illegal trafficking of firearms, the Administration and Treasury cut in half the number of licensed firearms dealers to 100,000. These and other measures, including the Youth Crime Gun Interdiction Initiative, contributed significantly to reducing homicide rates by more than a third during the Clinton-Gore years.

This section looks at the numerous initiatives taken by Treasury during the Clinton-Gore Administration to combat illegal firearms:

- Treasury provided crucial support in the successful fight for new firearms laws in 1993 and 1994.

- Treasury led the expansion of firearms enforcement activity to address a broader range of firearms crimes, including the illegal acquisition, possession, distribution, and use of guns.

- Through a series of reports, initiatives, legislative proposals, and public statements, Treasury expanded the public policy debate to address the need for greater measures to control the illegal market in firearms.

- Treasury made substantial investments in ATF information, technology, analytic capability, and human resources that increased the investigative and strategic impact of firearms enforcement activity.
- Through negotiations with Smith & Wesson and other initiatives, Treasury helped spearhead movement toward greater accountability and responsibility by the firearms industry and gun owners.

Each of these efforts is discussed in turn.

Enactment and Implementation of the Brady Act of 1993 and the Assault Weapons Ban of 1994

In the summer and fall of 1993, the Clinton-Gore Administration announced that it would make reduction of gun violence a priority of its overall crime reduction agenda. Gun control issues had not been significantly addressed since Lyndon Johnson's advocacy of the 1968 passage of the Gun Control Act (GCA), and, in fact, firearms regulation had been rolled back in the Firearms Owners Protection Act of 1986. The Treasury Department played an integral role in helping pass and implement two critical laws in the early part of the Clinton-Gore Administration: the Brady Handgun Violence Prevention Act of 1993 and the Assault Weapons Ban of 1994.

Brady Handgun Violence Prevention Act of 1993

On November 30, 1993, President Clinton signed the Brady Handgun Violence Prevention Act (the "Brady Act"), stating that "Americans are finally fed up with violence that cuts down another citizen with gunfire every 20 minutes. And we know this bill will work." The Brady Act marked the end of a seven year legislative fight to give law enforcement and licensed dealers the tools they needed to prevent felons and other prohibited persons from buying guns from gun stores. Secretary Bentsen lauded the Senate breakthrough, saying "a mandatory waiting period before buying a handgun will make an important contribution. It will save lives, and it will reduce the economic drain on society that handgun violence creates."

The Brady Act's interim provisions were in effect from February 28, 1994, through November 29, 1998. The interim provisions required Federal firearms licensees (FFLs) to contact State and local law enforcement officials for background checks on handgun purchasers. Beginning on November 30, 1998, the Brady Act required FFLs to contact the FBI's National Instant Criminal Background Check System (NICS) for a computerized background check prior to the sale of any firearm. The background checks required under the Brady Act have prevented more than 600,000 felons and other prohibited persons from purchasing firearms since February 28, 1994.

The Brady Act gave Treasury and ATF responsibility for administering the law's provisions affecting firearms licensees, and the FBI was given authority to administer the NICS. The FBI refers information to ATF regarding persons who have been denied a gun purchase under the Brady Act so that ATF may investigate and refer appropriate cases for prosecution. In addition,

ATF is responsible for retrieving firearms from those prohibited persons who have received firearms as a result of "delayed denials" issued by the FBI after three business days have elapsed.

Following passage of the Brady Act, data on thousands of persons denied gun purchases became available, and Treasury's Office of Enforcement worked with ATF to develop the means to integrate, disseminate, and prioritize the use of the data to support new kinds of criminal investigations focused on the illegal acquisition of firearms. One of the most significant legacies of the Treasury Department with respect to firearms violence in the United States is that agents, police, prosecutors, and policy makers now ask -- how did the criminal or juvenile acquire the gun. This has led not only to prosecutions of firearms traffickers, but also a far better public understanding of the costs of the current framework for firearms regulation.

In order to ensure that only legitimate gun dealers obtain Federal firearms licenses, the 1993 Brady Act increased the dealer licensing fee from $10 per year to $200 for the first three years and $90 for each additional three-year period. The Brady Act also requires license applicants to certify that they have informed the Chief Law Enforcement Officer of the locality in which their premises will be located of their intention to apply for a license. The Violent Crime Control and Law Enforcement Act of 1994, requires licensees to submit photographs and fingerprints as part of their application, and to certify that their firearms business complies with all State and local laws, including zoning regulations.

Over the next six years, ATF's enforcement of the new statutory requirements resulted in a reduction in the number of FFLs nationwide by two-thirds. In January 1997, Secretary Rubin issued "*A Progress Report: Gun Dealer Licensing and Illegal Gun Trafficking*," which documented the significant drop in the gun dealer population. The reduction in gun dealers was widely regarded as both overdue and necessary to permit effective regulatory enforcement of the firearms laws. As President Clinton stated at an event marking the seventh anniversary of the Brady Act, "even as we work hard to keep criminals from getting guns through the front door of a gun shop, we should do even more to lock the back door by cracking down on illegal gun traffickers. An enormous percentage of these illegal gun sales are done by a relatively small number of people."

Assault Weapons Ban of 1994 and Associated Regulatory Action

Treasury, under the leadership of Secretary Bentsen, also played a central role in the development and passage of the Assault Weapons Ban as part of the Violent Crime Control and Law Enforcement Act of 1994. With certain exceptions, the new law prohibited the manufacture, transfer, and possession of semiautomatic assault weapons. The legislation banned 19 weapons by name, as well as any copies or duplicates of such firearms. The legislation also banned semiautomatic rifles, semiautomatic pistols, and semiautomatic shotguns that had a certain number of features specified in the law. The 1994 law banned the future manufacture, transfer or possession of semiautomatic assault weapons, except for use by law enforcement and other government agencies. However, the law "grandfathered" all semiautomatic assault weapons lawfully possessed on the date of enactment, allowing the continued possession and transfer of such weapons. The 1994 law also made it unlawful to possess and transfer large capacity ammunition feeding devices manufactured after September 13, 1994. A large capacity

ammunition feeding device was generally defined as a magazine, belt, drum, feed strip, or similar device that has the capacity of, or that can be readily restored or converted to accept, more than 10 rounds of ammunition.

In framing the parameters of the 1994 Act, Treasury made two key contributions.

- On August 11, 1993, President Clinton issued a memorandum to the Secretary of the Treasury, directing him to reexamine the current importation approval system to determine whether the system should be modified to ensure that all nonsporting handguns are properly denied importation. Treasury issued a report to the President on September 7, 1993, outlining various proposals to implement the President's directive. These concerns were ultimately addressed through the 1994 legislation banning the manufacture, transfer and possession of assault weapons.

- A second key Treasury contribution to the 1994 Act was provided in the Presidential *Memorandum on Gun Dealer Licensing for the Secretary of the Treasury* (August 11, 1993), which was drafted by Treasury Enforcement staff and drew on ATF expertise. This Memorandum, which responded to public concern that there were "more gun dealers than gas stations," because licenses were too easy to obtain and the population of licensees too large to monitor effectively, required certain changes in the system of licensing firearms dealers. Many of the concerns outlined in the Presidential Memorandum were addressed in amendments made to the 1994 Act.

Moreover, as a Texan, Secretary Bentsen's advocacy of the assault weapons ban carried great weight in the legislative debate over the bill.

After the House of Representatives passed the assault weapons ban on May 5, 1994, President Clinton talked about the significance of this legislation. "This afternoon, the House of Representatives rose to the occasion and stood up for the national interest. Two hundred and sixteen members stood up for our police, our children, and for safety on our streets. They stood up against the madness that we have come to see when criminals and terrorists have legal access to assault weapons, and then find themselves better armed than police, putting more and more people in increasing danger of their lives. The 19 assault weapons banned by this proposal are deadly, dangerous weapons. They were designed for one purpose only: to kill people. And as long as violent criminals have easy access to them, they will continue to be used to kill people. We as a nation are determined to turn that around." President Clinton signed the assault weapons ban into law on September 13, 1994.

On April 6, 1995, ATF issued regulations implementing the 1994 law. The regulations required that semiautomatic assault weapons and large capacity ammunition feeding devices manufactured after September 13, 1994, must be marked "RESTRICTED LAW ENFORCEMENT/GOVERNMENT USE ONLY." The regulations also required the marking, with a serial number, of large capacity ammunition feeding devices manufactured or imported after September 13, 1994.

In the aftermath of the 1994 Assault Weapons Ban, foreign firearms manufacturers began to modify the designs of their weapons in order to evade the law's restrictions. On November 14, 1997, President Clinton and Secretary Rubin ordered a review of the importation of certain modified versions of semiautomatic assault rifles into the United States. In April 1998, Secretary Rubin approved an ATF determination that the ability to accept a detachable large capacity magazine originally designed and produced for a military assault weapon should be added to the list of disqualifying military configuration features. This decision resulted in barring the importation of 58 modified, semiautomatic assault rifles that accept large capacity military magazines.

Treasury's Office of Enforcement, led by Deputy Assistant Secretary David Medina and Senior Advisor Susan Ginsburg, worked closely with ATF in the design and drafting of the study and recommendation. Despite the contentious nature of the debate over setting limits on firearms importation, this report was widely accepted.

Expansion of Firearms Enforcement Activity

In the fall of 1995, Secretary Rubin determined that reducing firearms violence should be the top priority for Treasury's Office of Enforcement. Following this decision, Treasury took several measures to strengthen its efforts against firearms violence by targeting activities such as illegal acquisition and distribution of guns. While conventional approaches to gun enforcement focused exclusively on prosecutions *after* the commission of violent crimes, Treasury and ATF focused on a broader spectrum of enforcement activity addressing the illegal supply of firearms.

The Youth Crime Gun Interdiction Initiative (YCGII)

In September 1995, Senior Advisor Ginsburg, the Department's principal staff person on firearms matters, met with a group of gun crime experts from around the country to discuss how to address the tripling of juvenile homicide between 1985 and 1994. This meeting, and subsequent meetings held with ATF, led to Treasury's *Youth Crime Gun Interdiction Initiative (YCGII)*, which Under Secretary Ronald Noble recommended to Secretary Rubin in the fall of 1995 and Secretary Rubin strongly supported. On July 8, 1996, President Clinton announced this new ATF gun enforcement program to reduce illegal access to firearms, especially by juveniles and youth. At the announcement of this initiative, President Clinton stated that "we need a national campaign to cut off the flow of guns to teens who commit crimes . . . . In the 17 cities already mentioned, we will, for the first time, see that every time a gun is used in a crime and seized by law enforcement, it will be tracked through a national tracing system to find out where it came from. We will use that information to target those criminal gunrunning networks that are peddling guns to our teenagers." Since its inception, the YCGII initiative has helped to transform the understanding of how criminals and juveniles obtain guns, an achievement that has provided new ways to crack down on the illegal firearms market.

The program was based on the systematic gathering of information about the sources of guns used in crime, analysis of the information by age group, and strategic enforcement targeting of illegal sources of guns used by criminals and juveniles.

To improve information and enforcement concerning illegal users and sources of firearms, YCGII instituted comprehensive crime gun tracing to the first retail purchaser of the firearm in 17 jurisdictions, added enforcement resources in those cities, established a new Crime Gun Analysis Branch at ATF and an annual national report of crime gun trace information. A *Performance Report* was issued in 1999, and annual *Crime Gun Trace Reports* (described below) were provided to participating police departments and the public.

The initiative, initially funded with seed money from the Treasury Asset Forfeiture Fund and, beginning in 1998, supported with Congressional appropriations, provided a programmatic foundation for law enforcement to prevent and reduce gun crime in communities by arresting illegal sources of firearms, in addition to armed violent offenders. By 2001, 50 cities were participating in the YCGII, and ATF's field offices all conducted trafficking enforcement operations in conjunction with efforts to arrest armed violent offenders. YCGII served as one of several key vehicles for developing public understanding of and Congressional support for expanding ATF resources to enforce the Federal firearms laws. The program was a key component of President Clinton's FY 2001 proposal, enacted by Congress, to increase funding for a host of firearms programs.

The availability of crime gun information and other indicators significantly improved ATF's ability to carry out its regulatory, as well as criminal enforcement, mission. Indeed, as a result of this program, it was learned that most criminals buy their firearms from licensed dealers, gun traffickers or straw purchasers. That data, in turn, led police agencies to target corrupt dealers and illicit traffickers for the first time. Moreover, using the greatly expanded crime gun trace information made available through the YCGII and other efforts, in February 2000, ATF determined which Federal firearms licensees were most associated with crime guns and other indicators, and launched an intensified regulatory enforcement program focused on those sources of crime guns.

New Obligations for Federally Licensed Gun Dealers

During the Clinton-Gore Administration, Treasury and ATF also worked to ensure that Federally licensed firearms manufacturers and dealers were fully participating in the effort to prevent guns from entering into illegal commerce. Toward that end, on August 28, 2000, ATF proposed new rules to tighten reporting of guns lost or stolen in transit between FFLs. Separately, in his radio address on September 23, 2000, President Clinton announced the new ATF *EZ Check* website, developed at the direction of Under Secretary James E. Johnson, which allows licensed gun dealers to verify the Federal licenses of wholesalers and retailers to whom they are selling.

National Gun Enforcement Strategy

On March 20, 1999, President Clinton issued a directive requesting a national gun enforcement strategy. Treasury's Office of Enforcement and counterparts from the Justice Department drafted the directive in coordination with the White House Domestic Policy Council. The strategy encompassed a broad spectrum of enforcement activities and included a new cooperative framework between Treasury and Justice to promote Federal firearms enforcement, support for

locally based firearms initiatives, as well as a strong endorsement for further investments in firearms enforcement-related information systems. At the impetus of Deputy Secretary Stuart Eizenstat, the strategy was broadened to include a systematic review of firearms-related legislation. The strategy was released in January 2001.

Domestic Violence Enforcement Initiative

Recognizing that guns are often involved in domestic violence, Treasury and ATF, in coordination with the Department of Justice, began work in July 2000 to address the problem of gun-related domestic violence. As a part of that effort, in August 2000, ATF appointed a Domestic Violence Coordinator, and, by the end of the Administration, a number of domestic-violence related firearms initiatives were in the planning stages.

Negotiation of Firearms Protocol to U.N. Transnational Organized Crime Convention

Growing out of concerns raised by the Government of Mexico and other countries that drug traffickers were arming themselves with guns smuggled from the U.S., Treasury's Office of Enforcement began working with staff from the National Security Council, State Department and Department of Justice to construct a new international regime for firearms regulation. In 2000, Treasury's Offices of Enforcement and General Counsel took lead roles in negotiating new firearms-related international agreements, including in the Organization of American States and the United Nations Crime Commission. If completed, the U.N. firearms protocol would represent the first-ever global legal instrument controlling the international movement of firearms and requiring that all firearms be marked.

Providing Leadership in the Fight Against Illegal Firearms Markets

Beginning in 1996, Treasury and ATF published a series of reports to build public understanding of firearms crime and regulation, and State and local support for firearms enforcement and strengthened gun laws. These reports, which identified problems in the regulatory framework and proposed legislation to address them, helped to shape public and legislative debate on gun issues and provided significant new information for scholars and public policy analysts. For instance, following the policy of comprehensive crime gun tracing promoted through the Youth Crime Gun Interdiction Initiative and its annual *Crime Gun Trace Reports*, four states (California, North Carolina, Connecticut, and Illinois) enacted firearms tracing laws.

Perhaps the most important consequence of these efforts was raising the awareness of both law enforcement personnel and the public about the distribution and trafficking of firearms. This was seen as the foundation on which future gun enforcement strategy and laws would be built. The following are the key reports and legislative developments in this area:

Guide to Investigating Illegal Firearms Trafficking

In 1996, funds from YCGII were used to match funds from the National Institute of Justice to start the first study of illegal markets in firearms in five cities. In October 1997, also using funds from YCGII, ATF published a *Guide to Investigating Illegal Firearms Trafficking*, which was

distributed to hundreds of police departments nationwide. In addition, during the week of May 22, 2000, led by Assistant Secretary Elisabeth A. Bresee, the Office of Enforcement, along with the Department of Justice, sponsored a three-day trafficking training conference for Federal, State and local investigators and prosecutors. Secretary Summers and Deputy Secretary Eizenstat spoke at this conference.

Efforts to Close the "Gunshow Loophole"

Following discussions between Under Secretary Johnson and the Domestic Policy Council, on November 6, 1998, President Clinton issued a directive to Treasury, ATF, and the Justice Department to examine the need for Brady background checks by unlicensed sellers at gun shows, also known as closing the "gun-show loophole." The resulting report, entitled "*Report and Recommendations: Gun Shows: Brady Checks and Crime Gun Traces,*" released by President Clinton, Secretary Rubin, and Attorney General Reno on February 6, 1999, recommended that all gun show firearms purchasers be subject to the same background check and recordkeeping requirements as purchasers from FFLs. In announcing the report, President Clinton stated, "America cannot allow its gun shows to become illegal arms bazaars, where lawbreakers shop side-by-side with the law-abiding. That is why I strongly support the recommendations of Secretary Rubin and Attorney General Reno. We must close the gun show loophole: no background check, no gun, no exceptions." Secretary Rubin stated that "the report is clear evidence for the need to require background checks and to enable crime gun tracing on all firearms sold at gun shows. This is another step by this Administration to crack down on the supply of illegal firearms to criminals, juveniles and gun traffickers." This report was widely viewed as authoritative on the subject of gun shows, and documents the rationale for legislation passed by the Senate in May 1999 and referenda adopted in two States (Colorado and Oregon) in the elections held in November 2000.

At the request of the White House, Treasury and Justice drafted firearms legislation, including closing the gun show loophole and a range of enforcement provisions, that President Clinton submitted to Congress in April 1999, following the shooting at Columbine High School. On May 20, 1999, the Senate passed legislation to close the gun show loophole after Vice President Gore cast a tie-breaking vote. The gun show proposal was part of a broader juvenile justice bill that included a number of other gun initiatives. On June 17, 1999, the House passed a different version of the juvenile justice bill that did not include gun show legislation. Although Conferees on the two bills were appointed in 1999, no agreement was reached on the gun show legislation. Accordingly, the 106th Congress did not enact legislation to close the gun show loophole.

Report and Recommendations: Gun Crime in the Age Group 18-20 (June 1999)

In support of legislation that would raise the age of possession of certain guns to 21, Under Secretary Johnson and Deputy Attorney General Holder issued a joint Treasury-Justice Department report in June 1999 showing that 18-20-year-olds were the highest offending age groups for gun crime. This legislation was never enacted.

Annual Reports 1997-1999: ATF Crime Gun Trace Reports

The ATF annual Crime Gun Trace Reports provided a sophisticated analysis and breakdown of the market in illegal guns that significantly enhanced the ability of law enforcement agencies to do their job. The reports put into wide currency concepts like "crime gun" and "time-to-crime," which are used to describe and explain the illegal market in firearms. They specified the number, types, age groups, and sources associated with guns used in crime in cities participating in the Youth Crime Gun Interdiction Initiative. The reports also illuminated, by city, how many crime guns were obtained locally and in-State as compared to out-of-State, with implications for allocation of enforcement responsibility and national legislation. In addition, the reports identified, by city, the manufacturers of the most frequently traced crime guns, and which guns were most likely to be trafficked.

Annual Report: Commerce in Firearms in the United States

On February 4, 2000, Secretary Summers released ATF's and Treasury's first annual comprehensive compilation of U.S. firearms production and regulatory statistics. This report, which was modeled on the Council of Economic Advisors' annual report, included analysis of trends in firearms production, and an explanation of ATF's regulatory powers and some of their limitations. This report was the culmination of the Office of Enforcement's and ATF's expertise in firearms and the Office of Economic Policy's expertise in micro-economics. Upon releasing the report, Secretary Summers noted that it "provides new analysis leading us to new measures in our continuing efforts to decrease firearms violence and to keep guns out of the hands of criminals and youth."

Report: Following the Gun, Enforcing Federal Laws Against Firearms Traffickers

This report, which was issued by ATF Director Bradley Buckles in June 2000, presented a statistical analysis of ATF and prosecution case records in order to provide new information on the structure of the illegal market in firearms, and described problems that require legislative solutions. After the release of the report, President Clinton stated, "The report shows that loopholes in our laws help make gun shows and corrupt gun dealers major channels for gun trafficking. Many of the diverted weapons supplied by traffickers were later used to commit serious crimes, including homicides, robberies and assaults." Distributed widely throughout the country, the report greatly expanded understanding of the role of straw purchasers, corrupt dealers, and other illegal sources of firearms.

Legislation: Civil Asset Forfeiture Reform Act of 2000 (CAFRA)

During 2000, Treasury worked successfully with Congress to ensure that CAFRA would include provisions to expand the use of criminal forfeiture in prosecutions under the Gun Control Act of 1968 and the National Firearms Act. Prior to CAFRA's passage, firearms were generally only forfeited civilly because there was limited authority under Federal law for criminal forfeiture of firearms. Following passage of CAFRA, Treasury's forfeiture training initiatives were revised to include instruction on working with Federal prosecutors to encourage the use of criminal forfeiture in firearms prosecutions.

Strengthening ATF to Better Combat Illegal Firearms

Between 1993 and 2000, funding for firearms enforcement more than doubled. Building on President Clinton's efforts to prevent illegal gun acquisition through the Brady Act and enhanced dealer licensing, Treasury and ATF took a series of steps to increase Federal, state, and local ability to enforce laws against illegal transfers of firearms and to improve investigation of gun crimes generally. These steps included ATF's "On-Line Lead" system, which enables State and local law enforcement to retrieve crime gun trace data directly through a secure internet site (see below), the Youth Crime Gun Interdiction Initiative, and the E-Z check system. Legislative authority to implement these measures was provided in Treasury's FY 2001 appropriation, which provided significant additional funding for Federal firearms enforcement. These additional resources will substantially increase support for joint task forces with police departments throughout the country, through which ATF expertise and information are leveraged.

Increasing Access to Investigative Information

On November 30, 1999, Secretary Summers announced that ATF had achieved nationwide deployment of an illegal trafficking information system, Project OnLine LEAD, that was made available to State and local task forces through local ATF offices. Supported by funding from the Youth Crime Gun Interdiction Initiative, this system was envisioned as a first step in local law enforcement access to improved crime gun information. In May 1997, ATF's Crime Gun Analysis Branch also began providing crime gun mapping and analytic services for local police departments nationwide.

National Integrated Ballistics Information Network

In 1995, Treasury's Office of Enforcement began actively supporting ATF's efforts to develop ballistics imaging capability. In December 1999, ATF and the FBI signed an agreement to provide a coordinated approach to the development of ballistics imaging, to be known as the National Integrated Ballistics Information Network (NIBIN). The President's FY 2001 budget requested an appropriation of $23 million and 20 positions for NIBIN, anticipating a multi-year deployment of over 200 machines to state and local law enforcement agencies. Actual resources provided to ATF were $26 million and 20 positions in FY 2001. When tied to a ballistics image at the point of production, ballistics imaging is also expected to lead to a significant increase in ability to trace firearms. NIBIN was the first step toward fulfilling that capability.

FY 2001 Expanded Gun Enforcement Resources

For FY 2001, Secretary Summers advocated and President Clinton proposed the largest gun enforcement budget initiative ever, including $93 million to add 500 new ATF agents and inspectors to target violent gun criminals and illegal gun traffickers and to expand crime gun tracing and the NIBIN ballistics identification network. These funds supported a wide range of Federal, State, and local firearms enforcement initiatives, including the YCGII, and locally based initiatives like Boston's Project Ceasefire and Richmond's Project Exile, as well as expanded use

of Brady denial information. Actual resources provided to ATF were $96 million and 500 agents and inspectors in FY 2001.

Encouraging a Responsible Firearms Industry

Having devoted the first six years of the Clinton-Gore Administration to establishing a strong foundation of new firearms laws and effective firearms enforcement, Treasury began to focus on the role of the firearms industry and the public in preventing gun crime and other gun violence.

Smith and Wesson Agreement

On March 17, 2000, President Clinton announced in an Oval Office ceremony an agreement between the U.S. government and Smith & Wesson, the nation's largest gun manufacturer, to reform gun industry practices to increase firearms safety and reduce gun violence. This agreement followed months of negotiations between Treasury, the Department of Housing and Urban Development, and Smith & Wesson. The lead negotiators for Treasury were Deputy Secretary Eizenstat and General Counsel Neal Wolin. Smith & Wesson, which was among a group of gun manufacturers being sued by cities and municipalities across the country, agreed to extensive safety measures and controls on distributors, including safety locks, "smart gun" technology for new guns to prevent unauthorized usage, and a commitment not to sell weapons at gun shows without universal background checks. The Smith & Wesson agreement was a major tool for educating the public on the role that the firearms industry can take in preventing gun violence. "This agreement is a major victory for America's families," President Clinton said in an Oval Office address. "It means gun makers can and will share in the responsibility to keep their products out of the wrong hands. And it says that gun makers can and will make their guns much safer without infringing on anyone's rights."

Public Education Campaigns

In June 2000, at the direction of Secretary Summers, ATF began expanding its efforts to provide public information about gun safety as a part of its public outreach activities. Secretary Summers asked ATF to focus on the concept of "parents asking parents," in which parents are urged to ask parents of children with whom their kids play whether there is a gun in the home and whether it is safely stored.

This idea was effectively promoted through an organization called PAX, which worked with Treasury's Offices of Public Affairs, Enforcement and ATF in crafting a public service message that would reach the widest spectrum of gun owners and parents. With Treasury support, ATF also began working with the Ad Council on a new public education campaign, and ATF continued to work with the National Shooting Sports Foundation on industry compliance with provisions of the Gun Control Act.

Combating Arsons at Our Nation's Houses of Worship

On June 8, 1996, in response to a series of suspicious fires at African American churches in the South, President Clinton announced the formation of the National Church Arson Task Force (NCATF). The President announced that the NCATF would be chaired by then-Assistant Secretary Johnson and Assistant Attorney General for Civil Rights Deval Patrick. ATF, the FBI, Department of Justice attorneys, and Assistant U.S. Attorneys in the field formed the core of the Task Force. Under the direction of Secretary Rubin and Assistant Secretary Johnson, ATF, the premier arson investigation agency in the world, pursued the church arson investigations with a vigor that has resulted in an arrest rate more than double the national average for arsons. Both Secretary Rubin and Mr. Johnson -- first as Assistant Secretary and then as Under Secretary -- reached out to affected churches and communities and sent a forceful message on the Federal government's commitment to addressing their concerns.

The NCATF's efforts were supported by President Clinton as well as Congress, which strengthened Federal laws and provided additional resources. On July 3, 1996, President Clinton signed the Church Arson Prevention Act of 1996, which granted Federal prosecutors greater powers in pursuing burnings and desecrations at houses of worship. The following month, Congress provided more than $12 million to support ATF's role in the Task Force until the end of fiscal year 1996. An additional $12 million was appropriated for fiscal year 1997.

By December 2000, the Task Force had either overseen or monitored nearly 1000 cases. Thirty-six percent of these cases were solved with an arrest. This solve rate is more than double the national average for arson. The number of reported fires continues to decline, and the practices and procedures of the Task Force have been incorporated into the operations of the Federal government's constituent agencies. The Task Force submitted five reports to the President (an interim report as well as four annual reports).

The Task Force model of departmental co-equals was viewed as unorthodox at the time, but has since been replicated in the context of the Border Coordination Initiative, jointly overseen by the Under Secretary of the Treasury and the Deputy Attorney General, and the Money Laundering Steering Committee, the key organizing unit of the National Money Laundering Strategy, which is jointly overseen by the Deputy Secretary of the Treasury and the Deputy Attorney General.

II. Combating Money Laundering and Other Financial Crimes

The emergence of more sophisticated communications, banking and other technologies during the Clinton-Gore years, and the growth of cross-border trade and capital flows, provided new opportunities for criminals both to move and to disguise the proceeds of their crimes. As a consequence, a critical law enforcement goal of Treasury during the Clinton-Gore Administration was fighting domestic and international money laundering, and other financial crimes such as counterfeiting and identity theft. As Secretary Summers said on March 2, 2000,

"In a world where capital can silently traverse the globe with the push of a button, proceeds of crime can move just as quickly and just as quietly."

Money Laundering

Money laundering -- the process of introducing the proceeds of crime into the legitimate stream of financial commerce by masking their origin -- is a global phenomenon of enormous reach. Money laundering also facilitates foreign corruption, undermining U.S. efforts to promote democratic political institutions and stable vibrant economies abroad. Counter-money laundering efforts allow law enforcement to pursue those who commit the underlying crimes that produce dirty money in the first place -- whether drug dealing, fraud, corruption, other forms of organized crime, or terrorism -- and help law enforcement to defend the integrity of our financial system and institutions.

Among all of the issues that confront the Secretary of the Treasury, money laundering alone cuts across the following three major substantive areas of the department: Enforcement, Domestic Finance and International Affairs. Throughout the Clinton-Gore Administration, Secretaries Bentsen, Rubin and Summers recognized that, in order to combat money laundering effectively, there must be thorough coordination among law enforcement agencies at the Federal, state, and local levels, as well as between them and the financial services regulators and the international affairs agencies. In addition, Treasury recognized that government agencies must develop effective working relationships with the private-sector businesses that function as a first line of defense against money launderers.

Accomplishments Under Secretary Bentsen

Money laundering was first made a Federal crime in 1986. In 1989, the G-7 created the Financial Action Task Force (FATF) to coordinate anti-money laundering policies among the world's major financial centers and, in 1990, the Financial Crimes Enforcement Network (FinCEN) was established as part of the Treasury Department. These steps provided the foundation for the work begun by Secretary Lloyd Bentsen. His accomplishments included:

- Implementing Annunzio-Wylie Anti-Money Laundering Law: The Annunzio-Wylie Anti-Money Laundering Law was enacted only a few months before the Administration took office. That legislation gave the Treasury a range of new authorities and responsibilities concerning the deterrence and detection of money laundering. Most importantly, the law for the first time authorized the Secretary of the Treasury to require bank and non-bank financial institutions to report suspicious transactions. It also allowed for the promulgation of rules requiring anti-money laundering programs at financial institutions, required agencies to consider the revocation of the charter of depository institutions convicted of money laundering, and created the Bank Secrecy Act Advisory Group of government and private-sector experts.

- Transfer to FinCEN of Bank Secrecy Act Authority: One of Under Secretary Noble's first priorities upon assuming office was to oversee a thorough review of Treasury's money laundering control infrastructure. Building on that review, he worked

aggressively to consolidate organizational changes and to ensure that FinCEN matured to its full potential, transferring to FinCEN in 1994 the authority to administer the Bank Secrecy Act.

- Passage of the Money Laundering Suppression Act: In 1994, Treasury strongly supported passage of the Money Laundering Suppression Act, which reformed and simplified the currency transaction reporting system, consolidated the previously fragmented suspicious activity reporting system, and required the registration of so-called money services businesses (i.e. non-bank money transmitters; currency exchanges; check cashers; and issuers and sellers of money orders and traveler's checks) so that counter-money laundering requirements could be efficiently extended to that important part of the financial services industry.

Accomplishments Under Secretary Rubin

Secretary Rubin built on Secretary Bentsen's measures and highlighted the need to place counter-money laundering efforts on Treasury's general policy agenda. He summarized the importance of the problem in May of 1997, when he said, "Money laundering . . . is the 'life blood' of organized crime. But, it is also the 'Achilles heel,' as it gives us a way to attack the leaders of criminal organizations. While the drug kingpins and other bosses of organized crime may be able to separate themselves from street-level criminal activity, they cannot separate themselves from the profits of that activity." Secretary Rubin's leadership produced significant results:

- Updating of the FATF 40 Recommendations: Soon after its establishment, the FATF compiled a list of 40 Recommendations, establishing the international standard for a comprehensive anti-money laundering program that encompasses the criminal justice system, law enforcement, the financial system and its regulation, as well as international cooperation. The FATF members conducted mutual evaluations based on those recommendations. Following the first round of reviews, in 1995, during Under Secretary Noble's Presidency of the FATF, the 40 Recommendations were significantly revised and strengthened. Crucial changes included expanding the list of money laundering predicate offenses beyond drug trafficking to other serious crimes, requiring mandatory reporting of suspicious transactions by financial institutions, and including additional businesses as subject to counter-money laundering programs.

- Issuance of the First Public FATF Typologies Report: In 1996, FATF, for the first time, produced a public version of its money laundering typology report adopted by its plenary. This was, in large measure, a response to requests from the private sector financial services industry for more information on money laundering trends. This document, published annually, continues to represent perhaps the single most comprehensive catalogue of money laundering trends in the world each year.

- Presidential Decision Directive-42: In response to the direct and immediate threat international crime presents to national security, President Clinton issued PDD-42 on October 21, 1995. This Directive ordered Federal agencies to: (1) increase the priority

and resources devoted to combating international organized crime; (2) achieve greater effectiveness and synergy by improving internal coordination; (3) work more closely with other governments to develop a global response to this threat; and (4) aggressively and creatively use all legal means available to combat international crime. PDD-42 directed Treasury to make effective use of the authority of the International Emergency Economic Powers Act (IEEPA) to block Colombian cartel assets in the United States and prevent U.S. entities from trading with identified individuals and businesses. It also directed Treasury to lead an interagency process to work with countries especially vulnerable to money laundering to encourage them to address their deficiencies.

- Geographic Targeting Orders: GTOs can be issued by the Secretary of the Treasury to alter the reporting and recordkeeping requirements imposed on financial institutions for 60-day periods. On July 29, 1996, Under Secretary Kelly signed a series of GTOs supporting an investigation of narcotics money laundering among money transmitters in the New York metropolitan area. These GTOs resulted in a dramatic reduction in the amount of illicit funds moving through New York money transmitters by requiring 22 licensed transmitters to report information about the senders and recipients of all cash-purchased transmissions to Colombia of $750 or more. A second series of equally successful GTOs were subsequently directed at Dominican Republic-related money laundering activities.

- Advisories on Seychelles and Antigua: On February 1, 1996, the FATF condemned legislation of the Republic of the Seychelles for promoting an environment conducive to money laundering. This was the first time the FATF had taken action to apply its Recommendation #21, which urges additional scrutiny of transactions involving countries that insufficiently applied the FATF's 40 Recommendations. Subsequently, in March 1996, FinCEN issued an advisory on the Seychelles urging American financial institutions to exercise additional scrutiny of transactions involving that jurisdiction. In April 1999, FinCEN, in coordination with its counterpart in the United Kingdom, issued an advisory on Antigua and Barbuda after that country changed its laws in a manner that significantly weakened its anti-money laundering regime.

- Passage of the Velasquez Bill: The drive to create an effective and well-coordinated strategy against money laundering culminated in the enactment of the Money Laundering and Financial Crimes Strategy Act of 1998, which President Clinton signed in October of that year. This Act required the annual publication of a comprehensive interagency strategy to combat money laundering. Treasury Enforcement worked closely with Congress and the Justice Department on this legislation.

Accomplishments Under Secretary Summers

Shortly after taking office, Secretary Summers decided to improve U.S. and global efforts to combat money laundering and to make that effort a centerpiece of his tenure. In doing so, he built on the record of accomplishments of his predecessors and was assisted by Deputy Secretary Eizenstat, who had extensive experience in related international efforts against bribery and corruption, having previously been Under Secretary of State for Economic Affairs, Under

Secretary of Commerce for International Trade Administration, and U.S. Ambassador to the European Union. In their time in office, Secretary Summers and Deputy Secretary Eizenstat accomplished a great deal. In certain areas, the results were groundbreaking. For example:

- Issuance of the First National Money Laundering Strategy: On September 23, 1999, in response to a mandate from the Money Laundering and Financial Crimes Strategy Act of 1998, Secretary Summers and Attorney General Reno announced the first-ever National Money Laundering Strategy. "The attack on money laundering is an essential front in the war on narcotics and the broader fight against organized crime worldwide," said Secretary Summers. "Money laundering may look like a polite form of white collar crime, but it is the companion of brutality, deceit and corruption. This Strategy marks a new stage in the government's coordinated effort to follow the money." The following March, the National Money Laundering Strategy for 2000 was unveiled, setting forth the most comprehensive effort ever undertaken against money laundering while underscoring accountability by assigning lead officials and responsible offices for each of its scores of distinct action items. "Money laundering is a growing threat to the United States," Deputy Secretary Eizenstat said at the time. "It undermines confidence in the integrity of our financial systems, facilitates crime and corruption, and allows criminals to savor the rewards of their illegal actions."

- Designation of the First High Intensity Financial Crime Areas (HIFCAs): In March 2000, Deputy Secretary Eizenstat announced the first-ever designation of HIFCAs, which are designed to concentrate law enforcement efforts at the Federal, state, and local level to combat money laundering in high-intensity money laundering zones, whether based on drug trafficking or other crimes. The result of a process overseen by Under Secretary Johnson, the first HIFCAs included three geographic areas (the New York/Northern New Jersey region, the Los Angeles metropolitan area, and San Juan, Puerto Rico) and one systemic HIFCA to address cross-border currency smuggling/movement in Texas/Arizona to and from Mexico. A money laundering action team was created or identified within each HIFCA to spearhead the coordinated efforts.

- Awarding of the First Grants Under the Financial Crime-Free Communities Support Program (C-FIC). C-FIC was the first-ever Federal grant program specifically designed to provide seed capital for emerging state and local counter-money laundering enforcement efforts. Under Secretary Johnson directed the establishment of this program. On October 26, 2000, Secretary Summers and Attorney General Reno announced the award of $2.3 million to nine State and local law enforcement agencies and prosecutor's offices to fight money laundering and related financial crime. They included: the San Bernardino, California Sheriff's Department; the San Diego, California Police Department; the Arizona Attorney General's Office; the Texas Attorney General's Office; the New York State Police; the New York Attorney General's Office; the Illinois State Police; the Chicago, Illinois Police Department; and Florida State's Attorney's Office for the 15th Judicial District (West Palm Beach).

- Sharing Information with the Financial Community: In an important effort to share information on how FinCEN's data was being used to combat money laundering, FinCEN Director James Sloan began issuing two new, informative publications: the SAR Bulletin, which described key information drawn from the Suspicious Activity Reporting (SAR)

System; and the SAR Activity Review – Trends, Tips and Issues, which was released at the 12th Annual American Bankers Association/American Bar Association Money Laundering Enforcement Seminar on October 29, 2000. Taken together, these reports represented a vital, cooperative effort involving financial services representatives, Federal law enforcement and regulatory agencies. The reports include information about: SAR statistics; patterns and trends of suspicious activity that have been reported; tips and guidance for financial institutions on form preparation and filing; and recently released statistics from the ABA Check Fraud Survey.

- Bringing Non-Depository Financial Institutions Into the Efforts to Combat Money Laundering: The National Money Laundering Strategy identified as a weakness in our anti-money laundering regulatory regime the fact that depository institutions are subject to more stringent BSA requirements than other types of financial institutions. For example, only institutions under the jurisdiction of the Federal bank supervisory agencies are required to file SARs. In response, Secretary Summers directed FinCEN to issue final rules requiring suspicious activity reporting by money services businesses and casinos, and to work with the SEC in proposing rules for suspicious activity reporting by brokers and dealers in securities.

- Issuance of Guidance Regarding Senior Foreign Political Figures: In March of 2000, Secretary Summers and Deputy Secretary Eizenstat announced that the Departments of the Treasury and Justice, along with the Federal bank regulators, would work closely with the financial services industry to develop guidance for financial institutions to conduct enhanced scrutiny of those customers and their transactions that pose a heightened risk of money laundering and other financial crimes. The result of these efforts, led personally by Deputy Secretary Eizenstat, was the issuance, in January 2001, of the first-ever guidance regarding one type of high-risk activity – namely, transactions by senior foreign political figures, their immediate family and their close associates that may involve the proceeds of official corruption.

- Multilateral Identification of Non-Cooperative Countries and Territories: On June 22, 2000, in response to a request from the G-7 Finance Ministers, the FATF issued the first-ever report on countries and territories that were non-cooperative in the global fight against money laundering. This report "named and shamed" fifteen non-member states as having serious deficiencies in their anti-money laundering programs. The listed countries were: Bahamas, Cayman Islands, Cook Islands, Dominica, Israel, Lebanon, Liechtenstein, Marshall Islands, Nauru, Niue, Panama, Philippines, Russia, St. Kitts and Nevis and St. Vincent and the Grenadines. This effort complimented the concurrent work done by the Organization for Economic Cooperation and Development to deal with the problem of harmful tax competition and by the Financial Stability Forum on under-regulated offshore jurisdictions.

- G-7 Finance Ministers Issuance of Coordinated Advisories: On July 8, 2000, at the G-7 summit in Japan, Secretary Summers and his G-7 counterparts announced that they were each issuing formal advisories to their domestic financial institutions, urging them to give enhanced scrutiny to the countries and territories that have been listed by FATF. FinCEN issued its advisories that day. The G-7 Finance Ministers also issued a statement that they would consider additional countermeasures against those jurisdictions that did not take steps

to improve their anti-money laundering regimes. The FATF listing and subsequent advisories had a substantial impact. When FATF met a mere three months later, seven of the 15 jurisdictions that had been named reported that they had passed significant new laws to improve their anti-money laundering regimes.

- Putting Money Laundering on the Agenda of the IMF and the World Bank: On September 19, 2000, Secretary Summers solicited the support of World Bank President James Wolfensohn and the International Monetary Fund Managing Director Horst Kohler in addressing the problem of money laundering. Secretary Summers noted that "money laundering activities have the potential to cause serious macroeconomic distortions, misallocation of resources, and increased prudential risks." Secretary Summers' strong efforts to involve the international financial institutions more substantively in the global fight against money laundering began at the February 3 meetings of the Committee of Hemispheric Financial Issues in Cancun and was reinforced at the September 26 annual meetings of the IMF and World Bank in Prague. By 2000, the IMF and the World Bank were drafting a paper to better define their joint work on money laundering issues.

- Successful Negotiation of the United Nations Transnational Organized Crime Convention (UNTOCC): In December 2000, following two years of intense negotiations, the UN Convention Against Transnational Organized Crime was signed at a ceremony in Palermo, Italy. As a result of Treasury's role in the negotiations on the money laundering provisions, the UNTOCC was the first global, legally binding instrument to require countries to criminalize the laundering of illicit proceeds beyond narcotics proceeds, and to require countries to establish comprehensive counter-money laundering regimes.

- Combating the Black Market Peso Exchange: The Colombian black market peso exchange (BMPE), a trade-based system which provides the largest money laundering mechanism in the hemisphere, attracted high-level attention during the course of President Clinton's term in office. Drug traffickers used the BMPE to launder billions of narcotics dollars each year by placing the funds in U.S. and Mexican banks and then using the funds to finance the export of trade goods from the United States to Colombia. Shortly after becoming Under Secretary in 1997, James Johnson directed the formation of a multi-agency BMPE Task Force, which developed a strategy to coordinate Federal investigations, develop alliances with industry both here and abroad, and enlist the aid of the countries most affected by the system. In addition to law enforcement efforts, the Departments of the Treasury and Justice developed and implemented an aggressive outreach program to educate the U.S. business community about the BMPE system and the risks it poses to their businesses. On June 6, 2000, Deputy Secretary Eizenstat and Attorney General Reno met with industry leaders whose products were being used in the BMPE to help encourage the development of best practices guidelines to aid their companies in avoiding BMPE transactions. On August 29, 2000, Under Secretary Johnson joined representatives from Aruba, Colombia, Panama, United States, and Venezuela in Bogota, Colombia where they signed the "Black Market Peso Exchange System Multilateral Working Group Directive." Under the Directive, a group of international experts undertook to study the BMPE and report their findings and recommend policy options and actions to be taken against the BMPE by October 2001.

- <u>Promoting New Legislative Proposals</u>: Secretary Summers and Deputy Secretary Eizenstat actively promoted two new anti-money laundering proposals before Congress. The first would have provided new anti-money laundering tools to law enforcement, including the criminalization of bulk cash smuggling and the establishment of new money laundering predicate offenses, such as arms trafficking and foreign corruption. The second would have provided the Secretary of the Treasury with a range of new authorities to crack down on foreign money laundering havens. The first proposal never received a hearing by the Senate or House Judiciary Committees. The second proposal was introduced by House Banking Committee Chairman Leach and Ranking Member LaFalce and was passed out of the House Banking Committee by an overwhelmingly bipartisan vote of 31 to 1. However, despite its centrist, bipartisan support in both houses, at the close of the Clinton-Gore Administration, it had not been voted on by the full House, and had never received a hearing in the Senate.

Anti-Counterfeiting Efforts

Treasury Enforcement's efforts to protect the integrity of our nation's financial system included the development of strategies to employ all appropriate technological and investigatory methods to combat designers and traffickers in counterfeit currency and instruments. Among other initiatives, the Secret Service promoted a public education campaign to enhance the awareness of the anti-counterfeiting features of the new currency. Moreover, recognizing the increasing risk of counterfeiting posed by new computer technologies, on April 13, 1998, Secretary Rubin and Attorney General Reno wrote to all U.S. attorneys and Secret Service branch offices to encourage counterfeiting prosecutions.

In January 2000, Secretary Summers, in consultation with the Advanced Counterfeiting and Deterrence Committee, chaired by Under Secretary for Domestic Finance Gary Gensler, issued the report, "*The Use and Counterfeiting of United States Currency Abroad*." Secret Service officials also testified before Congress on amending U.S. law to keep up with emerging counterfeiting technology. Utilizing technology as a tool to combat counterfeiting, in 2000, the Secret Service created a pilot web site program, accessible to law enforcement and currency handlers, to check currency, report counterfeits, and track counterfeiting. Pursuant to a recommendation of the Advanced Counterfeiting and Deterrence Steering Committee and as approved by Secretary Summers on January 5, 2001, the Bureau of Engraving and Printing is on a path that will provide the option of issuing new currency as early as 2003. The new currency would include new design features such as a digital watermark, which will protect against creation of counterfeit currency on computer systems. (See Chapter 7 for a more detailed discussion of new currency features designed to thwart counterfeiting.)

Sentencing Guideline Reform Proposals

With Secretary Rubin's strong support, Treasury sought to increase the penalties for counterfeiting offenses. In March 1998, Secretary Rubin wrote to the Chairman of the U.S. Sentencing Commission to urge amendments to the sentencing guidelines for counterfeiting. In November 1998, Under Secretary Johnson requested that the U.S. Sentencing Commission examine not only counterfeiting, but also firearms trafficking and "cloning" of wireless telephones (which allows criminals to steal cellular telephone service, often as part of a larger

criminal scheme). Following the appointment of new Commissioners in 1999, Under Secretary Johnson reiterated these requests and submitted a proposal for identity theft sentencing on January 21, 2000.

During the last year of the Administration, Enforcement staff and counsel, Secret Service counsel and counterfeiting staff worked with the U.S. Sentencing Commission staff as they prepared the report to the Commissioners underlying their decision to propose changes. On September 28, 2000, Treasury also presented a demonstration of counterfeiting technology to a rare closed-door session of the Commission. Finally, Treasury commented informally on a draft of the Commission's proposals before they were published in *The Federal Register.*

After this process, the Commission published proposed changes to the guidelines in *The Federal Register* on November 7, 2000. While the proposed changes to the guidelines did not track exactly what Treasury requested, they provided for increased penalties in some circumstances, and made a much-needed correction to the application notes. Treasury remains concerned about the Commission's proposal's potential to decrease sentences for certain counterfeit currency manufacturers. Treasury Enforcement commented on the proposals during the public comment period, which ends in January 2001.

Treasury Enforcement staff also participated in the U.S. Sentencing Commission's process underlying changes to the Federal Sentencing Guidelines which increased penalties for identity theft and for use of "cloned phones." Under Secretary Johnson provided the Department's comments on the Commission's proposals during the public comment period. As of January 2001, the Commission was considering publication for comment of proposals for firearms trafficking, along the lines requested by Treasury.

Identity Theft

Identity theft, the criminal misuse of individuals' identifying information to commit fraud or other crimes, is an age-old threat. But new technology has made the crime faster, easier, and cheaper, as vast amounts of data are stored and transferred in electronic form. The Administration endeavored to address concerns about this increasing threat, without interfering with the advantages that technology brings. On March 15, 2000, fulfilling a May 4, 1999, directive from President Clinton, Treasury's Office of Enforcement convened a two-day National Summit on Identity Theft in Washington, D.C. As part of a larger Administration initiative on identity theft, the Summit gathered Administration officials, as well as consumer advocacy groups and representatives of private sector and non-governmental organizations. Secretary Summers emphasized to attendees that the Summit was the beginning of meaningful and long-term efforts to find cooperative solutions to the problem.

The Summit began a process of building public/private partnerships to combat identity theft, which continues through a series of workshops. On October 23-24, 2000, the Federal Trade Commission hosted a workshop on identity theft victim assistance, and the Social Security Administration organized a session on prevention on October 25, 2000. On December 6, 2000, the Secret Service and the Department of Justice led a law enforcement workshop.

In addition to coordinating the Summit, Treasury Enforcement participated in the U.S. Sentencing Commission's process underlying changes to the Federal Sentencing Guidelines, which increased penalties for identity theft.

Forfeiture Reform Legislation – Civil Asset Forfeiture Reform Act of 2000

As discussed earlier in this Chapter, Treasury officials participated in discussions with Congress in support of the Civil Asset Forfeiture Reform Act of 2000 (CAFRA), enacted on April 25, 2000. These discussions resulted in several important enhancements to law enforcement's ability to investigate criminal activity and to deprive criminals of the fruits of their illegal activities. Some of the more beneficial provisions of this legislation included the authority to use criminal forfeiture wherever civil forfeiture is authorized; authority to forfeit the proceeds of a increased number of offenses; authority to use grand jury information in civil forfeiture cases; authority to compensate victims in a larger universe of cases; and greater ability to forfeit the assets of fugitives who voluntarily and purposely leave the U.S. to avoid criminal prosecution. Further, CAFRA creates procedures for the U.S. to enforce a foreign country's forfeiture order, which will foster greater cooperation in the international arena.

III. Combating Drugs, Terrorism, and other International Initiatives

By going after the proceeds of crime, the Clinton-Gore Administration's anti-money laundering efforts almost certainly had a significant indirect effect on narcotics trafficking. At the same time, the Administration took a number of steps to improve America's ability to fight narcotics directly.

This section looks at Treasury's role in combating narcotics, international terrorism, and in discouraging trade in goods produced by forced child labor. Finally, it looks at the program to harmonize trade data required by customs administrations for processing international trade.

Treasury brought critical expertise to President Clinton's comprehensive anti-drug strategy through the Customs Service, which is responsible for interdicting drugs and other contraband at the border. Customs has been the principal enforcement agency at our nation's ports of entry. From 1993 to 2000, Customs stopped, on average, approximately 1 million pounds of drugs from hitting the streets of the United States each year. Customs seized more narcotics than any other Federal agency. In addition to the operational achievements of Customs and other Treasury bureaus, Treasury Enforcement and its bureaus were actively involved in developing and refining the Administration's counterdrug policy. The main achievements are discussed below.

Operations Hardline and Gateway

During 1994, the U.S. Southwest Border ports of entry experienced a dramatic escalation in violence associated with narcotics smuggling attempts. In February 1995, the Office of Enforcement began working closely with Customs in an attempt to permanently strengthen our ports of entry against border violence and to deny smugglers the use of commercial cargo as a means of introducing narcotics into the U.S. The joint Customs/Enforcement plan became known as Operation HARDLINE. The Office of Enforcement successfully supported Customs in seeking and obtaining Congressional funding for this vital program, which was a critical

component of the fight against drugs crossing our borders. The impact of Operation HARDLINE was immediate – port running (smugglers' practice of driving quickly through vehicular ports of entry, frequently resulting in injuries to Customs personnel) decreased and narcotics seizures dramatically increased.

Operation GATEWAY, initiated in March of 1996, was another collaborative effort between Customs and Treasury Enforcement. Operation GATEWAY was developed based on the highly-successful Operation HARDLINE. Because of Operation HARDLINE, many drug traffickers shifted their smuggling activity from the Southwest Border to the Caribbean. Treasury's Office of Enforcement and Customs responded by working closely on securing funding for the deployment of air and marine resources to the Caribbean. Operation GATEWAY's focused efforts led to a noticeable increase in drug seizures in the Caribbean.

Specially Designated Narcotics Traffickers (SDNT) Program

Because their activities posed an unusual and extraordinary threat to the national security, foreign policy and economy of the United States, President Clinton imposed sanctions against the Colombian drug cartels pursuant to Executive Order 12978 on October 21,1995, under the International Emergency Economic Powers Act (IEEPA). At that time, President Clinton named four Kingpins of the Cali cartel as the first specific targets of the sanctions. That sanctions program formed a key part of President Clinton's program against international organized crime, which he announced at the 50th anniversary session of the United Nations General Assembly on October 22, 1995. In his speech, the President observed that cooperation among nations is "[n]owhere . . . more vital than in fighting the increasingly connected groups that traffic in terror, organized crime, drug smuggling and the spread of weapons of mass destruction." President Clinton "call[ed] upon all nations to join us in the fight against them."

The IEEPA-based sanctions prohibit United States persons from financial or business dealings with nine drug kingpins of the Cali, North Valley, and North Coast drug cartels of Colombia, and more than 530 derivatively designated companies and individuals known as Specially Designated Narcotics Traffickers (SDNTs). The SDNTs, designated by Treasury's Office of Foreign Assets Control (OFAC) in consultation with the Justice and State Departments, are organizations or individuals that are owned or controlled by, act for or on behalf of, or materially assist or provide support to persons covered by the Executive Order. OFAC enforces the sanctions using the list of SDNTs as its principal tool. That list, often referred to as the "Clinton list" in Colombia, continued to grow throughout the Administration.

Using these powers, OFAC had increasing success in combating narcotics traffickers based in Colombia. From the start of the SDNT program on October 21, 1995 through December 7, 2000, OFAC, in consultation with Justice and State, expanded the SDNT list eleven times. The expansions from 1998 through 2000 reached beyond the Cali cartel to include the names of five other Colombian drug cartel leaders, thus increasing the drug kingpin total to nine. The businesses named as SDNTs included a drugstore chain, a supermarket chain, pharmaceutical laboratories, a clinic, hotel and restaurant service companies, radio stations, a communications company, poultry farms and distributors, construction firms, real estate firms, investment and financial companies, cattle ranches, and other agricultural businesses.

The SDNT list began with the four Cali cartel kingpins named by President Clinton -- Gilberto and Miguel Rodriguez Orejuela, Jose Santacruz Londono, and Helmer Herrera Buitrago -- and grew in five years to a list of nine Colombian drug kingpins from three cartels, 228 companies, and 311 other individuals involved in the ownership or management of the Colombian drug cartels' "legitimate" business empire. Many more actions resulting from this Presidential initiative were in progress as the year 2000 concluded.

After designation as an SDNT, all SDNT assets subject to U.S. jurisdiction were blocked, and the kingpins and the SDNTs were denied access to the U.S. financial system and to the benefits of trade with U.S. companies and individuals. Violations carried criminal penalties of up to $500,000 per violation for corporations and $250,000 for individuals, as well as imprisonment of up to 10 years. Civil penalties of up to $11,000 per violation could be imposed administratively.

Foreign Narcotics Kingpin Designation Act

On December 3, 1999, President Clinton signed into law the Foreign Narcotics Kingpin Designation Act ("the Kingpin Act"). This law was the result of legislation originally introduced by Senators Coverdell and Feinstein. The Kingpin Act established a program targeting the activities of significant foreign narcotics traffickers and their organizations on a worldwide basis. It provided a statutory framework for the President to impose sanctions against foreign drug kingpins when such sanctions are appropriate, with the objective of denying their businesses and agents access to the U.S. financial system and to the benefits of trade and transactions involving U.S. businesses and individuals. The Kingpin Act was modeled on the highly effective Specially Designated Narcotics Traffickers program that OFAC administered against the Colombian cartels under the authority of the International Emergency Economic Powers Act. OFAC was made the lead agency for implementation of the Kingpin Act.

During the spring of 2000, OFAC oversaw and coordinated with Justice, State, Defense, and the CIA the development of administrative records to support recommendations to the President for formal identification of significant foreign narcotics traffickers. On June 1, 2000, President Clinton identified 12 significant foreign narcotics traffickers or "Kingpins," located in Africa, Asia, the Caribbean, and Mexico. OFAC also coordinated the development of the statutorily required report that President Clinton delivered to Congress on July 1, 2000. President Clinton's classified report described the background on the 12 foreign drug kingpins and the resources allocated by different agencies to the Kingpin Act's implementation.

The Kingpin Act also established the Judicial Review Commission on Foreign Asset Control ("Commission") to review the current authorities relating to OFAC's blocking of foreign assets under economic sanctions programs. The Commission spent several months scrutinizing OFAC, and the issue of judicial review of OFAC actions. Its preliminary report went to Congress on December 4, 2000. The report, which was highly complimentary of OFAC, contained twelve recommendations to OFAC and Congress concerning OFAC and its programs.

Border Coordination Initiative

On September 29, 1998, Secretary Rubin joined Attorney General Reno, Deputy Attorney General Holder, Under Secretary Johnson, Customs Commissioner Kelly, and Immigration and Naturalization Service Commissioner Meissner in announcing the Southwest Border Coordination Initiative (BCI). The BCI, developed at the initiative of then-Under Secretary Kelly, was designed to improve cooperation between Customs and INS in several areas critical to effective Southwest Border enforcement. These efforts increased law enforcement effectiveness and facilitated trade by allowing faster processing of people and goods along the border. Bringing the goals of the BCI into focus, Secretary Rubin stated that "[b]ecause the criminal element is unyielding in its efforts to break through our borders, we must always search for ways to improve cooperation and achieve better results. By continuing to work together, Justice and Treasury will further strengthen our partnership in fighting the criminals who smuggle drugs across our borders, enforcing our laws, and protecting our borders."

General Counterdrug Intelligence Plan (GCIP)

The General Counterdrug Intelligence Plan (GCIP), issued on February 14, 2000, was the Administration's blueprint to streamline and enhance intelligence sharing and activities by Federal agencies with counterdrug responsibilities. Secretary Summers, as a member of the Executive Committee of the President's Council on Counter-Narcotics (PCCN), continued to support the effort to enhance counterdrug intelligence effectiveness and was one of eight Cabinet-level officials on the PCCN who submitted the final GCIP document to President Clinton on February 11, 2000. Deputy Assistant Secretaries Medina and Wehner were actively involved in the work of the Counterdrug Intelligence Coordinating Group (CDICG), which was comprised of representatives from 13 agencies involved in counterdrug intelligence activities, including the Treasury Department's Office of Enforcement, the U.S. Customs Service, and the Internal Revenue Service, Criminal Investigation Division.

U.S.-Mexico High Level Contact Group on Drug Control (HLCG)

At the initiative of Presidents Clinton and Zedillo, the HLCG was created on March 23,1996, to further bilateral cooperation in the struggle against drugs. At its first meeting on March 26-27, 1996, the HLCG agreed to produce a shared assessment of the drug problem in Mexico and the U.S., which was issued in May 1997. At their meeting on May 6, 1997, Presidents Clinton and Zedillo agreed to cooperate more closely to combat the problem of drugs and associated crimes. Both governments agreed to produce a common anti-drug strategy, which was released in February 1998.

The efforts of working groups created by the HLCG, and staffed by officials from Treasury Enforcement on the U.S. side, led to significantly increased cooperation between U.S. and Mexican authorities. For example, in January 2000, Under Secretary Johnson, a founding member of the HLCG, signed on behalf of the U.S., a memorandum of understanding between Treasury and Mexico's Finance Ministry on sharing information about cross-border currency and monetary instrument movements. This agreement paved the way for increased bilateral efforts

against money laundering and other financial crimes, and the formation of a bilateral anti-money laundering task force in Mexico City.

The binational HLCG working groups also developed the Binational Threat Assessment, published during President Clinton's visit to Mexico on May 5-6, 1997, and the Binational Drug Strategy, released by the HLCG on February 1, 1998. On February 1, 1999, the HLCG approved Performance Measures of Effectiveness to enable both nations to evaluate the binational drug strategy.

Plan Colombia

Treasury Enforcement played a key role in President Clinton's efforts to support the Government of Colombia in its fight against the debilitating effects of narcotics trafficking. Colombia had become the central focus of the United States' Western Hemisphere efforts to reduce the supply of illicit drugs.

Presidential Decision Directive 73, signed by President Clinton on August 4, 2000, established the coordination framework and assigned key agency roles and responsibilities for enhancing the U.S. effort to assist Colombia. This broad-scope support entailed significant efforts by many agencies throughout the U.S. government, including the Departments of State, Defense, Justice, and the Treasury, and the Office of National Drug Control Policy.

After April 1999, Treasury Enforcement became actively engaged in staff level interagency meetings on the future of U.S. relations with Colombia, focusing on the national security threat posed by narco-trafficking and associated criminal activity. On August 12, 1999, the first in a continuing series of interagency meetings was held to develop the programmatic goals that formed the basis for eventual emergency supplemental funding legislation. Treasury was represented by Policy Advisor Charles Garland.

On July 13, 2000, President Clinton signed into law a $1.3 billion assistance program for Colombia, which had received bi-partisan support in Congress. President Clinton clearly articulated America's commitment to Colombia during his trip to Colombia on August 30, 2000: "The United States has a strong interest in Colombia -- in the economic recovery of your country, in the conservation of your democracy, in the protection of human rights for the people of Colombia, and in your pursuit of peace, security, stability, not only for Colombia, but for the whole region, and, undoubtedly, in reducing the international drug trade. Meeting those objectives for us is what Plan Colombia is all about. It takes aim at all the interwoven challenges facing Colombia both in the economy and in the civil conflict, fighting drugs, defending human rights and deepening democracy. And as President Pastrana said, it is Plan Colombia -- a plan made by the leaders of Colombia for the people and future of Colombia." Treasury, led by Under Secretary Johnson, was heavily involved in interagency discussions regarding execution of Treasury's Plan Colombia responsibilities.

Counterterrorism and Sanctions

President Clinton directed considerable attention to the challenges posed by terrorism and weapons of mass destruction and to strengthening the Federal response to these threats. From the issuance of PDD-62, a classified document that outlines the Federal government's role in counterterrorism activities, to his use of the authorities provided by the International Emergency Economic Powers Act to impose sanctions on terrorists, President Clinton capitalized upon Treasury's capacity to prevent terrorist threats from developing into terrorist incidents.

During the Clinton-Gore Administration, Treasury was called upon to respond to a range of threats. The World Trade Center bombing, the bombing of the Murrah Federal Building in Oklahoma City, and the 1996 Olympic Park bombing in Atlanta were all examples of circumstances in which the efforts of Treasury personnel were critical to apprehending and convicting those responsible. Indeed, in the World Trade Center bombing investigation, an ATF agent recovered the critical piece of evidence from the bomb crater that led to prosecution of the offenders: the vehicle identification number from the vehicle used to transport the explosives.

In Oklahoma City, 168 citizens, mostly Federal employees, lost their lives in the single most deadly act of terrorism ever on American soil. Nine Treasury employees lost their lives in the line of duty. Immediately after the blast, Treasury agents rushed to the scene and entered the building to recover victims, commence the investigation, and comfort family members. Shortly after the explosion, Secretary Rubin attended the memorial service with President Clinton in Oklahoma City. Subsequently, when some agents on the scene reported that they too felt a need for assistance, Under Secretary Johnson tasked the Office of Enforcement with enhancing its Victim-Witness program to develop a response to the needs of law enforcement officers who must respond to difficult crime scenes.

A significant counter-terrorism accomplishment occurred in 1999 when Customs inspectors at Port Angeles, Washington, detected Ahmed Ressam attempting to smuggle into the United States a large quantity of explosive material hidden in his automobile. Although Ressam attempted to flee, he was apprehended by Customs officials and was charged with, among other things, Federal explosives and firearms-related offenses. It is believed that Ressam was part of an international effort to disrupt millennium eve celebrations with acts of terrorism.

Five-Year Counterterrorism Plan

The FY 1998 Department of Justice appropriations bill required the Attorney General to develop a five-year inter-departmental counterterrorism and technology crime plan to serve as a baseline strategy for the coordination of national policy and operational capabilities to combat terrorism in the United States and against American interests abroad.

In January 1998, representatives of Treasury's Office of Enforcement and the Treasury law enforcement bureaus began working with Justice to develop this plan. In February 1998, a Core Agency Group was established. Treasury was represented by Deputy Assistant Secretary Medina and Karen Wehner of Enforcement's Office of Policy Development, as well as representatives of the Secret Service, ATF, the Customs Service, and IRS-CID.

Among other things, the Group assessed the available counterterrorism measures and analyzed proposals for future action. Over the following ten months, a variety of counterterrorism issues were evaluated and numerous programs and initiatives were identified to combat the terrorist threat. The plan was completed in December 1998 and was forwarded to Congress on December 30, 1998. In the following years, the participating agencies analyzed their progress on the programs and initiatives. This information was then consolidated into an update of the plan, which was also forwarded to Congress.

Weapons of Mass Destruction

On February 11, 1999, Under Secretary Johnson testified before members of the Commission to Assess the Organization of the Federal Government to Combat Proliferation of Weapons of Mass Destruction (the Commission) regarding Treasury's numerous WMD-related activities. On July 14, 1999, the Commission issued its findings and recommendations. On that same day, President Clinton directed National Security Advisor Samuel Berger to coordinate an interagency review and assessment of the Commission's recommendations. Treasury Enforcement participated in this process. Indeed, two of the Commission's recommendations related directly to the Customs Service's prevention of WMD smuggling into the U.S., and both were favorably received by Customs and Treasury.

Specially Designated Terrorists

On January 23, 1995, President Clinton, under the authority of the International Emergency Economic Powers Act ("IEEPA"), signed an Executive Order entitled "Prohibiting Transactions With Terrorists Who Threaten To Disrupt the Middle East Peace Process." He stated that "Grave acts of violence committed by foreign terrorists that disrupt the Middle East peace process constitute an unusual and extraordinary threat to the national security, foreign policy, and economy of the United States." In his January 24, 1995, State of the Union address, President Clinton described this Executive Order as a powerful new tool to combat fundraising in the United States by "block[ing] the assets in the United States of terrorist organizations that threaten to disrupt the peace process. It prohibits financial transactions with these groups." This Executive Order became effective on January 24, 1995.

In the annex to the Executive Order, President Clinton designated twelve foreign organizations as terrorist organizations that threatened to disrupt the Middle East peace process. Immediately following the President's action, the Department of the Treasury's Office of Foreign Assets Control (OFAC), in consultation with the Departments of State and Justice, identified 31 pseudonyms for the 12 principal terrorist organizations, and it designated 18 individuals as Specially Designated Terrorists (SDTs) because they were leaders or senior officials of the 12 terrorist organizations. These designations, which were approved by then-Acting Secretary Frank Newman, included both Palestinian and other Arab terrorist groups, as well as an extremist Israeli group. This was a landmark in the use of a sanctions designation program against a non-state foreign threat.

On August 20, 1998, following the bombings of the U.S. embassies in Kenya and Tanzania, the President, again under the authority of IEEPA, signed an order adding four additional names as terrorists who threaten to disrupt the Middle East peace process. Through this action, President Clinton designated Osama bin Ladin, his organization, al-Qa'ida, and two lieutenants, Abu Hafs al-Masri and Rifa'i Ahmad Taha Musa, as Middle East terrorists. Through 2000, a total of 13 organizations and 24 individuals have been named as SDTs.

Antiterrorism and Effective Death Penalty Act

On April 24, 1996, President Clinton signed the Antiterrorism and Effective Death Penalty Act of 1996 ("Antiterrorism Act") in part to prevent persons within the U.S. or those subject to the jurisdiction of the U.S. from providing material support or resources to Foreign Terrorist Organizations ("FTOs"). On October 8, 1997, OFAC issued the Foreign Terrorist Organizations Sanctions Regulations to implement the sections of the Antiterrorism Act that concern the designation of FTOs and fundraising prohibitions. Under the Antiterrorism Act, financial institutions subject to U.S. jurisdiction must maintain control over all funds in which an FTO has an interest, block financial transactions involving FTO assets, and file reports consistent with Treasury regulations. U.S. persons are prohibited from providing material support or resources to FTOs, or to attempt or conspire to do so.

Under the Antiterrorism Act, designations of FTOs were made by the Secretary of State after consultation with the Attorney General and the Secretary of the Treasury. Secretary Albright, in consultation with Treasury and Justice, designated 30 organizations as FTOs on October 8, 1997. Two years later, on October 8, 1999, 28 foreign organizations were designated as FTOs (27 renewals and one new FTO). On September 25, 2000, with Secretary Summers' concurrence, Secretary Albright designated the Islamic Movement of Uzbekistan as another FTO for a total of 29 FTOs through 2000.

Taliban Sanctions

On July 4, 1999, President Clinton, under the authority of the International Emergency Economic Powers Act, signed an Executive Order entitled, "Blocking Property and Prohibiting Transactions With the Taliban." The President found that "[t]he actions and policies of the Taliban in Afghanistan, in allowing territory under its control in Afghanistan to be used as a safe haven and base of operations for Osama bin Laden and the Al-Qaida organization who have committed and threaten to continue to commit acts of violence against the United States and its nationals, constitute an unusual and extraordinary threat to the national security and foreign policy of the United States." This Executive Order became effective on July 6, 1999. In the annex to this order, President Clinton designated Mohammed Omar (Amir al-Mumineen (Commander of the Faithful)), the effective ruler of Afghanistan, as a blocked Taliban leader.

Combating Forced Child Labor

The Clinton-Gore Administration fought hard to prevent trade in goods produced by forced child labor. In his 1998 State of the Union address, President Clinton urged the international community to join the United States in the fight against "the most intolerable labor practice of all -- abusive child labor." Subsequently, in 1999, Treasury chartered the "Treasury Advisory Committee on International Child Labor Enforcement." Assistant Secretary Bresee chaired the Committee, which was made up of distinguished child labor experts from the human rights and worker rights communities and from industry.

The Committee focused on issues relating to compliance by industry with Federal law prohibiting the importation of goods produced with forced or indentured child labor. As part of this effort, Treasury drafted a Customs Advisory to help importers identify merchandise produced with forced or indentured child labor. The Advisory, which was released on January 16, 2001, specified the types of working conditions that could, in the view of the Customs Service, signal the presence of forced or indentured child labor. It presented two sets of indicators, "red flags" and "yellow flags," that businesses could use in seeking to determine whether specific merchandise was likely to be prohibited from importation on those grounds. The Advisory also summarized the law prohibiting the importation of goods made with forced or indentured child labor and provided information on steps businesses can take to help ensure that they comply with the law, including the use of monitoring firms.

G-7 Customs Data Harmonization

At the initiative of the Clinton-Gore Administration at the Lyon Summit in 1996, the G-7 countries agreed to harmonize data required by customs administrations for processing international trade and developing standard electronic messages for submission of data. By the end of 2000, this work was nearly complete. The goal of the agreement on standard data and electronic messages was to greatly reduce the cost of trading across borders and enhance the ability of governments to administer laws applicable to international trade.

On March 20, 1996, Customs Commissioner George Weise wrote to then-Deputy Assistant Secretary Bresee, recommending that a discussion of a model for customs processing developed by the International Chamber of Commerce be included on the agenda for the upcoming G-7 summit. Although many of the recommended customs procedures had already been adopted by G-7 customs administrations, the value of the G-7 forum in advancing customs reform was recognized, and Treasury staff prepared a proposal that the G-7 countries commit themselves to harmonization of data requirements and development of standard electronic messages.

On May 9, 1996, Assistant Secretary for Enforcement Johnson wrote to Secretary Rubin proposing three issues for the agenda of the G-7 summit in Lyons, France. He noted that "members of the [G-7] have different requirements and procedures for processing customs documentation and routinely require such information to be provided on paper. We propose that the [G-7] initiate an effort to harmonize customs documentation and standards for electronic

transmission of such documentation. If successful, this could accelerate processing and lower some costs of international trade."

On June 6, 1996, Secretary Rubin wrote to his counterparts in the G-7 countries to outline U.S. views on four major issues that the U.S. had proposed for the agenda of the G-7 summit in Lyon, and to urge their governments to support the U.S. objectives. His letter stated "[w]e have also proposed that the G-7 authorities take the lead in harmonizing trade documentation and electronic transmission standards. This is a promising area in which we can use new technology to facilitate trade, and I think it merits our encouragement."

On June 28, 1996, President Clinton and the other G-7 heads of state and government issued a communiqué, announcing the results of the summit meeting. In paragraph 25, the leaders announced that "[i]n order to facilitate the free flow of trade, we will initiate an effort to further standardize and simplify customs procedures among our countries. Uniform documentation and electronic transmission standards would reduce costs for business and government, complement efforts in the WTO by eliminating barriers to trade and development, and so promote growth."

During the second week of March 1997, representatives of each of the G-7 nations met in Washington, with the U.S. representative in the chair, to lay plans for undertaking the work mandated by the summit statement. They formed a technical working group to begin the effort of harmonization and an experts group to oversee the work of the technical group and to provide policy guidance.

At the 1997 G-7 summit in Denver, the heads of state and government issued, on June 21, a statement noting that "[i]n Lyon we initiated an effort to standardize and simplify customs procedures. We urge our experts to complete their work in the next year and report prior to our next meeting on their efforts to standardize both the data required by customs and other related administrations to carry out their responsibilities and the form in which data are to be reported electronically, and to reduce data requirements to a minimum consistent with effective administration of customs responsibilities. On September 15, 1997, then-Deputy Secretary Summers wrote to his G-7 counterparts asking that they designate officials of their governments to organize each government's efforts to address the data requirements of government agencies (other than customs administrations) that regulate international trade.

Work advanced steadily after the Denver summit, although achievement of objectives took longer than expected. By the end of 2000, formats for standard electronic customs messages were in place covering both merchandise and carriers. The G-7 customs administrations were expected to build on this success by working together to implement the new messages, and to simplify further the requirements for data reporting and record-keeping. By 2000, health and agriculture safety agencies (in the United States the FDA, the Animal and Plant Health Inspection Service, and the Food Safety Inspection Service) were working toward the same objective.

Harmonization of data requirements and electronic messaging standards will significantly reduce cost and complexity for businesses, and will enhance the ability of governments to cooperate with each other on trade regulatory issues.

IV. Reforming, Enhancing, and Defending Treasury Law Enforcement

During the Clinton-Gore Administration, Treasury Enforcement faced a number of significant challenges. From the events at Waco, Texas and their aftermath to reforms at the Federal Law Enforcement Training Center, Treasury consistently sought to convert problems and obstacles into opportunities to improve the law enforcement capacity of the Federal Government.

This section discusses Treasury's most important efforts to reform and enhance the Department's law enforcement capabilities, and to ensure that Treasury enforcement personnel maintained the highest standards of professionalism and reflected the diversity of the communities that they served.

Review of ATF Operation at Waco

On February 28, 1993, the Branch Davidian sect, led by David Koresh, fired upon ATF special agents as they attempted to execute lawful search and arrest warrants at the Mt. Carmel compound near Waco, Texas. Four ATF agents were killed and a number of agents were wounded in the ambush. Following the ambush, a 51-day standoff ensued between the Branch Davidians and agents of the Federal Bureau of Investigation, who had subsequently surrounded the compound. The stand-off ended tragically on April 19, 1993, when the Branch Davidians set fire to the compound, killing all 76 people who were on the premises. Following the standoff, ATF Director Stephen E. Higgins resigned, and Secretary Bentsen appointed then-Secret Service Director John McGaw to head the ATF.

On April 29, 1993, at the request of President Clinton, Secretary Bentsen established the Waco Administrative Review to examine ATF's actions at Mt. Carmel. Over the next five months, then-Assistant Secretary for Enforcement Noble headed an interagency team, assisted by three independent law enforcement experts, which conducted a comprehensive review of ATF's law enforcement operation at Waco and the adequacy of ATF's procedures, policies and practices.

On September 30, 1993, Secretary Bentsen submitted to President Clinton the "*Report of the Department of the Treasury on the Bureau of Alcohol, Tobacco and Firearms Investigation on Vernon Wayne Howell also know as David Koresh.*" Treasury and ATF officials, including Secretary Bentsen, subsequently testified before Congress about the Waco operation and the findings of the Treasury Report. The Treasury Report was praised for its accuracy and the thoroughness of its factual determinations and conclusions. Treasury's critical and candid assessment of ATF's Waco operation resulted in numerous improvements in ATF and Treasury law enforcement programs. In announcing the report to the American public, Secretary Bensten said, "[w]hat this proves is an agency with an excellent record, with expertise, with good people, can make a mistake. Any agency, including this one. Then the job is to set out to correct those things, to see that they do not happen again. I know that what you saw in Los Angeles, that what you saw in Philadelphia with MOVE, that those things, what happened there taught other enforcement agencies to make changes in their procedures."

In 1994, seven Branch Davidians who were present at the Mt. Carmel compound on February 28, 1993, were convicted in Federal district court on various charges including manslaughter, using or carrying a firearm during a conspiracy to murder Federal officers, and/or possession of an explosive grenade. One other Branch Davidian was convicted of conspiring to illegally possess and manufacture machine guns and aiding and abetting the illegal possession of machine guns. Those convicted ultimately received five-year prison sentences.

On September 20, 2000, following a Federal court trial of the civil suits brought by surviving Branch Davidians and relatives of deceased Davidians, the District Court found—as had the Treasury Report—that the Davidians initiated the gun battle on February 28, 1993, and that ATF agents did not use excessive force in attempting to execute search and arrest warrants. The court also found that the FBI was not negligent on April 19, 1993, in connection with the attempt to end the standoff or with respect to the fire.

Defense of ATF

During the tenure of the Clinton-Gore Administration, Treasury responded to several recommendations to abolish the ATF and move its functions to other Treasury law enforcement bureaus or to the Department of Justice. After each of these recommendations was seriously studied, the conclusion was reached that the best and most reasonable course of action was to keep ATF as a separate law enforcement agency within Treasury.

The first such recommendation came from within the Administration itself. On September 7, 1993, Vice-President Gore's National Performance Review (NPR) recommended merging the enforcement functions of ATF into the FBI, and ATF's revenue and regulatory functions into the IRS. There was also a great deal of discussion on Capitol Hill about disbanding ATF after the tragic events at the Branch-Davidian compound outside of Waco, Texas. Many in Congress questioned why ATF should remain a separate agency and why ATF's enforcement functions would not be better served in the Department of Justice. Secretary Bentsen, at a press conference on September 30, 1993, responded to questions regarding the NPR's proposal to disband ATF. He stated, "I'm quite willing to examine the proposal under the National Performance Review and see what can be worked out in that regard. The one thing I want to have ensured is that the expertise, the kind of experience that is shown by this agency and ATF, the things that they've been able to do, that that be preserved."

After studying the information provided by Treasury Enforcement and ATF, including an October 1995 report entitled "*ATF's Function and Role within the Department of the Treasury,*" the National Performance Review recognized that it made sense for ATF to remain a separate and distinct law enforcement bureau within the Treasury Department. The NPR dropped its recommendation to disband ATF by the time it issued its 1995 report.

Treasury also dealt with a similar recommendation made by the Commission for the Advancement of Federal Law Enforcement. The Commission, which was chaired by former FBI Director William Webster, and charged with a comprehensive review of Federal law enforcement, recommended that the ATF and DEA be merged into the FBI. "The risks and probabilities of our experiencing major terrorist threats continue to grow," Webster told the

Senate Judiciary Committee's Subcommittee on Criminal Justice Oversight on February 4, 2000. "These suggestions have been made before, but there is increased urgency that they be considered due to terrorism and global crime. It is not an effort to aggrandize one agency over another . . . but to create less confusion and more effective results."

In responding to the report, Secretary Summers and Attorney General Reno issued a joint statement stating, "Combining the diverse authorities of ATF and DEA into the FBI would seriously dilute the focus on specialized enforcement areas, which require detailed knowledge and a high level of expertise. For these reasons, we strongly oppose the recommendation of the commission to merge ATF and the DEA into the FBI." The report received very little support on Capitol Hill.

Under the guidance of Treasury's Office of Enforcement, ATF has remade itself in a way that ensures its continued existence. This success was reflected in President Clinton's strong support for 500 additional ATF agents and its significant budget increases for fiscal year 2001.

White House Security Review and Closure of Pennsylvania Avenue

On September 12, 1994, after a small plane crashed on the White House grounds, Secretary Bentsen directed Under Secretary Noble and Secret Service Director Eljay Bowron to undertake a review of White House security. After a shooting in front of the White House the following month, the Review was expanded to include this incident.

The Review Team was assisted by an Advisory Committee, chaired by Under Secretary Noble. The Advisory Committee was comprised of six highly regarded professionals, who were tasked to ensure that the study was conducted in an objective manner and that its recommendations were sound. The Review took eight months and culminated in both classified and public reports to Secretary Rubin in May 1995.

On May 20, 1995, based on the Review's work and conclusions, Secretary Rubin ordered that the Secret Service close Pennsylvania Avenue between 15th and 17th Streets, NW, to vehicular traffic. Since that time, there have been persistent calls for Pennsylvania Avenue's reopening. In 2000, the Federal City Council, a non-partisan group of business and civic leaders, unveiled a proposal for reopening the thoroughfare. The proposal, which was based on a study by the Rand Corporation, did not fully address the ongoing security concerns underlying the 1995 closure. As a result, the closure of Pennsylvania Avenue remained in effect at the end of the Administration.

Good O'Boys Roundup Review

On July 17,1995, Treasury responded to allegations that its enforcement agents, among others, participated in "Good O'Boys Roundups" held annually in Tennessee from 1980 to 1995. Among other things, the allegations related to racist activities and statements at the Roundups, focusing in particular on African Americans.

In light of the serious nature of the allegations, Secretary Rubin announced on July 17, 1995 that a comprehensive and independent investigation would be conducted by the Department's Inspector General and Under Secretary for Enforcement. On July 21, 1995, Under Secretary Noble testified before the Senate Judiciary Committee regarding the Roundups and stated that the Department was committed to ensuring that this issue would be fully examined and appropriate action taken.

On April 2, 1996, Secretary Rubin announced completion of the Inspector General's investigation and the Office of Enforcement's Policy Review. The announcement included seven follow-up actions, including policy recommendations relating to racism and bias in hiring, training, evaluation, and discipline. Treasury's law enforcement bureaus subsequently worked to ensure that these recommendations were fully carried out.

White House Commission on Aviation Safety and Security

On July 25, 1996, following the crash of TWA 800, President Clinton announced the formation of a commission to examine, among other things, the changing air travel security threat and how to address it. On August 22, 1996, President Clinton issued Executive Order 13015 directing the formation of a White House Commission on Aviation Safety and Security, to be chaired by Vice President Gore. Then-Under Secretary Kelly represented Treasury on the Commission.

The Commission's recommendations included: expanding the use of bomb-sniffing dogs; using the Customs Service to enhance security; providing comprehensive detection training to law enforcement, FAA and airport personnel; and creating a central clearinghouse within the government to provide information on explosives crimes. These recommendations were reflected both in the Commission's initial report, issued on September 9, 1996, and its final report, issued on February 12, 1997.

Federal Law Enforcement Training Center Reforms

In July 1997, then-Under Secretary Kelly directed a review and organizational assessment of management processes and practices at the Federal Law Enforcement Training Center (FLETC). As a result of that review, a number of important reforms were put into place under the leadership of FLETC's new Director, Ralph Basham. These included implementing a major reorganization with an increased focus on FLETC's primary training mission, increasing EEO awareness and training, strengthening FLETC's Safety and Environmental Division, and overseeing the creation of the FLETC Employee Development Services program. As a result of this major initiative, FLETC emerged as a stronger and sounder organization.

Customs Integrity Review

The Treasury and General Government Act of 1998 directed the Under Secretary for Enforcement to conduct a "comprehensive review of integrity issues and other matters related to the potential vulnerability of the U.S. Customs Service to corruption, to include an examination of charges of professional misconduct and corruption as well as an analysis of the efficiency of departmental and bureau internal affairs systems." Treasury Enforcement's Office of

Professional Responsibility (OPR) was tasked by then-Under Secretary Kelly with conducting this review. Under Secretary Johnson issued the Review's final report of findings and conclusions, entitled *"An Assessment of Vulnerabilities to Corruption and Effectiveness of the Office of Internal Affairs, USCS,"* on February 9, 1999. The Report identified many of the problems faced by Customs' Office of Internal Affairs and made numerous recommendations to strengthen the integrity and reduce the potential vulnerability to corruption of the Customs Service.

OPR's recommendations resulted in a number of improvements, including certain organizational changes, an increase in the number of training hours for agents and inspectors in integrity and ethics, corruption awareness and prevention, and the establishment of a Discipline Review Board. In his new capacity, Customs Commissioner Kelly (former Under Secretary Kelly had become Commissioner in August 1998) embraced, adopted, and built upon the Review's recommendations.

Customs Personal Search Initiative

In July 1998, in response to allegations that some Customs Service officers had used methods that involved bias when selecting passengers for personal searches at airports, Treasury and Customs moved to remedy improprieties and to establish new mechanisms to help prevent such problems from occurring in the future. Customs used internal and external focus groups to analyze problems with its personal search program, and to make recommendations for solving those problems. As a result of these efforts, Customs adopted a new Personal Search Handbook, trained almost 10,000 Customs inspectors and other officers on the new policy, and implemented a wide variety of measures (for example, stricter management oversight of the decision to conduct a personal search) to ensure that individual rights are protected at the border.

In July 1998, then-Under Secretary Kelly also directed Enforcement's Office of Professional Responsibility to initiate a national review of the Customs passenger enforcement targeting program. On June 30, 1999, Under Secretary Johnson issued to Customs OPR's memorandum on Customs Passenger Enforcement Targeting, which recommended that Customs conduct regular, periodic reviews of search techniques and criteria, collect data on the searches conducted, provide additional professionalism training to inspectors, develop a national complaint system, and develop a national program to educate the public about searches. These measures helped Customs successfully address criticisms of its personal search program. At the end of the Clinton Administration, even though the number of Customs personal searches were 60% lower than in 1999, Customs was interdicting 20% more hard drugs through improvements in personal search targeting.

Establishment of International Law Enforcement Academies (ILEAs)

ILEAs are a cooperative effort between the Departments of State, Justice, and Treasury designed to train foreign law enforcement personnel and thereby, among other things, support emerging democracies, help protect U.S. interests through international cooperation, promote social, political and economic stability, and address common problems associated with criminal activities. Under Secretary Johnson served on the ILEA Policy Board, which was comprised of

members from each department, and which provided guidance on and decided all significant matters affecting present and future ILEAs. Encouraged by the success of the ILEA in Budapest, in May 1997, President Clinton announced that an ILEA for Latin America (ILEA South) would be established in that region.

In January 1999, to support criminal justice institution building and to strengthen partnerships among countries in Asia, an ILEA was established in Bangkok, Thailand. By 2000, plans were well-underway for an ILEA in Botswana, which would provide African law enforcement personnel with opportunities for exposure to and training by United States law enforcement personnel.

Interagency Commission on Crime and Security in U.S. Seaports

On April 27, 1999, President Clinton signed a Presidential Memorandum directing the Secretary of the Treasury, the Attorney General, and the Secretary of Transportation to establish the Interagency Commission on Crime and Security in U.S. Seaports. Led by Assistant Secretary Bresee and Deputy Assistant Secretary Wehner, Treasury took the lead in establishing and implementing the Commission.

After consultations among the three departments and with White House staff, it was determined that the Commission would be co-chaired by Customs Commissioner Kelly, Assistant Attorney General James Robinson, and Administrator Clyde Hart of the Transportation Department's Maritime Administration. Assistant Secretary Bresee was Treasury's representative on the Commission.

On May 8, 2000, the Commission issued its report, which set forth an assessment of the nature and extent of serious crime in seaports, the overall state of security, an overview of the specific mission and authorities of Federal agencies, roles of state and local agencies, the effectiveness of coordination efforts, and made recommendations for improving the response of Federal, state and local governments to the problem.

Following review by the three departments, and a Commission briefing for Secretary Summers, the report was forwarded to the White House and to the Office of Management and Budget for review and implementation.

Fairness in Law Enforcement

On June 9, 1999, President Clinton issued an Executive Order entitled "*Fairness in Law Enforcement: Collection of Data,*" directing the Secretary of the Treasury, the Attorney General, and the Secretary of the Interior to design and implement a system "to collect and report statistics relating to race, ethnicity, and gender for law enforcement activities." Thereafter, at the direction of Under Secretary Johnson, Deputy Assistant Secretary Karen Wehner convened a departmental working group to formulate Treasury's data collection project and field testing plan. The working group consisted of representatives from ATF, the IRS, Customs, and the Secret Service.

In accordance with the President's Directive, on October 9, 1999, the Office of Enforcement submitted Treasury's data collection field test proposal to the White House Domestic Policy Council. The Attorney General and the White House approved Treasury's data collection proposal, which enabled the Secret Service and the Custom Service to collect data on race, gender, and ethnicity on such actions as traffic stops, pedestrian stops, and more extensive inspections or interviews than are customarily conducted with entrants to the United States. This data assisted Treasury and all of its bureaus in refining their policies and training to prevent racial profiling and other prohibited discriminatory actions.

Strengthening Treasury Law Enforcement Personnel

During President Clinton's tenure, several important measures were instituted to enhance the professionalism and diversity of Treasury law enforcement personnel.

In the aftermath of the Waco tragedy, the White House plane crash and shooting, and the Good O' Boys Roundups, Treasury Enforcement turned to outside staff and contractors to ensure that the reviews of those events were conducted in the most objective and impartial manner possible and that appropriate remedial actions were determined. As a result, several steps were taken to enhance the effectiveness of the Office of Enforcement and to provide more meaningful oversight of the Treasury law enforcement bureaus.

On December 10, 1994, the head of the Office of Enforcement was elevated from an Assistant Secretary to the Under Secretary level. This critical step assured that law enforcement issues would have a higher profile within the Department. Additionally, the need to expand the staff of the office was recognized. The Office of Policy Development (OPD) was the first new component to be formalized within Enforcement. Originally composed of only four staff members, OPD expanded over the last five years of the Administration to include a Deputy Assistant Secretary, an Office Director, eight staff members and four bureau policy liaisons. OPD served as the main policy component of Enforcement. It developed initiatives, coordinated policies among the bureaus, and consulted with counterparts at other departments. The staff worked on many high-profile issues including firearms trafficking, money laundering, drug trafficking, counterfeiting, and terrorism.

To further assist the Under Secretary in his oversight of the Treasury law enforcement bureaus, the Office of Professional Responsibility was established within the Office of Enforcement in January 1998. The staff consisted of an Office Director, senior advisors for each of the law enforcement bureaus and offices (including the Office of Foreign Assets Control and the Financial Crimes Enforcement Network (FinCEN)), as well as advisors for training, inspection, internal affairs, equal employment opportunity, and Organized Crime Drug Enforcement Task Force (OCDETF). The staff reported to the Deputy Assistant Secretary (Law Enforcement).

Under Secretary Johnson sought and obtained special hiring authorities for ATF and the Customs Service. On July 6, 2000, President Clinton signed an Executive Order on Schedule B Hiring Authority and the Federal Career Intern Program to provide new and more effective ways of attracting exceptional men and women to the Federal workforce. Implementing regulations were issued on December 14, 2000. The Federal Career Intern Program was designed to attract

exceptional men and women to the Federal workforce at the GS-5 to GS-9 level. In tandem with Schedule B hiring authority, this hiring flexibility addressed the staffing needs of Treasury's law enforcement bureaus by shortening the time required to hire new employees. Prior to these measures, the law enforcement bureaus on average had required more than one year to hire a new agent. A shorter hiring time frame was needed to compete with the private sector, as well as government agencies with excepted service hiring authority, such the FBI and the DEA.

CHAPTER SIX

E-COMMERCE AND TECHNOLOGY INITIATIVES

Introduction

When President Clinton and Vice President Gore took office in January 1993, there were fewer than 1,000 web sites on the Internet. By 1997, 19 million American were using the Internet. Three years later that number had multiplied by six with roughly 40 percent of American households wired to the Internet.[1] A report from the University of California released in October 2000 showed that the Internet has become the fastest growing electronic technology in world history. In contrast to the speed with which the Internet spread, it took 46 years for electricity to reach 30 percent of American homes and 38 years before telephones reached a similar proportion of American households.[2]

The explosive development of the Internet presented enormous challenges for the Administration. In framing its response, the Administration and Treasury recognized that e-commerce and e-finance would become the building blocks of the 21st century economy. As a consequence, Treasury helped pioneer a policy response that was designed to encourage the development of e-commerce and technology wherever possible by devising prudent ways of reducing regulatory and market barriers to e-commerce and promoting the development of electronic payment systems.

At the same time, Treasury worked to ensure that the new technology would benefit businesses and consumers alike, by working to minimize the potential risks that the new technology posed to the financial system and to the economy as a whole. This chapter is divided into three sections: first, Treasury's initiatives to encourage the development of e-commerce; second, using new technology to improve the efficiency and responsiveness of Treasury and the Federal Government; and third, adapting the tax system to the new world of e-commerce.

I. Encouraging Electronic Commerce

Treasury recognized that new technology could provide enormous benefits to both businesses and consumers by facilitating greater speed, efficiency, and transparency in commercial transactions. To that end, it sought to create the legal and regulatory safeguards that were necessary to engender business and consumer confidence in e-commerce. This involved providing the same legal certainty for online transactions as offline transactions; taking the lead in helping to develop a secure and credible electronic payments system; and, taking steps to protect the Internet from cyber-terrorism and other threats.

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[1] United States, Department of Commerce, Falling Through the Net: Toward Digital Inclusion. A Report on Americans' Access to Technology Tools, October 2000.
[2] The UCLA Internet Report. Surveying the Digital Future. October 2000. www.ccp.ucla.edu

Enactment of Digital Signatures Legislation

The Treasury, working with the Commerce Department and the National Economic Council, played a lead role in the development of so-called "digital signatures" legislation. Treasury's efforts were lead by Under Secretary for Domestic Finance Gary Gensler, Assistant Secretary for Financial Institutions Greg Baer, and Deputy Assistant Secretary Michael Beresik, with the assistance of Deputy Assistant Secretary for Legislative Affairs Marne Levine. The Administration's efforts culminated with the enactment of the "Electronic Signatures in National and Global Commerce (E-SIGN) Act," which President Clinton signed into law on June 30, 2000.[3]

E-SIGN represented a major achievement in promoting electronic commerce by ensuring the legal validity of electronic records and transactions. In particular, it contained provisions that ensure the legal validity of electronic signatures and contracts, permit the electronic delivery of legally required notices and disclosures, and allow for the satisfaction of record retention requirements through electronic means. Thus, the Act allowed for truly paperless business-to-business transactions, and also provided legal certainty for electronic records such as mortgage notes, which would foster the development and acceptance of fully electronic financial products.

E-SIGN was also technology-neutral, allowing contracting parties to choose the technology for authenticating their transactions without government intervention, thereby encouraging innovation and cost reduction. Finally, the Act ensured that on-line consumers have legal protections equivalent to those in the off-line world, and did not diminish the protections offered by any Federal or State law relating to the rights of consumers. Consumers retain the choice to do business and receive records on paper or on-line.

Encouraging the Development of New Electronic Payments Mechanisms

During the Clinton Administration, Treasury also faced the challenge of adapting pre-Internet payments systems to the new world of e-commerce. Given the limited usefulness of many of the old payments methods and the fact that they were connected to pre-Internet institutions and practices, this was a particularly important challenge.

The Treasury Department and its regulatory bureaus worked to identify provisions of law and agency regulations that may impose a barrier to electronic transactions or otherwise impeded e-commerce. For example:

- In 1995, the Office of the Comptroller of the Currency (OCC) undertook a comprehensive review of its interpretations, supervisory guidance and regulations to search for areas in which those rules might serve as an impediment to the conduct of electronic activities by national banks. In February 2000, the OCC formally requested public comment about laws and regulations that impose barriers to safe and sound bank participation in electronic activities. This information helped the OCC to determine which regulations and interpretive positions should be revised to facilitate and support emerging lines of business and the use of technology in banking, and eliminate needless barriers. In 1999, the OCC unveiled National

[3] Pub. L. No. 106-229, 114 Stat. 464.

BankNet -- an extranet web sit available exclusively to national bankers. OCC anticipated that, over the next few years, the majority of routine transactions between the OCC and national banks will be capable of being conducted electronically over BankNet.

- The Office of Thrift Supervision (OTS) also worked to identify legal or regulatory barriers to e-commerce. In 1997, the OTS asked for input on whether its existing regulations impeded savings associations' appropriate use of advancing electronic banking technology. On January 1, 1999, an OTS rule became effective that streamlines and updates its regulations relating to electronic operations. Under this rule, Federal savings associations may engage in prudent innovation through the use of emerging technology. The rule permits Federal savings associations to use, or participate with others to use, electronic means or facilities to perform any function, or provide any product or service, as part of an authorized activity.

Most recently, with the encouragement of Deputy Secretary Eizenstat, Treasury held a conference in September 2000 to promote developments in this area by looking at new payments technologies and how they could encourage the spread of e-commerce.

The conference brought together leaders from the technology and financial communities to address policy issues ranging from data security to personal privacy, and to discuss how to address these concerns without creating new obstacles to e-commerce. Deputy Secretary Eizenstat and Under Secretary Gensler opened the conference, with industry panels coordinated and led by Assistant Secretary Baer, Fiscal Assistant Secretary Hammond, and Deputy Assistant Secretary Beresik.

Critical Infrastructure Protection

The development of e-commerce was regarded as critically dependent on the reliability, integrity, and security of the information systems of the nation's banking and finance sector. Any degradation or destruction of this information infrastructure was certain to erode users' confidence, impeding or halting the transition to e-commerce. Intentional criminal or terrorist acts designed to exploit information system vulnerabilities in the banking and finance sector could be especially damaging to e-commerce.

The Report of the President's Commission on Critical Infrastructure Protection, issued in October 1997, and the subsequent Presidential Decision Directive 63 (PDD63) identified banking and finance as a sector of the nation's economy critical to national well being, and one that was increasingly dependent on computer and information systems. The Commission recommended a comprehensive program based on public-private partnerships and information sharing to protect banking and finance as well as other critical infrastructures against cyber and other threats.

PDD 63 assigned Treasury as the "lead agency" responsibility for working with the banking and finance sector of the economy. The primary goal of PDD 63 was the creation of private sector information sharing and analysis centers (ISACs) to identify information system threats, incidents, and vulnerabilities, and to the extent possible provide ISAC members with *ex ante* defensive measures.

Led by then-Deputy Assistant Secretary and later Assistant Secretary Greg Baer, Treasury worked with banking and finance industry leaders to establish the Financial Services Information Sharing and Analysis Center (FS/ISAC). The FS/ISAC (http://www.fsisac.com), a limited liability company where owners/members could anonymously share real-time information about cyber threats, opened for business in October 1999. As of November 2000, the FS/ISAC had forty members, including some of the largest banks, securities firms, insurance companies, and investment companies in the country.

The FS/ISAC gained public notice for protecting its members from the distributed denial of service (DDOS) attacks that shut down numerous Internet companies in February 2000, and for its performance during the serious attack of the "I Love You" computer virus in May 2000. At the end of 2000, cyber incidents such as these were growing in frequency and economic severity.

On May 18, 2000, in testimony before the Subcommittee on Financial Institutions of the Senate Banking Committee, the General Accounting Office cited the FS/ISAC as one of the best-performing of the various current public and private mechanisms intended to provide alerts and countermeasures to its members to defend themselves and the financial system against information system threats and incidents.

II. Adapting Government and Treasury to New Technology

The Treasury Department recognized that new technology could significantly improve the ability of government to raise efficiency levels, provide better customer service, and provide more value for money to taxpayers. As a result, Treasury was in the forefront of moving the Federal government into the world of e-commerce and e-government, especially in the areas of electronic payments and collections, electronic transactions, and electronic commerce infrastructure and security.

Led by Fiscal Assistant Secretary Don Hammond, Commissioner Dick Gregg of the Financial Management Services, and Commissioner Van Zeck of the Bureau of Public Debt, Treasury implemented important initiatives to improve government service and efficiency through the use of new technologies. Treasury also used the Internet to make government securities, including Savings Bonds, more readily accessible to institutional and retail investors alike.

Electronic Payments and Collections

Electronic payments and collections have substantial advantages over paper-based transactions, including reduced manual processing, greater accuracy, more timely transactions, better coordination of information, and substantially reduced costs. On April 26, 1996, the President signed the Debt Collection Improvement Act of 1996, part of the Omnibus Consolidated Rescissions and Appropriations Act of 1996 (P.L. 104-134) that mandates the use of electronic funds transfer (EFT) for Federal payments. This law applies to all payments made by Federal agencies that are disbursed by the Department of the Treasury or those agencies with delegated or statutory disbursing authority. This legislation had a major impact on the way the Federal government makes payments. In FY 2000, the Federal Government paid 79 percent of its 966 million payments electronically, including 97 percent of salary payments, 82 percent of vendor

payments, and 75 percent of benefit payments. At the close of the Clinton Administration, Treasury ran one of the largest payment collection systems in the world and collected electronically more than $1.5 trillion of U.S. government revenue, approximately two out of every three dollars. In order to accelerate the use of electronic transactions in Federal Government financial transactions and in the economy overall, Treasury introduced a series of programs and initiatives:

Electronic Fund Transfer Program (EFT)

The Debt Collection Improvements Act of 1996 included provisions requiring Treasury to substantially expand the use of electronic funds transfer for government payments. After the adoption of this important legislation, Treasury made substantial progress in expanding its use of EFT. In FY 1992, only 46 percent of Treasury-disbursed payments (excluding tax refunds) were being made electronically, including 53 percent of SSA payments, 19 percent of SSI payments, 43 percent of VA payments, 11 percent of vendor payments, and 82 percent of Federal salary payments.

By 2000, substantial progress had been made in converting Treasury payments to EFT. By the end of the Administration, 75 percent of all Treasury-disbursed payments (excluding tax refunds) were being made electronically, including 77 percent of SSA payments, 49 percent of SSI payments, 78 percent of VA payments, and 59 percent of vendor payments.

Electronic Transfer Account (ETA)

In 1999, Treasury launched the ETA program to enable individuals who did not have bank accounts to receive their Federal benefit, salary, or retirement payments by Direct Deposit through a low cost account with the same consumer protections available to other account holders. With the ETA, all benefit recipients were able to enjoy the safety and convenience of receiving their Federal payments by electronic funds transfer. An Internet site in English and Spanish provided users the capability to search by ZIP code, city, or state for the addresses of branches of financial institutions certified to offer the ETA. A toll-free telephone number allowed recipients to enter a 5-digit zip code to search for ETA branch locations through a Voice Response Unit (VRU).

Electronic Benefit Transfer (EBT)

In 1994, Treasury's Fiscal Service played an integral part in the Administration's National Performance Review initiative to improve the delivery of federal and state benefits to recipients nationwide. In addition to serving on the Vice President's Electronic Benefits Transfer (EBT) Task Force, Treasury worked with other benefit delivery agencies at the federal and state level to develop and implement a nationwide EBT program utilizing credit/debit card technology. In 1996, Treasury teamed with an alliance of seven southern states to acquire EBT services for the delivery of food stamp, social security, and state welfare payments on the Benefit Security Card. Today, millions of recipients of food and cash assistance in the southeast are able to enjoy the convenience and security of using card technology to access their benefits.

Electronic Federal Tax Payment System (EFTPS)

Launched in 1996, the Electronic Federal Tax Payment System (EFTPS) processes electronic payments from taxpayers to the IRS. In FY2000, EFTPS processed over 63 million transactions for 3 million taxpayers with an error rate of only 0.10 percent. During the Clinton Administration, EFTPS became one of the world's largest collection mechanisms, serving more than 2.5 million business taxpayers and enrolling 6,500 new businesses each week.

In 1999, Treasury began a pilot program in which vendors accepted taxpayers' credit card payments of federal taxes and sent them to the Treasury through EFTPS. The pilot was expanded in 2000 to include tax payments with filing extensions and estimated taxes. A pilot Internet application is scheduled to start in FY 2001, aimed at encouraging small businesses to enroll and begin paying taxes through EFTPS. This application would allow small businesses and other taxpayers to enroll, pay taxes, view their account history, and obtain customer service over the web.

Improving Service at the IRS

Created in 1996, the IRS web site (The Digital Daily www.irs.gov) became one of the hottest government sites on the Internet. Through November 2000, the site had over 3.7 billion hits and downloaded over 200 million tax forms and information documents to taxpayers. The site won numerous awards including the Nonprofits Online award for the best use of creativity and humor, the Federal Technology Leadership award in 1996, and received the highest ranking in a Brown University study of government sites. Since its inception, the site has received consistent praise in the media. "Written with a webby breeziness that belies its origins in one of the government's least humorous agencies," is how the Washington Post referred to this site. With tight security, user friendly applications, accessibility, creativity, and a retro look, the public responded to the site in record numbers

Intra-governmental Payment and Collection (IPAC) System

At the end of the Administration, Treasury and the Federal Reserve System were in the process of developing IPAC to replace the current on-line payment and collection applications for all non-retail type intra-governmental transfers. The new IPAC system was expected to give agencies improved transaction processing. Development and user testing of the system was also underway, and implementation was expected in spring 2001.

Stored Value Cards

Starting in 1997, Treasury and the Department of Defense developed the use of stored value cards to replace cash and paper voucher payroll systems for basic trainees. These stored value card programs were the largest in the United States with over $80 million in transactions by 2000, representing 3 million transactions and 375,000 cards.

The program continued to expand in the U.S., as well as to several peacekeeping bases in Bosnia and to military personnel in Taszar, Hungary. Beginning in December 1999 and continuing

through 2000, all soldiers, civilians, and contractors stationed at the camps used stored value cards to receive salary payments from the Army finance office and to make payments to merchants operating on the base. Use of the card in Bosnia significantly reduced cash requirements of U.S. personnel and the support costs related to holding and securing cash.

Internet Credit Card Collection System

In 1999, Treasury implemented the Internet Credit Card Collection System (ICCC) so Federal agencies could offer better customer service through acceptance of credit cards over the Internet for goods and services. Currently there are 35 Federal agencies involved in the project. For FY 2000, total collections through the ICCC exceeded $32 million -- more than twice the total for FY 1999.

Government Paperwork Elimination Act

Under guidance to implement the Government Paperwork Elimination Act (GPEA) of 1998, OMB on March 9, 1999 assigned to the Treasury Department the role of developing, in consultation with agencies and OMB, "policies and practices for the use of electronic transactions and authentication techniques for use in Federal payments and collections" that fulfill the goals of the GPEA. This assignment was consistent with a number of statutes that had long given Treasury authority over payments and collections. Treasury's guidance, which addressed the use of Public Key Infrastructure (PKI) (a system that uses public key cryptography for authentication, non-repudiation, integrity and encryption) by agencies with regard to payments and collections, was under development at the end of the Administration. PKI is the system that implements digital signatures and allows them to be used by specific programs to offer secure communications.

Processing Government Transactions Online

In July 2000, Deputy Secretary Eizenstat announced Pay.gov, one of Treasury's most recent initiatives to expand the government's internet services. Pay.gov, which was formally launched in October 2000, is a one-stop shop for people to make payments to the government using the Internet. In creating Pay.gov, Treasury leveraged its existing relationships with private banks and reached out to Internet service providers to create a low-cost web site that would enable users to interact with the government electronically. Pay.gov gave the government the capacity to handle online 80 million transactions previously processed on paper. In general, Pay.gov allowed the public to interact electronically with the government for three types of purpose:

- First, making payments. Pay.gov allowed corporations and consumers to use the Internet to authorize electronic transfers in order to pay government fees, fines, sales, leases, donations, and certain taxes. This included everything from a family paying for a national park camping license to a corporation paying fees or fines.

- Second, signing and processing forms. The site was used for direct electronic processing of government forms, such as direct deposit enrollment forms or order forms for government products.

- Third, processing and sharing information. Companies were able to view federal agency invoices and authorize payment, while agencies were able to immediately retrieve information about bills paid, forms completed or purchases made.

The Consumer Electronic Payments Task Force

During 1997, the Treasury Department participated in the Consumer Electronic Payments Task Force, which also included as participants the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Federal Trade Commission. It was chaired by Comptroller Eugene Ludwig, held widely publicized and well-attended hearings around the country, and produced a report on consumer electronic money and banking issues.

The Treasury Electronic Money and Banking Conference

In 1996, Treasury sponsored the Electronic Money and Banking Conference, which included Secretary Robert Rubin and Federal Reserve Board Chairman Alan Greenspan among the featured speakers. This Conference was the culmination of a year of work by the Treasury Department's E-Money Task Force, where all the Treasury bureaus examined e-money from different perspectives and produced a comprehensive report on the issues involved. This was the definitive conference on the subject that year.

Federal Public Key Infrastructure Steering Committee

Since 1998, Treasury, through the Chief Information Officer, has had the lead and has chaired the Federal Public Key Infrastructure Steering Committee. The Committee is comprised of representatives from all major Federal agencies, and is tasked with creating a uniform and compatible PKI for the Federal government.

Treasury Year 2000 (Y2K) Program

Like most other government agencies and private businesses, Treasury was concerned about the compatibility of its computer systems with the millennium date change, more commonly referred to as Y2K. From late 1995 through 2000, Treasury upgraded over 2500 pieces of computer equipment, 60 servers, and numerous desktop software applications to avoid system failure caused by Y2K. The Department worked diligently to upgrade, or in some cases replace, all systems for the rollover.

As a result of foresight, planning and testing, the Treasury rollover to the Year 2000 and subsequent rollover to March 1 (leap year) were non-events for the vast majority of Treasury's employees and customers. Through the Year 2000 Program, Treasury captured and maintained more complete inventories of systems and equipment, employed a more robust infrastructure to support bureau modernization efforts, and updated contingency and continuity plans to thwart future cyber-threats.

Selling Treasury Securities and Products Electronically

During the Clinton years, Treasury's Bureau of the Public Debt developed a strategy of enabling customers to purchase Treasury securities and to access their accounts electronically. Electronic services included web-based access and, in some cases, it also included options for automated telephone services. In addition, Public Debt instituted web-based services and enhanced existing electronic services.

Selling Savings Bonds over the Internet

The Bureau of the Public Debt, in partnership with Treasury's Financial Management Service, Mellon Bank, MasterCard and IBM, developed an Internet-based system, called "Savings Bonds Direct," to sell U.S. Savings Bonds directly to the public. The system was deployed on November 2, 1999, and was Public Debt's first initiative to sell directly to the public, augmenting its traditional network of over 40,000 commercial banks.

The system cost $350,000 to develop and implement, and within its first ten months of operation generated almost $63 million in bond sales. Both Series EE and I Bonds were available for purchase, using one of several major charge cards as the payment option. The delivery-time for bonds purchased through the Internet was cut by one-third. The system was recognized by the Industry Advisory Council and showcased in the E-Gov 2000 Convention.

Public Debt also planned to make debit ACH (electronic debit to designated bank account) a payment option during 2001, giving customers another online choice in payment method.

TreasuryDirect Electronic Services (TDES)

Implemented in stages from 1997 through 1999, TDES enabled retail customers who purchased and held marketable Treasury bills, notes, and bonds directly with the Treasury to purchase new securities, to reinvest maturing securities in new offerings, and to access and update their account information – via the Internet or automated phone services. A large percentage of customers in this system opted for electronic access. This was particularly noteworthy as many of those customers were senior citizens. This implied that a growing number of senior citizens were "wired" and wanted to conduct transactions electronically.

Enabling State and Local Government to Invest in Securities Online

Treasury's State and Local Government Securities program ("SLGS," pronounced "slugs"), which began in December 1999, enabled state and local government entities to invest in "special purpose" Treasury securities online and enabled their bond counsel and trustee banks, as authorized, to access and conduct transactions for their accounts electronically. Transactions often were requested in the range of several million dollars and, starting in 1999, were secured by digital certificates issued by Public Debt, with payments made by electronic funds transfer. At the end of the Administration, Public Debt was in the process of a multi-year rollout to provide secure web access to this system to state and local governments and agents authorized by them. It was anticipated that this web site, known as SLGSafe, would permit all

state and local government customers and their financial institutions to manage their accounts over the internet.

Using the Internet to Improve Access to Treasury Auctions

Begun as a pilot in April 1998, TAAPSLink provided smaller institutional participants in Treasury auctions with an inexpensive, easily accessible, user-friendly method for submitting tenders for marketable securities into Treasury auctions over the Internet. *TAAPSLink* was initiated in April 1998 and eliminated all paper (fax) tender submissions, fully automating the tender submission process. Approximately 1,000 institutions were using this web-based auction process by 2000. Public debt was also implementing a browser-based bidding capability for the larger institutional bidders, who were previously submitting bids via direct dial-up phone connections.

Digital Signature Policy

In addition to promoting Digital Signatures legislation for the private sector, Treasury recognized that the use of the Internet with appropriate electronic authentication techniques offered new opportunities to expand the use of the Federal payments system, and pioneered development of these systems. As a result, during 1999 and 2000, Treasury was responsible for developing government-wide policies on the use of electronic authentication techniques for Federal financial transactions.

The goal of policies being developed by Treasury were to protect the integrity of Federal payment and collection transactions by: first, ensuring that transactions were conducted only by authorized individuals: second, ensuring accountability and liability for transactions: third, providing assurances to the public about the identity of Federal servers and systems on open networks (such as the Internet): and fourth, receiving assurances about the identity of commercial servers and systems on open networks. Treasury planned to publish its electronic authentication policy during FY 2001.

III. Adapting the Tax System to Electronic Commerce

In 1996, Treasury's Office of Tax Policy published a paper, *Selected Tax Implications of Global Electronic Commerce*, which argued that the U.S. should adopt the principle of tax neutrality between traditional and electronic commerce as the guiding policy for future work concerning taxation of electronic commerce. The paper also stressed that existing tax rules should be applied to electronic commerce. It was drafted principally by Deputy Assistant Secretary Joseph H. Guttentag and Associate International Tax Counsel Bruce Cohen.

The principle of neutrality was embodied in the *Presidential Directive on Electronic Commerce*, issued July 1, 1997, in which President Clinton stressed that no new discriminatory taxes should be imposed on electronic commerce and that Treasury should work domestically and internationally in carrying out that directive. At the same time, the White House released *A Framework for Global Electronic Commerce* that provided the policy and guidance that executive department and agency heads should pursue.

At the international level, the Administration and Treasury succeeded in persuading America's partners to adopt the same principles of neutrality, efficiency, certainty and simplicity, effectiveness, fairness and flexibility, that guided our approach at the domestic level.

The Administration sought to implement its Internet tax policy principally through the Organization for Economic Cooperation and Development (OECD). At the OECD Ministerial meeting in Ottawa in October 1998, the OECD issued a report to Ministers, agreed to by all OECD-member country representatives, laying out the guiding taxation principles and a plan for taking work forward. The Treasury delegation to this meeting was led by Internal Revenue Commissioner Charles O. Rossotti and Deputy Assistant Secretary Joseph H. Guttentag. At the end of the Administration, discussions were still proceeding with business and non-OECD members within the OECD process regarding implementation of the Ottawa principles, which principles are fully consistent with the principles underlying the 1996 Treasury report and the 1997 *Presidential Directive*.

This section discusses Treasury's efforts to apply neutrality and fairness in the taxation of e-commerce at both the domestic and international level.

Internet Tax Freedom Act

The Administration helped shape and then actively supported the *Internet Tax Freedom Act*, which President Clinton signed into law on October 21, 1998. Key Treasury personnel involved in those efforts included Deputy Assistant Secretary Joseph Guttentag, International Economist Joann Weiner and Associate International Tax Counsel Michael Mundaca.

The Act placed a three-year moratorium on state and local government taxation of Internet access and multiple or discriminatory taxation of electronic commerce while the complex issues associated with state and local taxation of remote sales were analyzed. To ensure that analysis was carried out, the Act also created a Congressional Advisory Commission on Electronic Commerce to conduct a thorough study of Federal, state and local, and international taxation and tariff treatment of electronic commerce. The Departments of the Treasury and Commerce and the United States Trade Representative were represented on this commission along with state and local government and private sector representatives.

The Commission issued its report to Congress in April 2000. The Administration voted *against* the recommendations of the report and issued a separate statement of position. The work of the Commission is discussed more fully below.

Advisory Commission on Electronic Commerce

The Advisory Commission on Electronic Commerce (ACEC) was established by the Internet Tax Freedom Act to conduct a thorough study of Federal, state and local, and international taxation and tariff treatment of electronic commerce and other comparable intrastate, interstate and international sales activities.

The Department of the Treasury, the Department of Commerce and the United States Trade Representative all participated within the Commission, working in conjunction with the U.S. Government Working Group on Electronic Commerce and in coordination with the Office of the Vice President. Treasury was represented by Deputy Assistant Secretary Joseph H. Guttentag.

In May 2000, the ACEC finished its work and delivered its final report to Congress. The Administration representatives on the Commission voted against approving the content of that report, on the grounds that the drafting process was flawed and that the content did not receive the required two-thirds' approval.

The primary obstacles to a Commission consensus were the issues surrounding jurisdiction to tax and the power to impose obligations to collect taxes – commonly referred to as "nexus" issues. The business commissioners and the "no-tax" commissioners supported creating further limitations on states' ability to impose and collect taxes. The Administration recognized that the existing nexus rules, which were premised on physical presence, as required pursuant to Supreme Court Commerce Clause jurisprudence, allow many Internet sales to escape taxation and many Internet vendors to escape collection obligations. Further limiting States' taxing authority at this time did not seem necessary or prudent.

The Commission's report included the Administration's statement on Internet tax issues generally. In sum, that statement concluded that: there should be no taxes on Internet access (included to address "Digital Divide" and other issues); there should be no multiple and discriminatory taxation of electronic commerce; State and local taxes on telecommunications should be simplified and reformed; State and local sales and use taxes should be simplified; the continued viability of the Federal excise tax on communications should be reviewed; there should be no customs duties on electronic transmissions; and any international taxation of electronic commerce should be fair.

There were some areas of general agreement reached within the Commission. For instance, there was support within the Commission for simplifying state sales taxation, simplifying state and local telecommunication taxation and banning taxation of Internet access. There was also support for the Administration's position on opposing tariffs on electronic transmissions, as well as the Administration's work within the OECD.

The Debate over Repeal of the Telephone Tax

Both within the context of the ACEC deliberations and more general tax policy deliberations, the Treasury Department considered the continued viability of the telephone excise tax, which was established in 1898. Treasury concluded, and the Administration announced in its statement to the ACEC, that phase out of the tax is a worthy policy objective and should be considered, but must be weighed against other worthy objectives including other proposed tax reductions, and must not be allowed to threaten the important priorities of maintaining fiscal discipline, paying down the national debt, extending the solvency of Medicare and Social Security, and maintaining core government functions such as health care and education. As the ACEC statement noted, the tax contributes more than $4 billion in revenue per year, and therefore, because of the substantial budgetary impact of repeal, repeal cannot be considered in a vacuum, but must be weighed

against other important priorities.

In 2000, the Congress considered repeal of the telephone excise tax as "stand-alone" legislation; Secretary Summers and the Administration restated support for repeal from a tax policy perspective, and opposition to repeal outside the context of a fiscally responsible overall budget framework. Repeal was not enacted before the close of the 107th Congress.

Shaping an International Consensus on Taxation of E-Commerce

The United States worked with its partner governments and the business community within the OECD to help shape an international consensus on issues associated with electronic commerce taxation. During the October 1998 OECD Ministerial conference in Ottawa, Canada, taxation framework conditions and a work plan were issued. In accordance with that work plan, the OECD conducted meetings with member countries, non-members countries and the private sector to consider both direct and indirect tax issues associated with electronic commerce. The Treasury Department was active in all those efforts.

The discussions were focused on three main areas:

- The challenge of adapting indirect taxation to the world of e-commerce was the subject of the greatest attention and effort. Although the United States does not have a federal-level general consumption tax, the Treasury Department, led by Deputy Secretary Eizenstat, was very active in advancing the interests of good tax policy, with a particular emphasis on fighting efforts to impose discriminatory or distortive taxes. Preliminary results of the OECD's work regarding indirect tax issues were issued in 2000. Work would continue through 2001.

- Direct tax issues were also addressed, especially the question of how to determine primary tax location with respect to profits from e-commerce transactions. Deputy International Tax Counsel Patricia Brown and Associate International Tax Counsel Michael Mundaca were primary contributors to the OECD Model Income Tax Conventional Commentary to be released in 2001 regarding the circumstances in which the location of a computer server can constitute a permanent establishment.

- Finally, Treasury participated actively in the OECD-sponsored work regarding the income tax characterization of certain e-commerce transactions, issued in 2000. The OECD released commentary in 1999 on the income tax characterization of cross-border payments for computer software, based on principles put forward first in Treasury Department regulations issued 1998. Associate International Tax Counsels William H. Morris and Bruce Cohen, as well as Anne Shelburne of the Internal Revenue Service, were the principal architects of that regulation.

CHAPTER SEVEN

STRENGTHENING TREASURY'S CORE PUBLIC MISSIONS

Introduction

During the Clinton-Gore Administration, Treasury sought to strengthen some of its core functions. The most important of these efforts included the (i) historic reform of the Internal Revenue Service, (ii) successful reinvention of the Mint and a significantly restyled U.S. currency with enhanced security features, and (iii) major ongoing renovation of the Main Treasury building.

I. Reforming Tax Administration

Perhaps more than any other Administration since the President Truman, the Clinton-Gore Administration focused significant energy on building an IRS that works better, is less intrusive, more customer focused, and more efficient. Numerous studies, a Vice Presidential task force, Congressional hearings, and a joint commission all advanced the notion of reform, but the culmination came in the form of landmark tax legislation. Signed by President Clinton on July 22, 1998, the IRS Restructuring and Reform Act (RRA 98) signaled the beginning of a new IRS.

Confronting the Problems

Problems at the IRS grew over a number of years, but many became worse during the later half of the 1980s and early 1990s, creating significant challenges for the incoming Administration in 1992. The IRS had long been recognized as a very efficient agency for collecting taxes, but it became evident by the early 1990s that "service" had taken a back seat to enforcement and efficiency. Americans were not getting the kind of help they needed to meet their tax obligations. Years of mismanaged modernization programs, cost overruns, no overall technology architecture, and low employee morale contributed, but an underlying IRS culture which had not emphasized customer service compounded the problems, and had begun to erode public trust in the tax system.

One event that significantly alarmed the Administration and signaled trouble to a wider oversight audience came in the Spring of 1994. Following years of budget increases, Congress proposed reducing the IRS systems budget request by $367 million for fiscal year 1995. The reduction came on the heels of a General Accounting Office (GAO) report that sharply criticized the IRS Tax Systems Modernization (TSM) program and IRS management practices. Congressional hearings pointed to aging technology, failed efforts to modernize, taxpayer abuses, wasted resources, and general mismanagement. Then-Deputy Secretary Summers, in testimony before the National Restructuring Commission, described the severity of the problems faced by the IRS, indicating that in his and Secretary Rubin's assessment, there were "serious management problems at the IRS." Specifically he characterized the IRS modernization program as "off track" and called for a "sharp turn" at the agency.

IRS Management Board

Treasury took immediate steps to increase oversight, recruited top leadership from outside of the IRS, and strengthened the Department's role in day-to-day decision-making. Specifically, in April 1995, Treasury sought to assert a more active Departmental presence in IRS decision-making. An interim management board was established, co-chaired by Assistant Secretary George Munoz and IRS Commissioner Margaret Richardson, to begin a formal review of IRS planning and resource decisions. As the depth of the problems at the IRS became clearer, the IRS Management Board (IRSMB) was formed in June of 1996, chaired by then-Deputy Secretary Summers, and including senior executives from Treasury, IRS, OMB and the National Partnership for Reinventing Government. The Board was later permanently established under an executive order (#13051 dated June 24, 1997). The IRSMB moved quickly to halt work on many failing modernization projects. New leadership was recruited to help get the IRS on a structured, disciplined planning track, including, for the first time, a Chief Information Officer from outside the IRS. Monthly meetings of the IRSMB continued through the end of the Administration under the leadership of Deputy Secretary Eizenstat, serving as a regular checkpoint for the IRS on major decisions. The Treasury Department continued its hands-on approach to IRS oversight during a period of unprecedented reorganization and modernization at the bureau.

National Commission on Restructuring the IRS

In tandem with the Administration's reform efforts, the Congress established a commission in June of 1996, the National Commission on Restructuring the IRS, to find ways to improve the IRS. The Administration supported the work of the Commission, providing Treasury General Counsel Edward Knight and Commerce Assistant Secretary Larry Irving to serve on the 18-member panel of commissioners. Then-IRS Commissioner Richardson served as an ex officio member. The Commission worked for 12 months to formulate recommendations that would help create a more fair, efficient, and responsive IRS, interviewing stakeholder groups, academics, Members of Congress, and others during 12 days of public hearings. The Commission also reviewed thousands of reports and documents on IRS operations, management, governance, and oversight in preparation before issuing its final report in June 1997.

In its report, the Commission challenged the Congress and the President to create an agency that was fully responsive to the needs of the public. The report captured many recommendations strongly supported by the Administration, including a 5-year fixed term for the IRS Commissioner, more stable funding to support multi-year planning, a stronger focus on customer service, and a more structured approach to Congressional oversight. However, constitutional and administrative concerns prompted the Administration to oppose the Commission's majority recommendation to create an IRS Board of Directors outside the Treasury Department. The Administration worked with Congress to develop a more workable model, resulting in the IRS Oversight Board, which included the Treasury Secretary or Deputy Secretary, and which was subsequently established by RRA 98.

In January of 1997, Margaret Richardson announced that she would resign as IRS Commissioner following the end of the upcoming tax-filing season. Following her departure, Michael Dolan, the highest ranking career executive at the IRS, was sworn in as Acting IRS Commissioner (he would serve until Commissioner Rossotti assumed the post in November of 1997). Acting Commission Dolan was the only IRS official called by the Senate Finance Committee to answer allegations of taxpayer abuse leveled at the IRS during hearings before the Committee in the summer of 1997. During the hearings, which were chaired by Senator Roth, taxpayers testified on their mistreatment at the hands of IRS agents, many from behind privacy screens to conceal their identities. Former and current employees of the IRS testified, alleging the use of improper enforcement goals and bureaucratic procedures that encouraged the mistreatment of taxpayers. The Senate Finance Committee held another set of hearings in early spring 1998 focused on the pending IRS Restructuring and Reform legislation, hearing from employee representatives and management experts on proposals to restructure the IRS, and focussing on specific proposed changes to the tax laws. In April 1998, another round of congressional hearings focused on allegations that the IRS protected its executives, shielding them from sanctions despite evidence of wrongdoing. Additional taxpayer witnesses testified about unwarranted, heavy-handed raids of homes and businesses carried out by the IRS Criminal Investigations Division. This testimony served as a catalyst for the passage of RRA 98. However, many of the allegations were later proved to be unfounded.

President's IRS Reform Plan

In October of 1997, nine months prior to the passage of RRA 98, and subsequent to the issuance of the Report of the National Commission on Restructuring the IRS, President Clinton announced a comprehensive IRS reform agenda which expanded service hours, sharpened IRS accountability, and helped promote a more balanced reform approach in Congress. The plan derived from some 200 recommendations made by an IRS employee task force sponsored by Vice President Gore and Treasury Secretary Rubin. The recommendations included the establishment of independent Citizen Advocacy Panels to help taxpayers ensure that their problems and complaints were addressed. These panels were launched in June of 1998 and were left in place to continue their work into the next Administration, serving their local communities, holding public meetings and recommending ways to make IRS more responsive and customer oriented. The President's reform plan also prohibited the use of dollar collection goals among IRS employees (which had sometimes resulted in inappropriate enforcement activity), opened IRS offices in many locations on Saturdays, promoted electronic filing (see Chapter 7), expanded the power of the Taxpayer Advocate at IRS, and set the stage for subsequent discussions with Congress during the drafting of RRA 98.

In November 1997, President Clinton appointed Charles O. Rossotti as IRS Commissioner. Commissioner Rossotti broke the mold of past commissioners by not hailing primarily from the field of tax law. In contrast, Rossotti was an experienced IT executive from the private sector with a proven track record in managing large systems, implementing major change, and leading people. He began immediately to reorganize the agency by customer segment (e.g., small business, tax exempt organization), established a balanced measurement system which valued customer satisfaction, productivity, and employee satisfaction, and centralized the management of all information systems resources under the Chief Information Officer. In December of 1998,

the IRS awarded a PRIME contract to Computer Sciences Corporation and a team of leading technology and consulting firms to manage a multi-year program that was designed to modernize essentially all of IRS' business and technology systems over the following five to ten years.

IRS Restructuring and Reform Act

The RRA 98 was the culmination of years of work by the Administration, Congress, tax professionals, and private citizens to implement real and lasting tax administration reform, and codified many of the principal reforms already set in motion by the IRS Restructuring Commission and the Administration's reform agenda. Building upon the Taxpayer Bill of Rights 2, signed by President Clinton in July 1996 to create stronger taxpayer protections (see Chapter 1), the RRA 98 established further protections, strengthened personnel flexibilities to attract high-quality executives to the bureau, set forth a renewed focus on customer service, expanded taxpayer rights and remedies, focused on the importance of hiring IRS Commissioners with demonstrated management abilities, and ordered a sweeping top-to-bottom reorganization.

The RRA 98 was clear: "*The Internal Revenue Service shall review and restate its mission to place greater emphasis on serving the public and meeting taxpayers' needs...[and] establish organizational units serving particular groups of taxpayers with similar needs.*" Under Treasury's direction, the IRS moved to establish four new operating divisions in October 2000 specializing in providing services to specific groups of taxpayers, replacing the geographically based organization established in the 1950's.

Significantly, the RRA 98 strengthened IRS oversight, calling for the creation of a new oversight board and inspector general for tax administration. The IRS Oversight Board was unique in its structure and areas of responsibility. Comprised of seven private-sector members appointed by the President and confirmed by the Senate, Board membership also included by statute the Secretary of the Treasury and the Commissioner of Internal Revenue. The Board was given significant statutory powers with respect to the IRS budget and strategic plan and promised to be an important voice in decision-making at IRS in the years to come. Sworn-in by Secretary Summers on September 29, 2000, the Board began work to fulfill its role under the statute, meeting for the first time just 18 days following Senate confirmation. Beyond the Secretary's role, the Treasury Department provided administrative and other support to the Board and worked to ensure that the Board was properly positioned to carry forward its work under the statute. Secretary Summers pledged his support for the Board and the continuing effort to reform tax administration in the United States.

II. U.S. Coins and Currency

As the traditional custodian of the United States Mint and the Bureau of Engraving and Printing, Treasury continued during the Clinton-Gore years to fulfil its function of designing, minting, and printing the currency that the citizens of America, and people around the world, use on a daily basis. This section looks at significant developments undertaken at the United States Mint and the Bureau of Engraving and Printing during the Clinton-Gore Administration.

Reinventing the Mint

The United States Mint underwent a dramatic reinvention effort during the Clinton-Gore Administration. The Mint's funding mechanisms were revamped, factories were modernized, and significant design changes were made to both the quarter dollar and the dollar coin. The impact was an enormous increase in coin collecting and design, and substantial monies generated for the Treasury General Fund. The most significant changes included operating under a Public Enterprise Fund, the instatement of the 50 State Commemorative Quarters Program, designing a new dollar coin, and placing the Mint online.

In 1995, Congress approved legislation that allowed the Mint to operate under a Public Enterprise Fund, which means that it operates independent of congressional appropriations and without taxpayer funds. This single-fund structure vastly simplified Mint accounting, reduced costs, and assured continuous operating capital. As a result of the legislation, Mint operations are funded from the sale of circulating coins to Federal Reserve Banks and from the sale of numismatic and bullion products to coin collectors and investors worldwide.

This simple concept was premised on the notion that coins could be produced at a cost less than their face value, and then "sold" to the Federal Reserve at face value, resulting in sufficient revenue to cover production and administrative costs. Any "profits" resulting from the sale of coins would be transferred to the Treasury General Fund, off budget, and applied to the interest on the nation's debt. In the first four full years operating under the PEF, the Mint returned more than $5.2 billion in profits to the Treasury General Fund. With the growing popularity of the 50 State Commemorative Quarter and Golden Dollar programs, Mint profits rose to $2.6 billion annually in CY2000.

Fifty-State Commemorative Quarters Program

On December 1, 1997, President Clinton signed the 50 States Commemorative Coin Program Act (Public Law 105-124) into law. The 50 State Commemorative Quarters (Q50) Program, launched in January 1999, marked the first change in American coinage in more than 20 years. The program's origins began as an attempt to invigorate the dying hobby of coin collecting. To jumpstart the hobby, the U.S. Mint realized it was critical to create a program that would captivate the imagination of the American public and would encourage average families to start collecting coins.

Q50 was designed to release five new state quarters a year for ten years. The order the states were produced and released to the public mirrored the order that each state entered the union. Each quarter would be minted for a ten-week period, and each state would be asked to help with their state's individual design. The Q50 program's appeal was that anyone could become a collector by simply sorting through their pocket change to find metallic works of art depicting the history of the nation. Cost of collecting: 25 cents.

To make the design process as inclusive as possible, Secretary Rubin asked state governors to propose coin designs. Many governors held design contests entered by school children or convened citizen panels to suggest designs. The Mint solicited opinions on design finalists from the U.S. Fine Arts Commission and the Citizens Commemorative Coin Advisory Committee, as established by Congress, prior to sending final designs for approval by the Treasury Secretary.

When the Delaware quarter, the first 50 State Quarter minted, was released in January 1999, it was an instant sensation. Before the Q50 program, the Mint produced between one and 1.5 billion quarters each year. With the introduction of the Q50 program demand spiked almost immediately to more than six billion quarters per year. According to Mint research in CY2000, 114 million people nationwide were collecting handfuls of each coin. The most encouraging news was that young Americans became enthusiastic collectors and there was strong appeal among a diverse audience, thereby creating a new generation of coin collectors.

There were consequently significant financial benefits resulting from the Q50 program. In 1998, prior to the Q50 program, Mint profits from circulating coins were $924 million and Numismatic sales were $154 million. In 2000, nearly two years after the launch of the program, Mint circulating profits had increased to a staggering $2.6 billion and Numismatic sales had almost doubled to $299 million.

The Mint developed partnerships with Hallmark stores, National Geographic, and Jim Henson Productions to help educate the public and promote the new quarters.

Golden Dollar

On December 1, 1997, President Clinton signed the United States Dollar Coin Act (P.L. 105-124), authorizing the Mint to produce a newly designed dollar coin that would be golden in color and replace the Susan B. Anthony dollar coin. Unlike previous coin legislation that specified design concepts, this legislation gave Treasury and Mint discretion to create and choose the coin's design.

At the Mint's recommendation, Secretary Rubin created a citizens' panel to help select a design concept. When public consensus supported a design honoring Sacagawea, the young Shoshone woman who assisted Lewis and Clark on their expedition to the West Coast, the Mint conducted a nationwide design competition and more than 120 design concepts were submitted. The Mint sponsored exhibitions of the design semi-finalists and asked the public, historians, collectors, and artists to vote for their favorite obverse and reverse designs. Focus groups were polled and Native American organizations consulted to assure authenticity and acceptance of potential designs. The Mint then posted the semi-finalist designs on its web site, receiving 11 million hits on the first day. Within days, 120,000 citizens commented on their preferred design.

Secretary Rubin subsequently selected a Sacagawea design for the obverse, and an eagle in flight design for the reverse of the coin. The Mint received more than 130,000 comments on the proposed coin designs, the overwhelming majority favoring the selected design. In its first year, the new coin became the most widely produced and circulated dollar coin in American history, with more than one billion dollar coins minted in the first 12 months.

One unique aspect of the Golden Dollar Program was the public-private partnerships that were established to market the coin. The Mint partnered with General Mills to place 2000-dated pennies in 11 million boxes of Cheerios, including a Golden Dollar in every 2,000th box. The Mint also joined with Wal-Mart to dispense 94 million Golden Dollars in change through the retailer nationwide. Finally, to encourage circulation of the coin, the Mint embarked on an advertising campaign, depicting George Washington as the coin's spokesperson. Other promotional ventures included agreements with local banks and a private coin recycling service, Coinstar, to distribute the new dollar coins as incentives for using their services.

Putting the Mint Online

Launched in April 1999, the United States Mint operated a highly successful electronic commerce web site to sell Mint coins and other collectible products, receiving an average of 561,186 site hits per day. The site offered Internet catalog browsing and shopping services with mail and phone order capability, as well as secure credit card sales. By using e-commerce in its overall merchandising scheme, the U.S. Mint realized a return on investment for the project of more than 20%. Additionally, the U.S. Mint was able to offer improved service and communication to its customers, and this contributed to the overall reinvention of the U.S. Mint into a highly proactive, best-in-business organization. The United States Mint was recognized as one of the top 20 "e-tailers" in the United States, with total web sales of more than $156 million in FY 2000. In Summer 2000, USA Today and CIO Magazine recognized the Mint for having one of the top 100 sites on the Internet.

Redesigning the Currency

During the Clinton-Gore Administration, Treasury's Bureau of Engraving and Printing (BEP), which produced between nine and eleven billion notes annually, oversaw the first major currency redesign in over 70 years.

In 1996, the Federal Reserve System and the U.S. Treasury Department began a worldwide public education campaign with two primary objectives: first, to communicate to the general public that there would be no recall or devaluation of notes; and second, to combat counterfeiting by providing information that would enable the public, law enforcement personnel, central banks, depository financial institutions, and other cash handlers to authenticate the new series notes.

The process began with establishing the New Currency Design Task Force, which was comprised of representatives from the Treasury, Federal Reserve System, U.S. Secret Service, and Bureau of Engraving and Printing. The Task Force evaluated more than 120 security and design features based on the following criteria: effectiveness - how easily reproducible the note was; durability - how the note held up to a variety of tests including crumpling, folding, and laundering; production costs - how much the note would cost to manufacture; and appearance - whether the note still had the "American" look.

Many features on the notes remained the same, such as note size, color, paper blend and texture, and the motto "In God We Trust". However, new features were added to all newly re-designed notes that served to make the notes more difficult to replicate. In addition, the new notes were designed to enable the 3.5 million Americans with poor vision to more easily recognize the denomination. The new features included enlarged and slightly off-center portraits of past presidents on the front of the note, visible watermarks from both sides when held up to light, a polymer security thread indicating the note's denomination, fine line and micro-printing; and Federal reserve and high-contrast indicators.

The Series 1996 $100 note was released in March 1996, and the $50 note was released in October 1997. The release of the $20 note in Fall 1998 had special importance owing to the fact they are the most frequently used notes. The redesigned $5 and $10 notes were released in May 2000.

At the end of the Clinton-Gore Administration, the redesign of U.S. currency was expected to occur every 7 to 10 years. Under the direction of Under Secretary Gensler, Chair of the Advanced Counterfeit Design (ACD) Task Force, the ACD Task Force continued to seek and test new features to make U.S. currency even more secure and more readily usable as technology evolves. Future currency enhancements were focused on protection against digital counterfeiting. The U.S. worked with an international group of 25 countries to develop a deterrent system to protect against digital counterfeiting of U.S. currency. Pursuant to a recommendation of the Advanced Counterfeit Deterrence Steering Committee and as approved by Secretary Summers on January 5, 2001, the Bureau of Engraving and Printing was on a path that will provide the option of issuing new currency as early as 2003. The new currency would include new design features such as a digital watermark, which would protect against creation of counterfeit currency on computer systems. (See Chapter 5 for a more detailed discussion of Treasury anti-counterfeiting efforts.)

III. Restoration and Renovation of the Main Treasury Building

Between 1801 and 1833, Treasury witnessed three fires, the last one completely destroying the Treasury building. After the third fire, a new "fire-proof" building was constructed in 1838. Unfortunately, on June 26, 1996, the main Treasury building experienced its fourth fire. The 1996 fire originated on the north-wing roof and was caused by a welding torch that was being used in roofing repair. The fire resulted in extensive damage to one-third of the Main Treasury building, with estimated costs at $19,858,000.

Damaged in the 1996 fire was one of Treasury's most historic rooms, the Cash Room. Water damage and debris resulting from efforts to fight the fire caused major damage in the room, including cracked plaster, peeled paint and efflorescent ornamental plaster. Only the ingenious craftsmanship and high quality materials used in the original construction kept the room from sustaining more damage.

The 1996 fire was the catalyst for Treasury's $198,581,000 restoration program, which began in 1999. The Treasury Building and Annex Restoration and Renovation (TBARR) project sought

to preserve the historic integrity of the Treasury building while balancing the needs of a modern office environment. Specifically, TBARR's program goals were to:

- ***Enhance occupant safety***, through the use of a fire suppression system in buildings, the abatement of hazardous materials such as asbestos and lead paint, and the implementation of accessibility improvements for the physically challenged.
- ***Improve energy efficiency***, with the use of high performance windows, high efficiency heating and cooling systems, and energy efficient electrical power and lighting systems.
- ***Create a modern office environment***, including better climate control, improved lighting, and an improved telecommunications/data capacity.
- ***Preserve historical features of both the Main Treasury and Treasury Annex buildings***, by restoring barrel vaulted ceilings, ornamental plaster, woodwork and cast iron while minimizing destructive cutting.

Restoration of the Main Treasury and Annex buildings is slated for completion in early 2004. The project was devised in four discrete phases, each taking approximately one year to complete. This phased approach allowed for ongoing partial occupation of the Treasury building while the renovation was taking place.

TIMELINE OF MAJOR TREASURY MOMENTS*
1993 – 2000

1993

Deficit Reduction Package

Expansion of EITC

Extension of Targeted Jobs Tax Credit and Low-Income Housing Tax Credit

Establishment of Empowerment Zones and Enterprise Communities

Passage of NAFTA Implementation Act

Creation of North American Development Bank (NADBank)

Creation of Community Adjustment and Investment Program (CAIP)

Passage of Brady Bill

Waco

Resolution Trust Corp. Completion Act

Russian Financial Assistance Package

1994

Completion of GATT/Uruguay Round

Passage of Riegle-Neale Interstate Banking Act

Passage of Assault Weapons Ban

Health Care Reform Initiative

Passage of Riegle Community Development and Regulatory Improvement Act

Creation of Community Development Financial Institutions (CDFI) Fund

Creation of North American Financial Group (NAFG)

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* This timeline is organized chronologically year-by-year, but not within each year.

Creation of Committee on Hemispheric Financial Issues (CHFI)

Passage of Pension Benefit Guaranty Corp. Legislation (Pension Security)

Passage of Money Laundering Suppression Act

Resignation of Secretary Bentsen and Nomination of Secretary Rubin

1995

1995-1996 Budget Impasse and Debt Limit Crisis

Mexican Peso Crisis

Good O' Boys Roundup Review

Closing of Pennsylvania Avenue

Creation of Mint Public Enterprise Fund

Creation of Partnership in Education (PIE) Program

1996

Passage of Work Opportunity Tax Credit

Passage of Taxpayer Bill of Rights 2 Legislation

Passage of Kennedy-Kassebaum (Health Insurance Portability)

Passage of Minimum Wage Increase

Passage of Welfare Reform Legislation

Passage of Pension Simplification Legislation (SIMPLE)

Passage of Debt Collection Improvement Act of 1996 (EFTs)

Launch of Youth Crime Guns Interdiction Initiative (YCGII)

Launch of Electronic Federal Tax Payment System (EFTPS)

Introduction of New Currency Design

Announcement of Pension Portability Rules

Formation of National Church Arson Task Force

Formation of U.S.-Mexico High Level Contact Group on Drug Control (HLCG)

Treasury Fire

Passage of Deposit Insurance Funds Act of 1996

Passage of Sallie Mae Reorganization Act of 1996

<u>1997</u>

Passage of Balanced Budget Act and Taxpayer Relief Act

Passage of Welfare-to-Work, Hope Scholarship, Lifetime Learning, and Child Tax Credits

Asian Financial Crisis

Launch of 50 State Quarter Program and Golden Dollar

Launch of Inflation-Indexed Securities Program

Passage of DC Pension Legislation

Fast Track and Seattle

Climate Change — Kyoto

Establishment of Office of Community Development Policy

Establishment of Office of Government Sponsored Enterprise (GSE) Policy and Office of Sallie Mae Oversight

<u>1998</u>

Russian Financial Crisis and Long-Term Capital Management (LTCM) Crisis

Brazil Financial Crisis

Passage of IRS Reform and Restructuring Act

Japanese Yen Intervention

Reform of International Financial Architecture (also 1999)

Passage of IMF Funding Increase

"Save Social Security First"

Passage of Internet Tax Freedom Act

Launch of BusinessLinc Initiative

Passage of Homeowners Protection Act of 1998

Passage of Credit Union Membership Access Act of 1998

Passage of Tropical Forest Conservation Act

Elk Hills Privatization

USEC Privatization

Circuit Breakers Study

401(k) Automatic Enrollment Rules

<u>1999</u>

Passage of Gramm-Leach-Bliley Financial Modernization Act

Ecuador Financial Crisis

IMF Reform Initiative (and 2000)

Creation of G-20

Universal Savings Accounts (USAs) Proposal

First Money Laundering Strategy

Passage of Foreign Narcotics Kingpin Act

Launch of Electronic Transfer Account Program

Littleton, Colorado Shooting / Guns

Resignation of Secretary Rubin and Nomination of Secretary Summers

2000

Passage of HIPC Initiative

Passage of New Markets Initiative

Passage of Commodity Futures Modernization Act

Passage of China PNTR

Passage of Africa Growth and Opportunity Act

Euro Intervention

Launch of First Accounts Initiative

Launch of National Partnership for Financial Empowerment (NPFE)

Climate Change – The Hague

Corporate Tax Shelter Initiative

Argentina and Turkey Financial Crises

Launch of Debt Buyback Program

Retirement Savings Accounts (RSAs) Proposal

Passage of Digital Signatures Act

Issuance of FATF (Money Laundering), OECD (Tax Havens), and FSF (Offshore Financial Centers) Lists

First-ever Debt-for-Nature Swap with Bangladesh (under TFCA)

Treasury-HUD Predatory Lending Task Force

Systemic Risk Issues with GSEs Fannie Mae and Freddie Mac

Smith & Wesson Agreement

Passage of Plan Columbia

Revision of Auction Rules for Foreign and International Monetary Accounts (FIMA)