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TESTING & DISMANTLING the
LARGE ROCKET MOTORS
ENVIRONMENTALLY

pls. make a file –
Bob Rubin

To: Al
Fr: Katie
Re: Meeting with Bob Rubin

12-29-92

I'm attaching 2 memos that Reed, Jonathan and I put together for this meeting. The following is an overlay to those that goes into further detail on some issues and/or adds cautionary notes and follow-up information on others. Also -- the binder that I gave you this afternoon contains summaries of each of the policy documents that were forwarded to Reich for possible inclusion in the economic plan as well as a synthesis memo from Sperling. You should read at least Sperling's memo (and our accompanying memo that is attached) in advance of this meeting.

General points:

o The primary concern at this point is that you come to an understanding of the process that will unfold very rapidly in the next 2 weeks to put together the economic policy package. You need to make sure that Rubin understands that you want to be kept informed of all developments and copied on all paper flows.

o It is essential that Rubin understand that you expect to see options derived from the environment/energy options papers that we put together integrated in the final decision memo that he will prepare for Clinton and you.

o Having said that, it is equally essential that Rubin understand that your interest extends beyond just the environmental dimensions of the economic plans to the very core economic issues -- e.g. should we have a stimulous package at all; should we undertake deficit reduction efforts, etc. Let him know that you will weigh in heavily on the final decisions on these issues and therefore expect to be kept fully apprised of all developments leading to his final decision memo.

o You need to make a point of identifying me to Rubin as your eyes and ears on enviro dimensions -- and a person that you know he will want to rely on as he eagerly works to incorporate environmental dimensions to the econ policy options.....

o You need to make a point of identifying Reed and Jonathan to Rubin as your eyes and ears on general econ policy -- folks that Rubin certainly will want to be in contact with in order to ensure that he is staying in touch with you as his thinking progresses....

o On the foregoing two points, Jonathan suggests that you call us in at the beginning of your meeting briefly to introduce us to Rubin.

o If you succeed in impressing upon Rubin the importance of incorporating environmental considerations into economic plan and if, in fact he undertakes that effort, one school of thought is that he will see the fit between these issues and you will not have to hammer home to him a second point -- namely, that EPA, DOE, DOI, USDA will have a seat at the NEC. A second school, however (to which I subscribe) is nervous about timing on these decisions -- if McLarty has it in mind to begin to cement White House structure issues, we may not have the luxury of giving Rubin time now to become more comfortable with the idea of having the environment agencies in his shop. You got him in your office -- better to take advantage of the opportunity to make him understand your views on this (and your understanding with Clinton on this??). NOTE HERE HOWEVER -- I do not think it is appropriate for you to appear to be lobbying Rubin on any of this. You need to be above that. The White House structure is for you and Clinton to decide. You need to make these points clear to Rubin simply by assuming them to be so in your conversation with him -- not asking his opinion or in any way soliciting his agreement.

o After getting this stuff out of the way, then take advantage of this meeting time to explore with Rubin his own views of what the economic plan should include.

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1. Organizational memo on the National Economic Council

Reed has determined the background on this document. It was prepared by Lewis Kadin, an attorney at the law firm of Davis, Polk and Jim Johnson, chairman of FannieMae at Bob Rubin's request. Apparently it has been circulated to Bentsen, Altman, Penetta, Rivlin, Reich, McLarty under Rubin's signature with a request for comments.

We have not seen a copy of the memo. However, it is possible that it contains at least two items that are troubling:

<u>First</u>, it may recommend a membership structure for the NEC that would include only Treasury, OMB, and CEA. Among other obviously important agencies such as Labor and Commerce, this would exclude USDA, DOE, EPA and Interior. This will work against the necessary integration of economic and environment and natural resource issues, and could be dangerous given the signifigant economic import of "environmental" issues such as our participation in and contribution to the funds established under the Rio agreements; the GEF; restructuring of Superfund; rural devlopment issues that will arise in the context of the Forest Summit, etc.

participate in the deliberations of all three councils, he/she should have a direct link to Clinton (through McLarty) as will each of the AP's, rather than report to Clinton through any of the particular APs.

o The SA would have to have a small staff (3-5) in order to cover the deliberations of the three councils. In addition, the SA would be able to draw on the staff of CEQ. A question arises here as to whether this SA should also be the chair of CEQ. This is the subject of a separate memo on the role of CEQ. However, my initial impression here is that -- while there is potential for some conflict where the role of the SA and the chair of CEQ overlap (namely in tapping CEQs resources to staff the SA on council business), the role of CEQ -- and therefore the duties and mandate of the chair of CEQ -- can and should be broader than this -- i.e. -- broader than addressing simply the issues of the moment and be able to advance issues and ideas that are not immediately on the front burner.

Some "second best" considerations:

o If it is objected that the SA have a direct link to Clinton, it could be agreed that he/she would report to Clinton through the particular AP that chairs the council that is most relevant to the issue at hand.

o I had suggested to you that you ask Rubin for the opportunity to place a staff person on the NEC. (Rubin apparently is looking for a staff of 10-15). Others have suggested that this may not be a good idea unless Rubin seems very receptive to it. If he is disinclined, it could be self-defeating -- that staff person could find him or herself isolated on the council. My advice here is to play this one by ear and get a better sense of Rubin's receptivity. If he seems agreeable, this staff slot could prove very useful.

3. Economic Policy:

First, you will want to remind Rubin of the options presented in the Environment/Energy/Natural Resource papers.

Second, you will want to discuss with him your views on the synthesis memo that was prepared by Gene Sperling and explore his view on that memo and more generally on the key components of the economic policy package. See attached memo on Sperling's memo.

You need to make clear to Rubin that the enviro agencies will be incorporated in this group. (You indicated to me some time ago that Clinton agreed with you on this. How solid is your understanding with him on it?)

Second, the memo apparently recommends that, in Clinton's absence, Rubin would chair the meetings of the NEC. This obviously creates difficulties in terms of your ability to ensure that meetings coincide with your schedule and your ability to be fully apprised of and influence the agenda for those meetings.

You need to make clear to Rubin that you intend to chair the meetings in Clinton's absence.

CAVEAT:

o You should make the above points without referencing the memo or the conversations mentioned above. This is rumor-mill kind of stuff and you need to float above it in your dealings with him. Again -- these are decisions that you and Clinton will make; you need not lobby him on any of this.

2. Organization of environment issues in the White House

As noted above, you need to impress upon Rubin that the four environment-related agencies will have a permanent seat at the NEC table. (Note that both Rubin and Altman have expressed disagreement with this idea and have suggested instead that these agencies be housed in the DPC. In addition to the foregoing reasons demonstrating why it makes sense for these agencies to be in the NEC (need for integration of economic/envtl issues and significant economic import of many environmental issues), it is clear that these agencies should not be included in the DPC -- there is not a natural link between these agencies and the healthcare, childrens', welfare reform, drug, etc. policies that will be the focus of discussion in the DPC). Addressing this issue may lead to a more general discussion of the treatment of environmental issues in the White House. We recommend the following as the optimal scenario:

o EPA, DOE, DOI, USDA would have a permanent seat at the NEC

o When appropriate, EPA, DOE, DOI and/or USDA would also have a seat at the NSC and DPC depending on the issue under discussion

o There would be created a Special Assistant to the President for Environment and Energy Affairs. This SA (actually -- I guess it would be -- SAP!) would have a permanent seat on each of the three councils. This SA would be of lesser stature than the Assistant to the President for Economic Affairs (Rubin), for National Security (Lake), or for Domestic Policy (?), because he/she would not chair any particular council. However, because this Special Assistant will

MEMORANDUM

To: Al

From: Katie, Jonathan, Reed

Re: Bob Rubin.

Date: December 29, 1992

The following summarizes some issues that might be discussed directly or indirectly with Bob Rubin.

1. <u>The "Big Picture" Economic Policy Questions</u>

   a. What should be the deficit reduction goal for FY 97? What is your baseline assumption?

   b. What is your bias concerning the best way to accomplish the deficit reduction target? Cuts vs. revenue raisers? How do we define ourselves as New Democrats through our deficit reduction program?

   c. What should be the size of the fiscal stimulus? Sperling says $20-25 billion. But why not $30-40 billion? Or zero, if no stimulus is really needed? (Note that Sperling says Rubin favors $20-25 billion.)

   d. If stimulus includes outlays on infrastructure, shouldn't some outlays be directed to wastewater treatment, drinking water systems, and high-speed rail, instead of only roads?

   e. What are your views about the linkage between stimulus and deficit reduction?

2. <u>Procedural Issues</u>

   a. Memos about deficit reduction/ options/ etc. should go to Al Gore's economic advisers (Hundt and Sallet?) <u>or</u> Roy Neel, his chief of staff?

   b. Meetings of the NEC over the next few weeks on this topic should be attended by someone concerned about (i) someone concerned with economic issues (Hundt, Sallet) and (ii) someone concerned about the environmental agenda (McGinty/Browner).

   c. Shouldn't the different Assistants to the President (Rubin, Neel, etc.) be copied on all important NEC agenda setting and policy memos over the next few weeks, regardless of what procedures are set up post January 20? (Note that Roy Neel, VP chief of staff, should also be simultaneously an AP to the President, as has been the case with the VP's chief of staff since Dick Moe served Carter and Mondale in this way.)

d. What are Mac McLarty's plans on the subject of processing the policy debate over the next few weeks? Rubin's plans?

3. <u>NEC Structure and Function</u>

a. The VP should have a seat at the table for the NEC weekly meetings? When he cannot attend, his representative sit in the seat (just as Altman will presumably sit in for Bentsen when the Secretary is unavailable).

b. There should be a Special Assistant to the President for Environmental Affairs who has a seat at the NEC table (and for that matter the Domestic Policy and NSC meetings as well), so that the environmental dimension to economic issues can be dealt with successfully, and the environmental issues with economic effects can be placed appropriately on the NEC agenda.

c. Who will chair the NEC meetings when the President is absent? Note that Altman told Hundt that Bentsen says that Clinton has assured Bentsen and Rubin that Rubin will chair the meetings.

d. Should the different APs meet/circulate memos of their activities regularly so as to assure coordination among councils and APs?

e. What agencies should be represented on the NEC? Should the "environmental" departments (Agriculture, Interior, Energy, and EPA) be treated as a cluster? If they don't belong with NEC, why not and where do they better fit? (Note that both Rubin and Altman told Hundt that these agencies don't belong with the NEC, but should be lumped in with Justice, HHS, HUD, Veterans, Education, and Transportation as part of the Domestic Policy Council.)

f. How big will be Rubin's staff? What kinds of people is he looking for? Environmental economists? Regulatory policy experts? (Note that an important issue for the next Administration is where in government will regulatory oversight take place, especially if the Council on Competitiveness is abolished? The options seem to include OIRA, NEC, whatever White House council is appropriate for a given regulation, or some other freestanding White House unit. This issue's importance is enhanced by the regulatory moratorium. Predictions are that 2500-2600 regulations will be issued this year as opposed to the normal 2000. Clean Air Act regulations alone will be very significant for environment and industry groups.

MEMORANDUM

To: Al

From: Reed and Jonathan

Date: December 29, 1992

Enclosed herewith is one volume including Gene Sperling's cover memo outlining a so-called "core budget" and the summaries of each of the policy task forces that worked under Bob Reich's umbrella. Three additional volumes (that we have) contain the back-up memos by the different task forces.

The summaries appear to be unchanged from what was submitted by the different task forces. Insofar as they contain redundancies, discrepancies, and contradictions, they are unreconciled. As an example, the "environment, energy, natural resources" group's summary done by the McGinty/Sussman/Chupka/Adcock/Harwood/Burton/WRI/Hundt group (erroneously attributed only to the latter person) covers some of the same infrastructure proposals found in the "infrastructure" summary done by Rob Shapiro, although there are important differences in emphasis and design between the two discussions.

Sperling's memo addresses, first, stimulus and, second, the deficit. Although placed behind in importance, the deficit reduction proposal in Sperling's "core budget" for FY 94 is in many respects the most interesting topic in the memo. Sperling's "core budget" in effect puts in place some, but not all, of the PPF commitments by spending $50 billion in FY 97 in "investment," and aims for a deficit of $204 billion in FY 97.

Deficit Reduction

Sperling's deficit target of $204 billion in Fy 97 is not consistent with the PPF promise to reduce the deficit by half in four years, but is justified, according to Sperling, Summers, and Altman, because if achieved and maintained after FY 97 it would stabilize the ratio of total national debt to GNP at approximately 2/3. [1] Furthermore, if no additional spending took place, continuing growth in GNP would cause the ratio to go down over time.

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1. The always-cited contrast is Italy, where the ratio exceeds 1.0 and assertedly the country is therefore in constant turmoil. Economists say that if the United States' debt/GNP ratio continues to climb, the financial markets fear that "we will become Italy" and therefore, among other things, long-term interest rates stay high and even go up, crippling investment activity and hurting growth -- in short, a negative feedback loop.

By comparison, Magaziner's chapter on deficit reduction in the summary volume proposes to achieve a different stable ratio, namely the ratio between the annual deficit and GDP that is half of the current ratio.[2] For 1992, the ratio was 5%; reducing it to 2.5% means achieving a deficit of $190 billion by 1997. Whether the target is $190 billion or Sperling's slightly higher number, the purpose is the same: restore fiscal stability to federal government budgets, bring down private long-term rates, and enhance private investment, thereby assuring greater productivity and growth.

If any serious budget deficit reduction is a goal of the new Administration, then the revised budget projections said to be released soon will mean that the Sperling proposal falls way short of achieving its own stated goals. In effect, the new numbers describe a budget crisis that not only exists now but also intensifies over the first term of the Administration.

However, two questions begged by the proposed "core budget" are, one, whether the core budget will lead to positive economic results if implemented, and, two, whether the Sperling core budget reflects the sweeping and persuasive vision that presumably is a prerequisite to both passage and political success for the Administration.

Both questions are plainly very hard to answer. However, the current information suggests at least that the answer to the first question is likely to be negative, for a reason outside Sperling's control. The difficulty is that, as we have been recently told, the OMB revised numbers for budget outyears show a deficit will be considerably worse in outyears than set forth in the Sperling memo. PPF projected an uncapped[3] baseline deficit of $210 billion in FY 97 absent any new legislation; Sperling assumed a $299 billion baseline; **the new OMB baseline is supposedly $375 billion.** The new, soon-to-be-released CBO figures are said to show **$340 billion for FY 97.**[4]

What happened? The so-called technical adjustments (re-estimates of revenues from taxing, etc.) are down because of

2. GDP measures production within US borders; GNP includes extraterritorial production. Kuwait generates substantial revenues from its investments outside Kuwait, and therefore its GNP is much larger than its GDP. For the United States the two numbers are not meaningfully different in the context of the ratios discussed in this memorandum.

3. Uncapped means that you assume the expiring legislative budget caps are not renewed and so expenditures on current programs grow with population and economic growth.

4. CBO has a different economic growth projection.

predictions of worse economic growth over the long-term <u>and</u> health expenses are going up faster than thought <u>and</u> S&L bailout is $10 billion/year higher than expected.

If they are relied on, the effects of these revised numbers on the forthcoming budget debate are staggering. What are we to do? Eliminate public investment as a centerpiece of the Clinton/Gore Administration? Downplay deficit reduction as a goal? Implement a broad-based energy tax to close the deficit group?

Or can we hope that the estimates will be wrong in a positive instead of negative direction? Only if the economy unexpectedly grows by, say, 4-5% per annum, or some major activity of government can be surprisingly curtailed beyond current imagination (e.g., we don't need to bail out the S&L's after all or the defense budget can be radically cut). In short, in making decisions now, we are well advised to assume the likelihood of future bad news with respect to budget projections. After all, it's always easy to deal with good news by implementing tax cuts or new investment spending.

Without answering these questions, it is worth noting that the CBO and OMB deficit projections for FY 97 have oscillated between the low $200s and high $300s over the last 8 months. (Is this why the SEC bans projections in prospectuses for new stock issues?) How is one supposed to make serious government decisions affecting nothing further away than the next Presidential election year when the relevant projections so wildly vary from quarter to quarter?

One response is that a variation of $100 billion in a budget projection results from only minor variations in estimates of total government spending or revenue received. If spending estimates are, say, raised by 3% and revenue estimates are lowered by 5%, the total swing produces a deficit about $100 billion greater than predicted. How can anyone say that estimates for FY 97 won't be off by that much or more when 1997 is over? Or that the FY 97 estimates won't change by that much from time to time over the next several years.

In any event, the topics in the Sperling memo are allegedly being re-addressed now by Bo Cutter and Laura Tyson for Bob Rubin, and also by Panetta and Rivlin. (Both camps reportedly reject the memo as deeply flawed.) Ira Magaziner is also said to be writing memos for Rubin on the deficit and health care issues. Rubin is said to be planning a meeting of job designees and presumptive designees for next week to tee up these issues in a way different from Sperling's memo.

Whatever demerits may be charged against the memo and however quickly it may be disregarded, nevertheless its baseline assumptions are worth examining. They are:

For FY 97 ($US billion):

Assumed projected baseline: deficit	$299
New investments:	60.41
Savings:	144.66
Contributions to deficit reduction	84.25
Interest savings	7.
Resulting projected deficit	203.75.

"Investment"

"New investments" is the sum of outlays to implement the PPF public investment and investment-in-people agenda. It includes investment in some environmentally beneficial infrastructure and some environmental technology, but achieves overall only about half the public investment spending that PPF promised. There will be a major debate over the next two months concerning how any "investment" money should be spent.

"Savings"

The "savings" category includes:

-- reductions in outlays totalling $46.5 billion, the two biggest being additional defense cuts of $18 billion and management savings of $10 billion.[5]

-- reductions in entitlements totalling $31 billion, relating in significant part to eliminating health care expenditures.

-- closing tax loopholes totalling $12.7 billion, including increasing taxation on pension plan contributions, and decreasing deductions for meals and entertainment expenses and home mortgage interest.

-- charging or increasing fees on 18 separate programs, totalling $9.34 billion, the biggest of which is auctioning radio spectrum

-- raising new revenues totalling $33.7 billion, the two biggest being increasing the marginal rate to 36% on those with taxable income of $115k (single filer)/$140k (married). These levels are below the $200k cutoff for higher income taxes promised in the campaign.

5. All numbers are for FY 97, and presumably are achieved by phasing in cuts, taxes, and outlays over the years between now and then.

Each of these separate categories of "saving" contains numerous politically charged and economically significant policy suggestions.

One salient point is that Sperling relegates so-called "green taxes" to secondary or tertiary level consideration apparently because he deems them to be politically difficult to implement and because they run afoul of the campaign commitment not to increase taxes on the middle class.

However, the various user fees, cuts and tax loophole closings proposed by Sperling will impact on many members of the middle class directly and indirectly. Furthermore, the total package of revenue raisers may take for the government monies from the private sector that otherwise would go to investment, whereas, a broad-based energy or pollution tax deters consumption (and is, therefore, favored by economists over taxes on income, all other things being equalled.)

Moreover, many current subsidies of natural resources exploitation (such as oil depletion allowance) are not set for elimination in Sperling's memo.

In addition, there are some major mistakes on the face of the Sperling memo. For example, the "entitlements" section on page 27-28 double counts $4.5 billion in medicare cuts. The "tax expenditures" section on page 26 includes a $5.0 billion saving also counted in "costs" below. These two mistakes alone total nearly $10 billion (about the revenue raised by a $5/ton carbon tax). Magaziner holds that there are $26 billion in total mistakes in the memo.

Finally, a very important but inexplicitly described point in Sperling's memo is that it does not provide for universal health care. Judy Feder's companion memo on health care (which we have not seen) reportedly says this goal **<u>will require $70 billion in new governmental spending by FY 97</u>**.

Sperling suggests that "second level" "savings" -- which are really revenue raisers -- should be considered only if there are major changes in the investment and deficit reduction goals stated in his memo. Such "second level" items might include, e.g., taxing employer payments of health insurance premiums ($26 billion a year) and an oil import fee of $12.3 billion a year set off by an energy credit of $4.0 billion for a net addition $8.3 billion.

Sperling suggests further that still more painful, so-called "third level" actions could include the carbon tax at $30/ton grossing $39.2 billion or eliminating Social Security COLAs to recoup $22 billion. He does not discuss the reasons for dividing between the second and third levels.

Stimulus

As stated above, Sperling's memo addresses initially the stimulus package. He proposes a stimulus of about $20 billion by October 1992, and an additional $5 billion soon thereafter,[6] consisting principally of an ITC and some outlays that in large part constitute down payments on the PPF-type investments. Some of the outlays _might_ be for environmentally beneficial infrastructure projects. We should expect vigorous debate in the next two weeks concerning the ends and means of such outlays.

Sperling describes a modest stimulus with admittedly modest goals. The stimulus is in size equal to Bush's stimulus in the Spring of 1992. It purports to reduce unemployment by only .2%: less than the decrease in unemployment in the last six months and only about 1/8th of the way to full employment. It is plausible that Sperling's recommended stimulus is based on the judgment that some stimulus is politically wise, but hardly any is economically necessary. In short, Sperling seems to be saying between the lines that the economy will do reasonably well in the short-term without meaningful stimulus and that a little stimulus, already expected by the markets, will give the Administration a chance to take credit for the long overdue upswing in the business cycle.

Very important questions Sperling does not clearly answer include:

1. Why not propose a $30-40 billion stimulus, with more exciting outlays, more ambitious job creation goals, and less risk that, at the end of the first year, unemployment will be up?

2. Why do any stimulus, if the results of $20 billion in stimulus are so modest?

3. If there is any stimulus package, should it be _not_ exclusively road and bridge construction and maintenance, but rather also include increased funding for wastewater treatment, drinking water systems, high-speed rail, and acceleration of Northeast rail corridor improvements?

4. Why should the ITC be permanent?

Sperling disagrees with what is said to be the Panetta view on "linkage" between deficit reduction (FY 94) and stimulus (FY 93). Panetta believes that the linkage should be tight --

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6. The goal of spending $20 billion by October 1993 and only $5 billion as follow-up is going to be very hard to achieve. Skeptics believe that such front-end loading, while desirable, is unlikely to occur in implementation.

fiscal stimulus and long-term budget deficit reduction should be included in the same legislative proposal. If so, either the stimulus may be delayed, or the deficit reduction package may have to be accelerated.

Sperling adopts the school of thought holding that the proposed stimulus is too small to worry the markets, and therefore it does not require legislative linkage with a FY 94 budget deficit reduction proposal. Moreover, he believes that the stimulus needs to be expedited through Congress to accomplish its economic purpose, and that linking it to the FY 94 means it might be delayed or not be accomplished at all.