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Economic Policy Meeting - January 15, 1993

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To: Al
Fr: Katie
Re: Econ Policy meeting 1-15-93 at 10
1-24-93

I just spoke with Bob Rubin who informed me of the Econ Policy meeting that will take place tomorrow from 10 to 11:30. He was not certain, but thought that energy tax options might be discussed. If so, Bentsen will argue for an ad valorem tax and against a BTU tax. Rubin said Bentsen will argue that we can't get a BTU tax through the Hill. You need to argue against him on this. Chupka is preparing a more detailed memo that I will get to you before the meeting tomorrow. However, the main points are as follows:

o While these folks might think the environmental community will like whatever kind of energy tax we give them, that is not the case. In fact, because it is likely that an ad valorem tax will favor coal relative to other fossil fuels, the environmental community will likely <u>strongly oppose</u> an ad valorem tax. (Note that this consideration is also very important to the political calculus and something that I would imagine Bentsen is not sensitive to).

o This point is presented in more detail in Chupka's memo, but bottom line is that, because coal is the cheapest of the fossil fuels, an ad valorem tax will add the smallest absolute amount to the price of coal. Natural gas and oil are relatively <u>disfavored</u>. From an environmental point of view, this of course is bad. From a political point of view, this will mean that Byrd will not fight as hard against (though he still won't be happy given that coal still becomes more expensive and this opens the door to these kinds of taxes). However, TX, LA, CO, etc -- oil and natural gas states will strongly resist this approach. Moreover, this approach contradicts our strong campaign rhetoric in favor of natural gas.

o International competitiveness: The European community will not feel obliged to join us in an ad valorem tax because there is no way to argue that the tax is part of our plan to fulfill our international obligations with regard to climate change (becuase coal is favored). Note that we will also have an argument to make them feel obliged to join us in a BTU tax if that tax is not of sufficient magnitude to make the case that it will lead to carbon reductions. However, at least with respect to a BTU tax we can argue that this sets us on that course and that -- in addition to the other energy efficiency measures we will undertake -- it will help us to achieve stabilization.

So bottom line -- ad valorem tax will make the environmental community go bat sh*t; will make the oil and gas states go bat sh*t;

and will result in our having to go it alone because the Europeans will not join us in it.

To Bentsen's political argument, all of the above is important. In addition, it is important to note that -- at the levels we are talking (25-30 billion) -- our analyses show that a BTU tax will not result in significant fuel switching -- coal use will not immediately be threatened.

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Two further points from a conversation I just had with Chupka:

1. As noted above, the BTU tax we were talking about was <u>fuel neutral</u> (fuel switching not expected). It would not, however, be environmentally neutral. Rather, we should expect it to be environmentally positive. All other things being equal, emissions will be reduced as conservation is induced and overall fuel usage declines. Note however that an ad valorem tax (if imposed at the minemouth, etc.) is not fuel neutral (coal relatively favored) but could be argued to be environmentally neutral (increased emissions due to increased coal usage offset by decreased emissions from overall reduction in fuel consumption). <u>If we are worried about political reactions on the hill, fuel neutrality should be a cornerstone of our policy. And, as long as we are doing this, why not choose the solution that has positive environmental effects as well</u>. On both fronts, the BTU tax is preferable.

2. BUT --- there appears to be some talk that the ad valorem tax Bentsen is talking about would not be imposed at the minemouth, etc. but would be a retail level tax. Chupka's read is that, if that is the case, then the ad valorem tax probably would also be fuel neutral. (This is because a tax imposed at the retail level would not likely trickle back up the supply line to induce the original user of the fuel input to switch fuels). HOWEVER -- there are other reasons to oppose this type of tax. First, administratively it is much more difficult. Instead of taxing 13,000 energy producers, we are taxing 250 million energy consumers. Second, from a political point of view, it is certainly more preferable to impose a tax on as few as possible --rather than having people see this tax at the gas pump; in the purchase of home heating oil, etc. -- this hits 'em directly and many times over.

YOU NEED TO GET A CLEAR READ FROM BENTSEN AS TO EXACTLY WHICH TYPE OF TAX HE IS TALKING ABOUT.

YOU SHOULD ALSO ASK HIM FOR AN ANALYSIS OF HIS PROPOSALS IN TERMS OF THEIR IMPACT ON FUEL USE CHOICES. (Note that it is unlikely that Treasury is able to produce analyses of the fuel markets. HOWEVER -- EPA does have that capability......You should make clear that you want those numbers and projections.....)