Withdrawal/Redaction Sheet
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	MAILMGT@A1 to Janet L. Yellen at 16:54:30.00. Subject: Confirmation: Appt. Request for Yellen, Janet L. (partial) (1 page)	06/12/1997	b(7)(C), b(7)(E), b(7)(F), b(6)
002. email	WAVES_CONF to Janet L. Yellen at 16:46:27.00. Subject: WAVES Confirmation. (partial) (1 page)	06/19/1997	b(7)(C), b(7)(E), b(7)(F), b(6)
003. email	Janet L. Yellen to Records Management at 16:24:57.00. Subject: Official USSS WAVES Request - Records Management Document. (partial) (1 page)	06/19/1997	b(6)
004. email	Jeffrey A. Frankel to Alicia H. Munnell and Janet L. Yellen at 12:32:46.00. Subject: JoAnna Gray and other summer visitors. (1 page)	07/03/1997	b(6)
005. email	hermalin@haas.berkeley.edu to Janet L. Yellen at 12:20:42.00. Subject: Admission of Paul Gertler to EAP + more teaching glory. (2 pages)	07/09/1997	Personal Misfile

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
CEA ([Yellen])
OA/Box Number: 950000

FOLDER TITLE:

[06/12/1997 - 07/13/1997]

2013-0723-F
ab1270

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

- P1 National Security Classified Information [(a)(1) of the PRA]
- P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
- P3 Release would violate a Federal statute [(a)(3) of the PRA]
- P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
- P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
- P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

- b(1) National security classified information [(b)(1) of the FOIA]
- b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
- b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
- b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
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- b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
- b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
- b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Caroline Thompson (CN=Caroline Thompson/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:12-JUN-1997 22:53:09.00

SUBJECT: Update on CEA-SPC dialogue

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Cristian J. Santesteban (CN=Cristian J. Santesteban/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: John D. Montgomery (CN=John D. Montgomery/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
The State Planning Commission of China will be visiting Washington from June 25-27. The specifics of the agenda are still taking shape, but a broad outline has already been agreed upon by the various agencies and the Chinese. I have attached a recent copy. Please let me know if you have any problems with the scheduling. I have checked with your secretaries and your calendars look clear for the times listed on the agenda (Wednesday morning June 25 and Friday afternoon, June 27.) Jeff and Janet, you have also been invited to a dinner hosted by the National Committe on U.S. China Relations on June 25 at 6:30pm with the SPC. (Neither of you have anything scheduled on your work calendars.) The National Committee is the "super host" organization which is overseeing the SPC delegations visit to the United States (Washington is only one "leg" of their whirlwind tour of the US). Michele thinks there isn't a problem for you attending, legally. The dinner will be at Legal Seafood which is not too far from here. As far as I know, they will not be serving live scorpions! (Recall that Joe was served live scorpions when the SPC hosted him at a lavish banquet in Beijing)

Carrie

Carrie

Withdrawal/Redaction Marker
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	MAILMGT@A1 to Janet L. Yellen at 16:54:30.00. Subject: Confirmation: Appt. Request for Yellen, Janet L. (partial) (1 page)	06/12/1997	b(7)(C), b(7)(E), b(7)(F), b(6)

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
CEA ([Yellen])
OA/Box Number: 950000

FOLDER TITLE:

[06/12/1997 - 07/13/1997]

2013-0723-F
ab1270

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

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RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: MAILMGT@A1@CD@LNGTWY (MAILMGT@A1@CD@LNGTWY [UNKNOWN]) (SYS)

CREATION DATE/TIME:12-JUN-1997 16:54:30.00

SUBJECT: CONFIRMATION: APPT. REQUEST FOR YELLEN, JANET L

TO: Janet L. Yellen@eop (Janet L. Yellen@eop [CEA])
READ:UNKNOWN

TEXT:
FROM: WAVES OPERATIONS CENTER - ACO [redacted] [001]
Date: 06-12-1997
Time: 16:45:06

This message serves as confirmation of an appointment for the visitors listed below.

Appointment With: YELLEN, JANET L
Appointment Date: 6/12/97
Appointment Time: 6:00:00 PM
Appointment Room: 314
Appointment Building: OEOB
Appointment Requested by: YELLEN JANET L.
Phone Number of Requestor: 55107

WAVES APPOINTMENT NUMBER: U40988

If you have any questions regarding this appointment, please call the WAVES Center at 456-6742 and have the appointment number listed above available to the Access Control Officer answering your call.

****
TOTAL NUMBER OF NAMES SUBMITTED FOR ENTRY : 1
TOTAL NUMBER OF NAMES OF CLEARED FOR ENTRY: 1
****

AKERLOF, GEORGE [redacted] [redacted]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:13-JUN-1997 18:27:28.00

SUBJECT: Me and Climate Change

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Francine P. Obermiller (CN=Francine P. Obermiller/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Jason Shogren (CN=Jason Shogren/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Janet,

(1) Jeff Hunker from Commerce has asked me to help brief Secretary Daly on GCC this coming week. I agreed.

(2) T.J. Glauthier from OMB called to suggest that maybe he and I could, as a team, be the ones to replace Ev as overseer of the models (and that I would have to be the one to testify). I said that I would talk to you and think it over (and that, in any case, it would require having some relevant people lent to us from Commerce or DOE).

JF

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:16-JUN-1997 13:13:47.00

SUBJECT: Re: Update on CEA-SPC dialogue

TO: Caroline Thompson (CN=Caroline Thompson/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
The plans with respect to our dialogue with the Chinese sound fine. I've
put all of the events on my calendar.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:17-JUN-1997 10:28:49.00

SUBJECT: Thurs. Senate testimony on Climate Change

TO: WILLIAMS_A (WILLIAMS_A @ A1 @ CD @ LNGTWY [UNKNOWN]) (WHO)
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Jason Shogren (CN=Jason Shogren/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Let's meet with Jay, preferably before 11 or 12-2, to discuss how to respond: Tim Wirth called to suggest that I go up with him when he testifies on GCC on Thursday, to talk about the models. He also wants to release the model results that day. I assume the answer to both is "no". But we should discuss before I return Tim's call.
JF

Withdrawal/Redaction Marker
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
002. email	WAVES_CONF to Janet L. Yellen at 16:46:27.00. Subject: WAVES Confirmation. (partial) (1 page)	06/19/1997	b(7)(C), b(7)(E), b(7)(F), b(6)

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
CEA ([Yellen])
OA/Box Number: 950000

FOLDER TITLE:

[06/12/1997 - 07/13/1997]

2013-0723-F
ab1270

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

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RR. Document will be reviewed upon request.

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RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: WAVES_CONF@OPUS.EOP.GOV (WAVES_CONF@OPUS.EOP.GOV [UNKNOWN])

CREATION DATE/TIME:19-JUN-1997 16:46:27.00

SUBJECT: WAVES Confirmation

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
ADDRESSEES: JANET_L._YELLEN
SUBJECT: CONFIRMATION: APPT. REQUEST FOR YELLEN, JANET
FROM: WAVES OPERATIONS CENTER - ACO: [redacted] [002]
Date: 06-19-1997
Time: 16:41:35
This message serves as confirmation of an appointment for the
visitors listed below.
Appointment With: YELLEN, JANET
Appointment Date: 6/19/97
Appointment Time: 6:30:00 PM
Appointment Room: 314
Appointment Building: OEOB
Appointment Requested by: YELLEN JANET
Phone Number of Requestor: 55107
WAVES APPOINTMENT NUMBER: U43729
If you have any questions regarding this appointment,
please call the WAVES Center at 456-6742 and have the
appointment number listed above available to the
Access Control Officer answering your call.
****
TOTAL NUMBER OF NAMES SUBMITTED FOR ENTRY : 1
TOTAL NUMBER OF NAMES OF CLEARED FOR ENTRY: 1
****
SKLAR, JEFFREY [redacted] [redacted]

Withdrawal/Redaction Marker
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
003. email	Janet L. Yellen to Records Management at 16:24:57.00. Subject: Official USSS WAVES Request - Records Management Document. (partial) (1 page)	06/19/1997	b(6)

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
CEA ([Yellen])
OA/Box Number: 950000

FOLDER TITLE:

[06/12/1997 - 07/13/1997]

2013-0723-F
ab1270

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

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RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:19-JUN-1997 16:24:57.00

SUBJECT: Official USSS WAVES Request - Records Management Document

TO: Records Management (Records Management @ EOP [UNKNOWN])
READ:UNKNOWN

TEXT:
Requestor: Yellen, Janet
Requestor Phone: 3955107
Requestor Pass Type: WHS
Appointment With: Yellen, Janet
Appointment Room: 314
Appointment Date: 6/19/97
Appointment Building: Old Executive Office Building
UNumber:
Comments:

Visitors
Time Last Name First Name DOB
Cit COA SSN
06:30:00 PM SKLAR JEFFREY
[redacted] Y US [redacted] [003]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:23-JUN-1997 14:28:15.00

SUBJECT: Beginning the electricity decision process.

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Thomas A. Rhoads (CN=Thomas A. Rhoads/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Kathleen M. Wallman (CN=Kathleen M. Wallman/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

CC: Cristian J. Santesteban (CN=Cristian J. Santesteban/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
The electricity legislation decision process is supposed to begin tomorrow morning. I just got an email from Kathy Wallman, listing tomorrow's agenda as covering:

1. Consumer info
2. reliability
3. jurisdictional issues
4. federal power, but not TVA

Let me mention a few points about these in turn. In the interest of time, I'll cover the first three now, and I hope have time to say something about the fourth later this afternoon.

Consumer information

In a WEB article a while back on pilot electricity programs, we talked about how some consumers in New Hampshire were willing to pay a premium for environmentally-sensitive power, e.g., not nuclear, fossil fuel, or hydroelectric, if the river damming for the hydroelectric project had been environmentally destructive (as is claimed for Hydro Quebec). To facilitate this, many have advocated that electricity sellers be required to list the emissions and fuel sources of their power, using labels akin to the nutrition labels on food items in the grocery store. This seems pretty reasonable to me.

A second consumer information issue may be a bit more problematic. Many believe that power marketers will offer power with a mix of up front fees, minimum purchase requirements, and volume discounts--not unlike long distance service. That experience has led many to support some sort of standardized pricing mechanism, so consumers can better compare electricity rate plans. I'm somewhat reluctant to go along with this. First, a virtue of retail competition is exactly that consumers can have greater choice of payment plans, including how power bundled with related services (e.g., buying appliances from power marketers, who would then have an incentive to economize on energy use). Standardized rate cards might discourage this beneficial product differentiation. Second, the less varied are pricing plans, the easier it is to collude, and we do not know yet how competitive retail markets in electricity are likely to be. For that reason, I'm likely to at least question the move to promote standardized pricing plans. If there is demand for making comparisons, I'd prefer to leave that to independent entities such as Consumer Reports.

Reliability

We also did a WEB piece this winter, I think, on the West Coast power blackout, highlighting the potential problems as the electricity industry moves from a world of nonoverlapping franchised utility monopolies to competing owners of a regional transmission grid. One fear is that power producers may not cooperate enough, leading to more frequent and longer blackouts. A second fear is that they may cooperate too much, leading to anticompetitive effects, e.g., reducing capacity of (regulated) transmission networks so as to raise electricity prices.

DOE is recommending that FERC (Federal Energy Regulatory Commission) be given authority to charter and oversee the existing regional utility "reliability councils," which operators of generation, transmission and local distribution facilities would have to join. This seems to be a reasonable compromise between doing nothing and attempting to regulate the whole thing.

This is a serious issue, in that reliability is something of a great unknown here. There is undoubtedly a lot of sophisticated engineering and operation entailed in maintaining power levels on a grid when facilities can go out and demand can fluctuate quickly. How this will all work is a bit unsettled. On an optimistic note, a colleague at RFF reminded me the other day that virtually all blackouts occur within local distribution areas, e.g., following the storms in DC last week. To that degree that is so, interfirm coordination may not be a huge problem.

This may be one place to try to push for a strong stance regarding making transmission and distribution operation, and ideally ownership, independent of generation and marketing. Letting an independent regulated wire monopolies deal with keeping the wires together, and letting power suppliers and sellers compete given the rules they set, could be a big step in the right direction.

Jurisdictional issues

Retail sales of electricity, and thus the decision whether or not to allow retail competition, are generally within the purview of states. When it comes to the dirty details, however, the legal relationships between states and the federal government on electricity matters are far from clear. Issues include:

a) Can states order distribution companies to "wheel" power from unaffiliated generators to retail customers?

DOE proposes to clarify state authority to order retail wheeling -- sounds good. As a contextual matter, DOE is espousing the view that states should be given the option to decide if they want to adopt retail competition, rather than be forced to do so. For a variety of reasons, I agree with DOE on this. (A few bills introduced by the Republican majority members in Congress would take the "mandate" approach.) That position affects DOE's and my analysis of these jurisdictional issues, but I note that the overall decision whether or not to mandate retail competition was not included on Kathy's list of issues.

b) Can states impose "access charges" to local distribution grids to recover "stranded costs" (i.e., undepreciated utility construction costs and contractual obligations that would not be recovered with competitive pricing)?

If you have to have stranded cost recovery from electricity consumers, access charges on the local grid seem to be about as competitively neutral a way to do so as I can think of. This begs the question of whether or not there should be stranded cost recovery. Again, this is not on tomorrow's docket, partly because of the view that leaving retail competition to the states means that stranded cost recovery is that state's headache--as, I think, it should be.

c) Who should regulate retail transmission prices?

DOE recommends that states should regulate transmission when it is part of the bundled price of electricity charged to consumers, but that FERC should regulate transmission when it is unbundled. I'll need to get clarification on this. Who regulated what should be independent of what is essentially a marketing decision on whether or not to separate the prices of component parts of a product. I suspect that this apparently nonsensical distinction is an artifact of some legal nuance associated with defining federal jurisdiction over electricity markets, and that DOE's proposal is meant to disrupt the complex jurisdictional balance as little as possible. It is important to remember that state PUCs are themselves a nontrivial special interest group here.

Finally, there's some need to ensure that FERC's regulatory authority over open access to transmission grids for wholesale electricity sales, i.e., Order 888, is clarified by statute. This seems unobjectionable.

Federal power (other than TVA)

More to come ...?

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Jason Shogren (CN=Jason Shogren/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:23-JUN-1997 11:40:55.00

SUBJECT: draft outline 2

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Alicia H. Munnell (CN=Alicia H. Munnell/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Outline: An economic assessment of US global climate change policy
--draft--
23 June 97

Pages

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:23-JUN-1997 18:02:49.00

SUBJECT: Electricity, part 2

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Thomas A. Rhoads (CN=Thomas A. Rhoads/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Kathleen M. Wallman (CN=Kathleen M. Wallman/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

CC: Cristian J. Santesteban (CN=Cristian J. Santesteban/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
In a memo I sent out earlier this afternoon, I talked about consumer information, reliability, and jurisdictional issues. I promised something on ...

Federal power (other than TVA)

The Federal government operates six entities in the power marketing business. Four of them are fairly small power marketing administrations or "PMAs," primarily engaged in wholesale marketing of power produced by federally owned dams. Three of these four, the Alaska, Southwestern, and Western PMAs, own their own transmission facilities, while Southeastern is primarily a marketer. Bonneville Power Administration, or BPA, is a much larger entity, providing hydroelectric power at resale in the Northwestern U.S.

The sixth entity, the Tennessee Valley Authority (TVA), is a multibillion dollar enterprise, owning its own coal-fired and nuclear-powered generators as well as hydro facilities. It is a special case, to be discussed later. In addition, the Federal Government, through the Rural Utilities Service, insures loans to utilities and cooperatives providing electricity in rural areas. The RUS position on this issue is particularly puzzling. On the one hand, they claim that no one will enter to serve their rural customers, but on the other hand, they claim that they expect to bear considerable stranded costs. Can't have it both ways.

In all of these cases--RUS, TVA, BPA and the other PMAs--the case for federal involvement is very weak. As appealing as privatization may be, however, it is not on the table. Moreover, privatization probably would not do much to solve the main problem of Treasury exposure to competition-related losses.

The primary policy context is whether to extend the reach of FERC's current policies to PMAs, which currently are exempted from its requirement to open their transmission grids to independent generators. When the Federal government owns or lends money to the PMAs, it becomes the potential bearer of stranded costs. From the perspective of the Treasury, the choice of whether to open electricity markets to competition is no longer neutral. DOE estimates that $70 billion of BPA, TVA, and RUS debt may be threatened.

DOE's recommended solution to this thorny problem is the always appealing "commission a study." I'm not too satisfied with this solution; how could one be? However, the political pressure to balance the budget may well rule out a dispassionate analysis of the degree to which the government made genuinely bad investments in power generation, and unfortunately should bear the costs rather than shift them onto consumers in the areas served by federal power marketers. The best that we may be able to accomplish is getting stranded cost recovery mechanisms competitively neutral, so that they do not unduly discourage entry, but no detailed proposals have been offered. On this one, I'll probably keep fairly quiet, and see if more substantive ideas develop.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Sanders D. Korenman (CN=Sanders D. Korenman/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:24-JUN-1997 11:31:49.00

SUBJECT:

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Janet,

I looked over the paper on the caseload decline by Ziliak et al. that you sent me yesterday. The paper reports a smaller role for waivers than Phil found. There are many differences between the two analyses that could account for the different findings. The most important are probably that, unlike Phil, they do not include leads of state waiver programs that account for about 1/2 the effect in Phil's paper, and second, there is likely to be more measurement error in their policy variables than Phil's because Phil did a very careful job of classifying state policies.

Please let me know if you would like a detailed memo on this paper, or if you would like me to write to the authors. I plan to send a copy of the paper to Phil.

Sandy

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:24-JUN-1997 17:01:06.00

SUBJECT: Today's product liability meeting

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
While I was talking to you, Ellen Seidman left a message. When I returned the call, she mentioned two things:

1) Today's meeting may be "wide ranging," in that some of the Principals may want to argue about whether we should be negotiating about the contents of the bill at all, instead of simply refusing to deal and trying to block any legislation. So, some "big picture" stuff may come up.

2) [You'll love this] There may be a second Principals' meeting on this topic scheduled for Thursday. This may be partly because today's meeting may be taken up too much with the big picture and not the options. Also, some Principals (e.g., Bowles) want to be in on this but can't come to today's meeting. I asked if there was a chance today's meeting would be cancelled, and Ellen said "no."

Tim

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:24-JUN-1997 12:36:27.00

SUBJECT: Product liability -- the short version

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Overall question: How to reconcile the President's veto of last year's product liability bill with this year's version, to avoid getting unacceptable, veto-proof reform.

Perspectives

Economic: The point of product liability is to induce manufacturers and sellers to provide levels of safety that consumers would be willing to pay for, if "transaction costs" were zero, information were symmetric, etc.

Administration: The point of product liability is to make sure that no reasonably innocent victim of loss from defective products goes uncompensated. To do so, we take money from manufacturers and give it to consumers when things go awry.

Predicted economic effect of Administration perspective: Product liability law forces manufacturers and sellers to insure customers against losses, where product prices go up by the "premium." Manufacturers do not "eat" losses in the long run. If insurance were the goal, we would not need a liability system. In fact, consumers could purchase defective product insurance on their own. (Recent WEB article.)

Decision issues (from Ellen Seidman's options memo)

* Joint and several liability: When many are responsible, should each be potentially liable for damages caused be all? This can be efficient, if it is possible for all to evade liability for taking due care, but it will not be efficient if some defendant has to be left holding the bag.

Options: Attempts to preserve J&S for noneconomic damages, with different standards for when defendant is also at fault, and whether the bill would preempt both defendant-friendly as well as plaintiff-friendly state liability law. Differences between these seem minor. The most peculiar aspect may be a reliance on a concept of "percentage of fault." The bill does not threaten J&S for economic damages. (No principled distinction for treating economic and noneconomic damages differently was provided in the interagency group. Perhaps there is an argument that noneconomic damages are harder to measure, and thus present greater risk of being set inappropriately high.)

* Punitive damages: Critics of the current system think punitive damage awards are out of control; the Administration wants to preserve them. For efficient accident prevention, damage awards greater than those necessary to compensate for losses are generally unnecessary, unless negligent carelessness systematically occurs without victim compensation.

Options: Four are listed in Ellen's memo, but there is a mix. Among those worth supporting are uniform federal standards for a tighter "clear and convincing" evidence for punitive damage awards, give 75% of punitive awards to the state (to discourage frivolous suits), and give judges the final say in determining punitives following an advisory jury provision. A fourth proposal would cap punitives, but allowing the judge to go above the cap if the cap is found "insufficient to punish or deter." The most troublesome aspects of the cap proposals are (a) not telling juries about the cap, and (b) giving a smaller cap to small businesses. The latter may be controversial.

* Statute of repose: Manufacturers are concerned that they are endlessly liable for product defects. A statute of repose sets a time limit on liability.

Option: Ellen's proposal largely tracks S. 648, the proposed bill, by adopting an 18 year statute of repose (longer than that by virtually all states that have such statutes). The main proposed change would be to let plaintiffs (i.e., victims) make a "clear and convincing" case that the product had a longer useful life. Also, Ellen proposes that statutes of repose apply only to workplace durables; consumers would not be subject to such time limits. The theory here is that any workers injured beyond the statutory time limit could still get workers compensation for injuries.

Potential CEA contributions to the discussion

1. Remind participants that product liability law does not redistribute wealth from manufacturers to consumers, but from all consumers to those who suffer losses. (Expected damages get passed through in higher product prices -- the "insurance" point.)

2. There is no economic justification for having lower punitive damages for small business.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:24-JUN-1997 14:23:42.00

SUBJECT: word from Joe Minarik on IAT

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
As I mentioned.
JF
---------------------- Forwarded by Jeffrey A. Frankel/CEA/EOP on 06/24/97
02:23 PM ---------------------------

Jeffrey A. Frankel
06/24/97 02:07:30 PM
Record Type: Record

To: Jason Shogren/CEA/EOP, Alicia H. Munnell/CEA/EOP
cc:
Subject: word from Joe Minarik on IAT

Joe says that Henry Kelly has a copy of a Commerce memo that plans a re-capture of the IAT process at Commerce. Names Seidel, Hunker and Romm were on the memo, perhaps as the suggested heads of IAT from here on out. For what it is worth.
And this "inter-agency group" that TJ started at OMB is still meeting regularly (e.g., right now) to give guidance to the IAT team.
So you see that many other people are still very much on other tracks.
JF

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:24-JUN-1997 13:59:38.00

SUBJECT: June 24th electricity issues

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Daren K. Wong (CN=Daren K. Wong/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: Randall W. Lutter (CN=Randall W. Lutter/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: Cristian J. Santesteban (CN=Cristian J. Santesteban/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: James Mietus (CN=James Mietus/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: Douglas.w.smith (Douglas.w.smith @ hq.doe.gov [UNKNOWN])
READ:UNKNOWN

CC: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Kathleen M. Wallman (CN=Kathleen M. Wallman/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TEXT:
As discussed in yesterday's memo, the interagency electricity group today looked at the following four issues: consumer information, reliability, assorted jurisdictional issues, and federal power issues (excluding TVA). The expressed consensus positions at the meeting are generally agreeable, but there are some places where I or CEA might want to seek modifications.

Consumer information

Consensus position: The Secretary of Energy, consulting EPA and the FTC, will have authority to require disclosure of generation resources and emissions characteristics. The current position, I think, mandates disclosure to consumers of prices, variable charges, nature of the service (including interruptibility), miscellaneous charges (e.g., exit fees), and other information.

Suggested CEA proposal: Because power may be marketed in lots of different ways, including being bundled with appliances and other energy management services, I'm slightly concerned that requirements to disclose "price" could make it difficult for some marketers to offer innovative bundling plans, volume discounts, and energy services. The draft legislation does not mandate a standard form for this disclosure, so perhaps there's no reason to be concerned that we are restricting options in the bill. Just to be on the safe side, perhaps we could add a phrase to the legislative draft saying something like "Nothing in section 119(b)(1) of this amendment to PURPA should be construed as limiting the manner in which electricity is priced or marketed to retail customers."

Reliability

Consensus position: DOE will charter and oversee a single national reliability organization, which will include power marketers as well as generators, transmission companies, and local distributors.

Suggested CEA question: The argument in favor of a single national reliability organization is the concern that a regional organization might set standards that, in effect, reduced imports from outside the region. While some see virtues in maintaining nationwide reliability standards in principle, the organization would be free to adapt standards to regional conditions, e.g., where electricity is a more crucial component for home heating. I wonder whether such a national organization would be consistent with allowing states to decide on their own whether to adopt retail competition, or at least to "opt out" of a federal mandate.

Jurisdictional issues

Consensus positions: The group agreed that states should be allowed to order retail transmission within the state and to impose fees to cover stranded costs or public benefit programs. We also agreed that FERC's authority over interstate transmission should cover retail as well as wholesale, and that its authority to mandate open access as under Order 888 should be clarified, and extended to municipal utilities, co-ops, Federal power marketing administrations. The law would also encourage, in some unspecified way, multistate regional transmission planning groups.

Suggested CEA observation: In presenting these options, DOE advocated a "simplification" approach, which would be to limit the amount of new policies that would be incorporated in the bill. This seems close to a "status quo" bias approach I'd advocated in earlier meetings. I think we should support this, and keep it in mind as we evaluate environmental and social policies that might be proposed in connection with this legislation.

Federal power issues (except TVA)

Consensus position: Open access requirements might be deferred for Federal power suppliers if the Secretary of Energy finds that stranded cost recovery mechanisms are put in place.

Suggested CEA complaint: This position presumes that the Federal government should get full stranded cost recovery. I strongly expressed the view that this should not be presumed; rather, that some neutral party or open regulatory process be instituted to determine how much of the stranded costs should be covered by the taxpayers, and how much should be covered by charges to the consumers of power sold by PMAs, rural utilities, and TVA. [Other issues specific to TVA will be discussed later.] DOE's argument in favor of full cost recovery is that the federal government did not have an "upside" chance of making money. Utilities have argued, similarly, that they did not have a chance for an upside, as their earnings were constrained to cover only the cost of capital.

More importantly, the issue is whether the taxpayers or the consumers should bear the costs of all government decisions, including bad ones. Recall the savings and loan debacle. My understanding is that a major cause, if not the primary cause, of the debacle was public policy, namely choosing not to regulate the portfolios of financial institutions, where the consumers had federally-provided deposit insurance against losses. In that case, the government ate the costs of their bad decisions, rather than sticking the losses with the consumers.

We should therefore have some process by which consumers could make a case that they should not pay for poor decisions made by the taxpayers in building or funding generators that were really unnecessary. If we are serious about making the government accountable, this might be a good place to start.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:25-JUN-1997 16:39:35.00

SUBJECT: Thoughts on yesterday's meeting

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Ellen S. Seidman (CN=Ellen S. Seidman/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TEXT:
Jeff,

I made a few notes during yesterday's meeting that could be helpful for tomorrow's meeting.

1) I just did an article search on "product + liability + economics," and did not come up with anything that looked like an empirical investigation of the effects or abuse of the product liability system, at least going back to 1989. There may be studies of these things in other disciplines, but I'm not aware of them. Posner's Economic Analysis of Law, a.k.a. "the Bible," doesn't say much other than that "Product failures that cause serious injury are extremely rare." He uses this as a rationale for pla cing liability on manufacturers, so as to raise the price of dangerous goods and thus divert customers to safer products with lower social costs. However, where the hazards are well known--cigarette smoking is specifically mentioned--"the defense of assumption of risk will bar the injured consumer from obtaining damages--the correct result from an economic standpoint."

2) The case for using liability law to provide compensation for noneconomic damages is that insurance against such damages may be hard to come by. However, one often does not purchase insurance against noneconomic losses. Insurance is worth buying when the marginal utility of a dollar is larger after a loss than before it. For noneconomic losses, this is not necessarily so--death being the clearest example.

3) Regarding one-way preemption, one could make an argument that the purpose of the bill is not to create uniformity, but to prevent abuses in terms of how defendants are treated in these cases. One could respond that plaintiffs could be abused as well by state law. If so, however, the optimal federal policy may well not be two-way preemption that specifies a uniform rule, but a law setting minimum and maximum bounds on defendants' rights in product liability cases.

4) The Breaux bill that was mentioned is a shorter alternative to S. 648,

the main focus of the Administration's attention. The Breaux bill's approach is quite different. Its primary provisions would:

a) Control frivolous lawsuits by getting attorney's from affidavits swearing that the complaint is supportable by a reasonable inquiry into the facts, with sanctions for misrepresented claims, frivolousness ("frivolity" doesn't seem quite right here!), or suits filed solely to harass or raise costs.

b) Attempts to discourage litigation by allowing settlement offers to be filed by either side in court without being admissible as evidence, and by encouraging use of alternative dispute resolution procedures.

c) Adopting a "clear and convincing" standard for punitive damages, defined as "reckless, egregious, willful or wanton misconduct, or conscious, flagrant indifference to the safety of persons who might be harmed by the product." Much effort goes into these adjectives. There would be no cap on punitive damages.

d) Defines a statute of repose, limited to "capital goods" (a.k.a. "durable goods in the workplace"), equal to the product's "useful, safe life," with a rebuttable presumption that this ends after 20 years.

5) It may be too late to accept Gene Sperling's invitation to come up with an ideal liability bill. However, to the extent the door is open, I would suggest the following:

Joint and several liability: Retain, but allow all defendants to evade liability if they took due care. To deter deep pocket searches, immunize firms with "insignificant" responsibility. Liability law should be a way to ensure optimal care, not to provide insurance.

Punitive damages: Perhaps ensure that these look as much like "criminal" violations as possible, with appropriate burdens of proof, definitions, having judges set damages (as they issue sentences for convicted criminals), and having payments beyond reasonable court costs awarded to the state.

Statute of repose: I have a hard time wrapping my brain around this one, mostly because I don't see how manufacturers can do additional work to design products not to break a long after they are manufactured, if they have designed them not to be defective during a short time period. Still, long term liability can serve a useful function when manufacturers or sellers advertise a long life for the product, or when manufacturers come across data about a product's safety that were not available when the product was initially sold. Whether this liability should be limited by a fixed number of years or "useful safe life" seems to me to be a fairly small issue, especially when one can allow plaintiffs to plead that the liability should extend beyond a specific year limit.

Whatever ....

Tim

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Susanne Bachtel (CN=Susanne Bachtel/OU=OSTP/O=EOP [OSTP])

CREATION DATE/TIME:25-JUN-1997 13:13:32.00

SUBJECT: POTUS speech at UN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Rosina M. Bierbaum (CN=Rosina M. Bierbaum/OU=OSTP/O=EOP @ EOP [OSTP])
READ:UNKNOWN

David B Sandalow (CN=David B Sandalow/OU=CEQ/O=EOP [CEQ])
READ:UNKNOWN

TEXT:
Jack Gibbons called in from Tennessee and asked me to get you the following message.

He thinks you would agree with him the the sentence on p. 3 of the President's draft UN speech "It will carry significant costs" is too stark, quotable and needs qualifiers. At a minimum, Jack thinks "will" should become "could".

Our preferred language however is:

"It could carry significant costs unless we fully harness the promise of technology, support RD&D, and promote rapid innovation." (The next sentences capture the idea of needing multiple decades.)

Please call Rosina at 6-6077 if you want to discuss this. I think time is of the essence to finalize the speech, and your vote on this section should be transmitted to Daniel Benjamin (6-9371) of the NSC as soon as possible.

Thanks!

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:25-JUN-1997 14:42:37.00

SUBJECT: Principal Product Liability Mtg

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Francine P. Obermiller (CN=Francine P. Obermiller/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: WILLIAMS_A (WILLIAMS_A @ A1 @ CD @ LNGTWY [UNKNOWN]) (WHO)
READ:UNKNOWN

CC: BRENNAN_T (BRENNAN_T @ A1 @ CD @ LNGTWY [UNKNOWN]) (WHO)
READ:UNKNOWN

TEXT:
Janet
If I don't hear from you otherwise, I will assume that you want me to go to the second and final principals mtg. on product liability. If you want to go, or to be briefed on what happened at the first meeting, just let me know.
JF
---------------------- Forwarded by Jeffrey A. Frankel/CEA/EOP on 06/25/97 02:39 PM ---------------------------

Alice H. Williams
06/25/97 12:33:55 PM
Record Type: Record

To: Jeffrey A. Frankel/CEA/EOP, Francine P. Obermiller/CEA/EOP
cc:
Subject: Principal Product Liability Mtg

---------------------- Forwarded by Alice H. Williams/CEA/EOP on 06/25/97 12:33 PM ---------------------------

From: Melissa Green on 06/25/97 12:24:41 PM
Record Type: Record

To: See the distribution list at the bottom of this message
cc:
Subject: Principal Product Liability Mtg

Mr. Bowles has requested that Mr. Sperling hold another Principal Product Liability meeting tomorrow (6/26/97 at 3:00pm) to finish the work that was started in yesterday's meeting. A final decision on what recommendation to make to the President will be made by the end of tomorrow's meeting. This is the last chance for any Principal to be heard. Please make sure that your Principal is aware of the meeting and of what happened in yesterday's meeting. The meeting will take place in the Roosevelt Room.
Many thanks

Message Sent
To:
Andrew Pincus @ 482-0042 @ fax
Donald Remy @ 514-8071 @ fax
Edward Murphy @ 622-1294 @ fax
Givern @ 622-1188 @ fax
Beth @ 622-0081 @ fax
Julie @ 622-1800 @ fax
Anabella @ 622-0000 @ fax
Ron Matzner @ 205-6846 @ fax
Fran Allegra @ 514-1724 @ fax
Pam Gilbert @ 301-504-0121 @ Fax
John Dwyer @ 514-0238 @ fax
Jeffrey Hunker @ 482-4636 @ fax
Cheryl @ 307-2825 @ fax
Dalia @ 482-0052 @ fax
Ronnie @ 205-6802 @ fax
Rebecca R. Culberson/OMB/EOP
Janet L. Graves/OMB/EOP
Jason S. Goldberg/WHO/EOP
Carole A. Parmelee/WHO/EOP
Jill M. Blickstein/OMB/EOP
June G. Turner/WHO/EOP
Alice H. Williams/CEA/EOP
Elisa Millsap/WHO/EOP
Tracey E. Thornton/WHO/EOP
Peter G. Jacoby/WHO/EOP
Debbie B Bengtson/OVP @ OVP
Elizabeth Harrington/OVP @ OVP
Cathy Armstrong/ONDCP/EOP
Laura Emmett/WHO/EOP
Jennifer D. Dudley/WHO/EOP
Jonathan A. Kaplan/OPD/EOP
Robert G. Damus/OMB/EOP
Timothy J. Brennan/CEA/EOP
Charles W. Burson/OVP @ OVP
Lisa M. Brown/OVP @ OVP

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:25-JUN-1997 15:35:42.00

SUBJECT: Thoughts on the tobacco settlement payments

TO: Alicia H. Munnell (CN=Alicia H. Munnell/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Sarah J. Reber (CN=Sarah J. Reber/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: David L. Sunding (CN=David L. Sunding/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Cristian J. Santesteban (CN=Cristian J. Santesteban/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Mark J. Mazur (CN=Mark J. Mazur/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Charles F. Stone (CN=Charles F. Stone/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
[WARNING: JUST FINISHED; NOT PROOFREAD ....]

I've looked over the text of the tobacco settlement delivered to CEA yesterday. Among the many provisions regarding underage use, tort immunities, FDA regulation, and advertising, are three provisions that are expected to affect the price and, perhaps, the competitiveness of domestic cigarette sales. Very briefly, these three provisions entail:

1) Annual payments from cigarette manufacturers to local, state, and federal governments that will eventually rise to $15 billion per year. A noteworthy feature would be a statutory requirement that the annual payments "be reflected in the prices manufacturers charge for tobacco products."

2) An additional surcharge of up to $2 billion per year if teenage smoking (or use of smokeless tobacco) rises above certain prescribed percentages.

3) A provision setting an aggregate cap on subsequent outlays by cigarette companies in judgments or settlements associated with lawsuits from individuals, and where each dollar of such outlays reduces that manufacturer's payment to governments by 80 cents.

I'll describe each of these in more detail, with some predictions on their effects. At the outset, it is important to keep in mind that policy implications are particularly ambiguous here. Typically, price increases and output reductions would be justifications for opposing a policy initiative. In the cigarette context, the clear objective is to raise price and reduce consumption. To criticize aspects of this plan because they may lead to monopolistic behavior may miss the boat.

Annual payments

The largest financial aspect of the settlement is an annual payment that cigarette manufacturers would pay local, state, and federal governments to fund regulatory enforcement efforts, health care and research, and as a substitute for punitive damage claims that might have been paid to states in litigation. The basic features of the payment plan are:

1) An up front $10 billion payment, payable when enabling statute is signed.

2) An annual payment, beginning 12/31 of first full year after statute is signed, starting at $8.5 billion in year one and rising to $15 billion in year 5. This aggregate amount is subject to a volume adjustment, described below. During the first 8 years, between $2.5 billion and $5 billion per year are reserved for a "public health" trust.

3) Annual payments would be adjusted by the greater of 3% per year or the CPI.

4) Payments would be given "priority" in case of bankruptcy.

5) Payments would be tax-deductible.

6) The actual annual payment would be adjusted on the basis of actual sales volume.

a) If total unit sales increase, the annual payment at the end of that year would be the ratio of total sales in that year divided by total sales in 1996.

b) If total unit sales decrease, the annual payment at the end of that year would be the ratio of total sales to adults in that year, divided by total sales to adults in 1996. Any decrease in the annual payment resulting from this adjustment would itself be reduced by 25% of any increase in "net operating profits" over 1997 levels.

[Note 1: Why the unit sales base year is 1996 but the net profits base year is 1997 is not explained in the settlement. I'll assume it makes no difference to qualitative predictions on effects.]

[Note 2: The formula for decreasing the annual payment if aggregate sales fall would increase the payments at the margin if sales to minors fall. Since the payment in the event of an aggregate sales decrease would be based on sales to adults only, a cigarette sold to an adult instead of a minor would increase rather than decrease payments. As noted above and described below, there is a volume-based surcharge if sales to minors exceed prescribed levels. Whether this overcomes the other effect is not clear to me. It surely will not if sales to minors are below the prescribed levels.]

Leaving aside the "adult/minor" effect, the adjustment formula essentially means that the actual Annual Payment will be akin to a per-pack tax on cigarettes. Based on WSJ data indicating that roughly 25 billion packs of cigarettes were sold in the U.S. in 1996, the Annual Payment will result in a per pack tax ranging from 34 cents in the first year up to 60 cents (not counting the inflation adjustment). If there is an increase in net operating profit, however, the per-pack annual payment will fall by less than these amounts, reducing the marginal effect of the tax. If there's time, I'll come back to this below.

Market effects of the Annual Payment

If this tax were passed through to consumers penny for penny, the Annual Payment would raise cigarette costs by about 18-30%, based on an annual average per pack price of $1.91 (also from the WSJ). In principle, whether this would happen could depends on

a) how the annual payments affect the costs of each individual company,

b) the elasticity of demand for cigarettes, and

c) whether the marginal costs of producing cigarettes increase, decrease, or are constant over the range of sales volumes we are likely to see with and without the settlement,

d) whether the cigarette industry is characterized by price competition, product differentiation, quantity-limited oligopoly, or collusion.

Let's look at each in turn.

a. The effect of the tax on marginal cost.

Unfortunately, the settlement describes only the aggregate industry payment. The only places I can find with references to how those obligations would affect particular companies are

a) Summary, p.8 -- Payments would be "the joint responsibility of the participating companies."

b) Settlement statement, p. 35 -- The annual payment obligation would be "applicable to all sellers of tobacco products" [manufacturers? retailers? 7-11?].

The best guess at this point is that each company's share of the payment would be based on its market share, as the aggregate Annual Payment is based on actual aggregate volumes. Therefore, it's reasonable to think that each firm's marginal cost will go up by the amount of the tax.

b. Demand elasticity

A recent WEB article indicated that the elasticity of demand for cigarettes is -.4 in the short run and double that in the long run. Were the price of cigarettes to rise by the amount of the tax, the reduction on sales would go from about 7% in the long run (18% price increase times -.4) to 24% in the long run (30% price increase times -.8), assuming demand elasticity is constant over the relevant range.

c. The pattern of marginal costs

The usual economic assumption is that marginal production costs are constant. This seems reasonable here. The output effects are substantial only in the long run. Moreover, and perhaps more importantly, the sales percentage reductions calculated above are only domestic sales, and do not count exports, which I take to be a substantial and growing component of sales by U.S. cigarette manufacturers. Accordingly, the easy assumption--constant marginal costs at the margin--seems the safest.

d. Competition, collusion, or something in between?

The usual assumption in making back-of-the-envelope calculations is that markets are competitive. With constant marginal costs, one would get the simple and straightforward prediction that market prices would rise by the size of the tax, as discussed above.

That assumption might seem reasonable, as the industry has, I gather, at least five somewhat substantial competitors. However, I gather that there is an extensive economic literature arguing that this industry's performance significantly diverges from the ideal competitive model. Until we get a better sense of the industry, we might want to keep some options open:

1) If the industry is characterized by meaningful product differentiation, i.e., consumers do not view different cigarette brands as close substitutes, then we might expect price to be a constant markup over marginal costs. Assuming the different brand-specific elasticities of demand are constant over the relevant range, I think one would expect that the Annual Payment tax would lead to a more than penny-for-penny increase in the price of cigarettes. Of course, this assumption is probably impossible to validate in advance of experience.

[Note 3. There could be product differentiation downstream from the manufacturers, i.e., among cigarette retailers, but I think it better and safer to assume that the retail component of cigarette sales is pretty competitive.]

2) If each firm in the industry sets a quantity target--"Cournot oligopoly"--predicting what happens to market price depends on whether

demand elasticity is constant, and how costs vary across companies. Making the simplest assumptions--constant elasticity of demand and equal costs across companies--a ballpark estimate of the effect of the Annual Payment tax is that it would increase price by anywhere from 1.3 to 2 times the size of the tax.

[Note 4: This comes from the fact that the ratio of prices to marginal cost in a Cournot oligopoly meeting the assumptions in the text equals ne/[ne - 1], where n is the number of firms and e is the (constant) absolute value of the elasticity of demand. With n = 5 (the number of companies signing the agreement) and e = .8 (from long run elasticity of demand), the ratio of prices to marginal costs would be 4/3. With e = .4 (from short-run elasticity of demand), the ratio of prices to marginal cost would be 2/1.]

3) The industry could be collusive, but if so, they are leaving some money on the table, in that a cartel would set prices up to the point where elasticity of demand is greater than 1 in absolute value. The industry could be a cartel constrained by imports, but my very vague sense of the U.S. cigarette market is that imports are not a big deal.

All of these predictions are sensitive to assumptions that are probably impossible to verify. With different assumptions, e.g., marginal costs in cigarette production that increase with output, or elasticity of demand that increases as price increases, prices could rise by less than the Annual Payment tax, or not at all. However, that latter case may be ruled out by the provision in the settlement stating that the Annual Payment tax would "be reflected in the prices manufacturers charge for tobacco produc ts." How this proposed statutory provision would be enforced is a good question. It may result in setting a cartel-like price floor on cigarettes. Normally, we would regard this as a bad thing, but in this case, one cannot be sure. This could also be said of price increases that are passed through to consumers on a more than one for one basis.

The youth smoking surcharge

A second, less consequential financial aspect of the settlement is a provision to penalize the industry if smoking by 13-17 year olds [actually, 8th, 10th, and 12th graders] fails to fall to prescribed percentages of that population--from a 30% reduction in years 5 and 6 to a 60% reduction by year 10. (A similar reduction is prescribed for smokeless tobacco.) The penalty the industry would pay is $80 million times each percentage point that the actual reduction fails to meet this target, up to a $2 billion limit. This appears to rely on a percentage of a percentage. The WSJ reports, 35% of high schoolers have smoked in the past year. If there are about 3.5 million people in each of these three grade cohorts, then each additional person in those cohorts who smokes would cost the cigarette industry about $22.

[Note 5: $80 million divided by 10.5 million in the three cohorts, divided again by .35, the base percentage who report smoking.]

[Note 6: "The surcharge [in any given year] will be reduced to prevent double counting of persons whose smoking had already resulted in the imposition of a surcharge in previous years." I take this to mean that the $22 estimate is paid only once, not per year.]

Offsetting this effect would be the fact that any effort to advertise or sell cigarettes to persons in these three age cohorts would stimulate sales to those in adjacent cohorts, and perhaps adults as well. Moreover, the surcharge amount is fixed on a per youth-smoker basis. Suppose price exceeds marginal cost by 50%, implying an average per pack marginal profit of about 64 cents. ($1.91 times 2/3). Then, if one were to sell about 35 packs of cigarettes for each one of these "taxable" customers drawn into the market, the industry would break even.

If the surcharge payment obligation is likely to be assigned on a market share basis, each firm would retain a financial incentive to market cigarettes to younger consumers if they thought they could meet the break-even quantity. Moreover, each firm would retain an incentive to market disproportionally to younger customers, if the surcharges are allocated by share of the overall cigarette market.

Damage payments

While the settlement would end class action and state lawsuits, individuals would remain free to pursue cases. Any such payments made in those cases would reduce the industry's obligations on an 80 cents-on-the-dollar basis. There is an annual limit, but awards in excess of that limit are used to reduce annual payments in subsequent years. This essentially makes the recipients of the Annual Payment funds--local, state, and the federal government--liable defendants in these damage suits. One can surely predict that tobacco companies will be less willing to resist settling for large damage awards, or to put as much effort to litigating against individuals. I wonder if local, state, and federal governments will participate in these cases to protect their vested interest in minimizing payments to individuals.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:26-JUN-1997 10:36:07.00

SUBJECT: Becky Blank; I've been reading her stuff.

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
If you want to discuss...
JF

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Rosina M. Bierbaum (CN=Rosina M. Bierbaum/OU=OSTP/O=EOP [OSTP])

CREATION DATE/TIME:27-JUN-1997 09:17:50.00

SUBJECT: IPCC Press Release and Bolin Statement

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: T J. Glauthier (CN=T J. Glauthier/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

TO: Daniel K. Tarullo (CN=Daniel K. Tarullo/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Alicia H. Munnell (CN=Alicia H. Munnell/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Mark J. Mazur (CN=Mark J. Mazur/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

Jason Shogren (CN=Jason Shogren/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

Robert J. Tuccillo (CN=Robert J. Tuccillo/OU=OMB/O=EOP [OMB])
READ:UNKNOWN

TEXT:
In case you saw the Greenwire story questioning the Admin interpretation of the science, here's what we sent McCurry and below that is the official IPCC response issued today Hard copies en route. Rosina
****
To: Mike McCurry

On June 23, Fred Singer one of the most vocal climate skeptics issued a press release titled: Chairman Says Current Weather Extremes Not Linked to any Global Warming; Claims by Gore, Environmental Activists Cause for Mistrust. The statement implies that the international science body, the IPCC (Intergovernmental Panel on climate change), finds fault with Administration interpretation of climate science. The allegations were based on a verbal debate between Bert Bolin, Chair of the IPCC, and Singer which took place in Europe.

Yesterday,s Greenwire picked a piece of the Singer press release with a title IPCC Chair refutes Link to Weather and questioned whether Gore could link extreme weather events to climate change and whether the science was sound enough to call for action to reduce greenhouse gases. Because of the visibility of the Greenwire story, both the central IPCC office and

Bert Bolin personally have issued refutations of Singer press release (attached.)

Bolin denied criticizing Vice President Gore. Bolin noted that the statement attributed to Gore that this year's floods in the Upper Midwest "are consistent" with the predicted effects of climate change is a scientifically accurate statement and "no cause for criticism." He added that the large majority of governments at the Ministerial segment of the Second Meeting of the Conference of Parties to the UN Framework Convention on Climate Change (held in Geneva in June 1996), "while recognizing uncertainties, believe that we know enough to take some actions now," and that this position was supported by 2000 independent scientists in a letter to President Clinton several weeks ago..

GENEVA, 26 JUNE 1997

FOR IMMEDIATE RELEASE

Climate Change: IPCC Chair Denies Attack on VP Gore, Environmentalists

The Chairman of the UN's scientific advisory body on climate change denies criticizing Clinton administration officials and many environmentalists who have commented that recent extreme weather events may be the result of rising global temperatures.

According to a story which appeared in Greenwire (Thursday 26 June, story #3), Professor Bert Bolin, chair of the World Meteorological Organization/United Nations Environment Programme Intergovernmental Panel on Climate Change (IPCC) for the last 9 years, is alleged to have refuted statements by US Vice President Al Gore that this year's floods in the Upper Midwest of the United States "are consistent" with the predicted effects of climate change. He is also alleged to have said that efforts to establish such a link by environmentalists "is why I do not trust the Greens," and that "man-made increases in temperature are so small as to be barely detectable."

In a statement made from his home in Stockholm, Sweden, and issued through the IPCC office in Geneva, Bolin, a well-respected meteorologist, criticized the account of a climate-change debate in which he is alleged to have made these remarks, as "inaccurate and misleading."

Bolin denied criticizing Vice President Gore. Bolin noted that the statement attributed to Gore that this year's floods in the Upper Midwest "are consistent" with the predicted effects of climate change is a scientifically accurate statement and "no cause for criticism." Bolin went on to explain that "observations show that some extreme events are becoming more intense (heavy rainfall events in some regions), some are becoming less intense (cold spells), while others show no statistically significant changes (hurricanes). While it cannot yet be concluded that these changes are caused by human-induced changes of climate, neither can this association be excluded."

Bolin also denied taking issue with Tim Wirth, Under-secretary of State for Global Affairs. Regarding the statement that scientific questions about climate change have been resolved, Bolin observed that "considerably more research is required to fully clarify and interpret what is happening to climate, especially on a regional scale, and how changes will affect human societies over the years to come." He added that the large majority of governments at the Ministerial segment of the Second Meeting of the Con ference of Parties to the UN Framework Convention on Climate Change (held in Geneva in June 1996), "while recognizing uncertainties, believe that we know enough to take some actions now," and that this position was supported by 2000 independent scientists in a letter to President Clinton several weeks ago.

"I do not mistrust the 'Greens'," stated Bolin, who went on to observe that neither does he "agree with everything they say, however, just as I do not agree with everything that might be said by representatives of the fossil fuel industry, for example." He noted that his role as Chairman of the IPCC "is not to trust or mistrust any of the participants in the climate-change debate" but to ensure that the IPCC scientific assessment process is "fair and unbiased" and open to all "with a scientifically-supportable viewpoint based in research."

On the question of whether observed changes in climate can be attributed to human activities such as burning fossil fuels, Bolin noted that "The global mean temperature has increased by 0.3-0.6 degrees C since the late 19th century, and about 0.3 degrees over the last 40 years." He recalled that in its last major statement on this topic, the IPCC noted that "our ability to quantify the human influence on global climate is currently limited because the expected signal is still emerging from the noise of natural variability and because there are uncertainties in key factors." Nonetheless, the IPCC concluded that "the balance of evidence suggests that there is a discernible human influence on global climate."

# # #

For further information, contact Dr. Narasimhan Sundararaman, Secretary of the IPCC, at +41 22 730 8288.

Professor Bolin's full statement follows:

Dr. Fred Singer of the University of Virginia has distributed a press release, in which he refers to remarks I made, when he early this month presented his views about the IPCC Second Assessment (SAR) in Stockholm. As Chairman of the IPCC, and on the basis of the assessment conducted by the IPCC, I criticized a number of his "findings" severely. His account of what happened at this meeting is inaccurate and misleading.

The six "latest findings" that he refers to in his press release have either been considered by the IPCC and refuted or have not been published in the open scientific literature so that they could be assessed for their validity. The view that man is not so important as to affect the climate (quotation attributed to Professor Wibjorn Karlen) is irrelevant, since no evidence is presented that supports this view. Regarding Singer's self-congratulatory statement that the "discussion appeared to go decidedly against Dr. Bolin's IPCC position," I had rather the impression that Dr. Singers views did not convince those present.

Singer misinterprets several of my statements:

I do not mistrust the "Greens". This is not to say that I agree with everything they say, however, just as I do not agree with everything that might be said by representatives of the fossil fuel industry, for example. My role as Chairman of the IPCC is not to trust or mistrust any of the participants in the climate-change debate, whether they belong to environmental groups, industry associations or individual scientists. My role is to ensure that the IPCC process is fair and unbiased, as far as possible, and open to all those with a scientifically-supportable viewpoint based in research.

The occurrence of extreme events requires careful analysis. The problem with Fred Singer's press release is that he is not as precise as he should be. There are different types of extreme events. In fact, the IPCC SAR, which Singer says provides an accurate account of the state of scientific knowledge, highlights some of these distinctions, see pp. 168-173 of Volume I of the SAR for a discussion of our present scientific knowledge about extreme events. Observations show that some extreme events are becoming more intense(heavy rainfall events in some regions), some are becoming less intense(cold spells), while others show no statistically significant changes (hurricanes). These changes are consistent with the kind of changes that would be associated with a warmer climate. While it cannot yet be concluded that these changes are caused by human-induced changes of climate, neither can this association be excluded. To state that these sorts of changes that 'are consistent' with the predicted effects of climate change, as Vice President Gore is quoted to have stated, is a scientifically accurate statement and no cause for criticism.

The key issue is of course, if a human induced change of climate can be detected. The global mean temperature has increased by 0.3-0.6 degrees C, since the late 19th century and about 0.3 degrees over the last 40 years. Is part of this change due to our emissions of greenhouse gases to the atmosphere? Climate varies naturally and the issue is if we can detect a human-induced change of climate in spite of the "noise" due to the natural variability. The IPCC concluded: "our ability to quantify the human i nfluence on global climate is currently limited because the expected signal is still emerging from the noise of natural variability and because there are uncertainties in key factors. These include the magnitude and patterns of long term natural variability and the time-evolving patterns of forcing by, and response to, changes in concentrations of greenhouse gases and aerosols, and land surface changes. Nevertheless, the balance of evidence suggests that there is a discernible human influence on global climate." It should be noted that the inertia of the climate system and the counteracting effects of aerosols delay the appearance of a climate change, makes the issue more difficult to grasp, but does not diminish the possible seriousness of the issues.

Finally, I did not take issue with Tim Wirth, Under-secretary of State for Global Affairs in this debate. As Chairman of the IPCC, I have no reason to comment on the views of Mr. Wirth on this matter, nor did I do so at the meeting in Stockholm. Regarding the substance of the comment attributed to Mr. Wirth, namely that scientific questions about climate change have been resolved, considerably more research is required to fully clarify and interpret what is happening to climate, especially on a regional scale, and how changes will affect human societies over the years to come. It is also important to note that most governments at the Ministerial segment of the Second Meeting of the Conference of Parties to the UN Framework Convention on Climate Change (held in Geneva in June 1996) concluded that there is sufficient evidence to warrant reductions in emissions of carbon dioxide and other greenhouse gases, based on IPCC's Second Assessment Report. Therefore, the large majority of governments, while recognizing uncertainties, believe that we know enough to take some actions now. This position was supported by an independent group of 2000 scientists in a letter to President Clinton several weeks ago.

I find it most annoying that the account of the meeting in Stockholm has been presented in such a biased manner.

Bert Bolin (signed)

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RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Cristian J. Santesteban (CN=Cristian J. Santesteban/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:28-JUN-1997 17:07:58.00

SUBJECT: Article for the WEB: Computers and Productivity (Revisited)

TO: STONE_CF (STONE_CF @ A1 @ CD @ LNGTWY [UNKNOWN]) (WHO)
READ:UNKNOWN

TO: Alicia H. Munnell (CN=Alicia H. Munnell/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D8]MAIL438816878.116 to ASCII,
The following is a HEX DUMP:

SPECIAL ANALYSIS

Computers: "Everywhere, But in the Productivity Statistics?"

Over the last three decades, firms have made large investments in information technology. In spite of these purchases, trend productivity growth shows no signs of reversing its post-1973 slowdown. This raises the question of whether computer technology has had any real effect on the productivity of the U.S. labor force?

Some macroeconomic facts. Real investment growth in computing equipment has been large, averaging xx percent annually since the early 1970s. Partly, this has been a consequence of computing power becoming increasingly less expensive. The quality-adjusted price of computers has seen annual decreases of 18 percent for almost thirty years. Despite the high rate of investment, computing equipment remains a small fraction of the total net capital stock of the U.S. economy (see chart). In 1970, it was a mere 0.8 percent, while in 1993 it increased to 2.0 percent, significant but hardly "everywhere," as some economists have claimed. Using traditional growth accounting computers would be expected to contribute only 0.16 percentage points per year to growth in real gross output of the U.S. economy -- very small indeed.

Microeconomic evidence. Looking at research at the level of the firm reveals a potentially different story. Between 1987 and 1991, gross return on investment for computer capital averaged 81%, much more than the return to other types of capital investment. In addition, spending on computer workers generates several times as much output as spending on non-computer labor. Data for the financial services sector of the economy, including banking and insurance, show that firms invested very heavily in computing equipment in the last three decades. Research studies reveal substantial benefits arising from such large investments in computing equipment, on the order of two times the amount actually spent for computing equipment.

How to reconcile the two? Much of the output of computer-intensive sectors is in intermediate goods, which are not measured in final output, and thus do not directly contribute to productivity growth. In addition, many of the new innovations created by computers are in the form of hard-to-measure services. Traditional measures of productivity in services industries are not very good, as they understate quality improvement. Moreover, new services that result from computerization are also slow to be introduced into the statistical measures. Admittedly, this has always been the case; but, in the case of computer services the rate of new innovations might make measuring output more difficult than before. Although, computers may not yet be a big fraction of the total capital stock in the United States, the effect on output may be far larger.

Organizational delays. Most large modern establishments do not immediately adopt the newest generation of computing platform, delaying potentially revolutionary applications. A good example can be seen in the present transition from mainframe-based computer platforms to those based on PC Local Area Networks (LANs). The adoption of LANs has finally taken off in the 1990s after more than a decade of media hype and technologists' predictions of enormous benefits. In most organizations, the process of integrating PCs into the existing large business systems has been very difficult. It has called for developing new organizational forms, new job definitions for workers that use computers, even new relationships between the firm and its suppliers and customers, as in the case of networked computing. The new LAN platform itself is not strictly better than the old on all dimensions but instead has strengths and weaknesses (see table). If firms want to take advantage of the strengths and avoid the weaknesses, they must undergo tedious learning. Aware of the costs involved in experimentation, firms do not immediately invest in the new technology. As a result the social return to new technology may be driven, not by the raw technology itself, but by the organization using it.

Conclusion. Undoubtedly, information technology is changing the way we work and live. This transformation has not explicitly translated in a surge in the productivity growth statistics. Part of the reason is that in spite of the huge rates of investment, computers are still a small chunk of the total capital stock. Nevertheless, some industries, namely those that were particularly heavy investors of the technology, have benefited tremendously. Mismeasurement problems may also partly explain why we are not seeing productivity increases in the official statistics. Regardless, the fruits may be on their way as it takes time for firms to redesign their productive organization around potentially revolutionary technology.

Mainframe Computing	**PC LAN Computing**
High cost of achieving customized output	Huge improvement in user-interface and functionality
Powerful and reliable for large problems	Not proven for large computationally

because of established methods	intensive problems.
Low cost of using software as rate of innovation is slow	High cost of learning due to rapid development of applications

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:30-JUN-1997 14:16:29.00

SUBJECT: staff changes

TO: Alicia H. Munnell (CN=Alicia H. Munnell/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Next Monday, July 7, Chris Carroll, Randy Lutter and Joe Aldy (the PMI) all will be starting. July 7 also will be Cindy's last day. And, Tim Brennan has agreed to stay on an extra week (until July 11). Just so you know, there may be some short-term chaos with the office situation. There are more people coming then going in the next couple of weeks, so we'll have some temporary quarters and possibly some doubling up. Hopefully it won't create problems.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:30-JUN-1997 17:21:21.00

SUBJECT: Electricity #2: Tax-exempt bonds; public benefit funding

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: douglas.w.smith (douglas.w.smith @ hq.doe.gov [UNKNOWN])
READ:UNKNOWN

CC: Kathleen M. Wallman (CN=Kathleen M. Wallman/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

CC: Cristian J. Santesteban (CN=Cristian J. Santesteban/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Randall W. Lutter (CN=Randall W. Lutter/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: Thomas A. Rhoads (CN=Thomas A. Rhoads/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Following the meeting on June 24th to discuss positions on consumer information, system reliability, state/federal jurisdiction, and Federal power, the interagency group met on June 27th to reach positions on funding of "public benefits" and tax issues. On both topics, Treasury has taken a lead role and circulated some views that differ from DOE's. Here's a rundown of the issues and differences of opinion, and some recommended CEA positions.

Tax exempt bonds and public power

A first, technical issue involves the tax treatment of funds set aside for the decommissioning of nuclear power plants. DOE and Treasury seem pretty content on this one, and there do not appear to be significant policy issues at stake.

A more interesting issue has to do with the ability of states and municipalities to issue tax-exempt bonds (TEBs) to fund publicly-owned utilities. There is a "private use" rule that prohibits use of TEBs that would limit the right to continue to deduct interest from these bonds if the utilities they finance look sufficiently like competing privately-owned power producers. Both DOE and Treasury agree that already-issued TEBs should be grandfathered, to prevent serious disruptions in municipal bond markets. Both also agree that TEBs should continue to be used to pay for local distribution facilities owned by public utilities.

The difference of opinion pertains to how TEBs should be used in the future. Treasury would allow TEBs to pay for new transmission and generation facilities "not used in a deregulated environment." Use of new TEBs to maintain generators already funded by TEBs, but that are used in a deregulated environment, would not be allowed. DOE would allow use of new TEBs for transmission, and for maintenance of generators funded by already-issued TEBs.

There are two arguments for limiting TEBs for new enterprises. The familiar generic one, offered by Treasury, is that tax-exemption is typically fiscally inefficient, in that the federal treasury loses more money than local governments save. On those grounds alone, Treasury would want to reduce the use of tax-exempt bonds for funding subsequent utility investment, but it recognizes that this is not the occasion for a broad challenge to the institution of exempting local bond interest from federal income tax. A second argument is that a utility with access to TEBs will have an artificial competitive advantage over those that do not when competing in power markets. At the margin, less efficient public power providers would displace lower cost private power providers.

Both of these points support most of Treasury's position. Since transmission is not likely to be supplied competitively in the foreseeable future, the only disadvantage there is fiscal inefficiency. In the interest of maintaining clean legislative lines, and assuming we can't cut such funding altogether, I'd recommend continuing our policy regarding tax-exempt funding of transmission facilities--whatever that policy is--rather than trying to identify transmission facilities "in the deregulated environment."

Treasury's willingness to allow funding for only generators (or transmission providers) not in the deregulated environment is consistent with avoiding inefficiencies created by artificial competitive advantages. A sunk funding advantage in construction does not distort the market, but allowing TEBs for maintained or expanded facilities would. This specifically argues against DOE's position that TEBs continue to be used to maintain existing TEB-funded generators.

Treasury proposed defining a "deregulated environment" as passage of power through transmission facilities managed by independent system operators (ISOs). This seemed rather awkward to most of the interagency group. Treasury's intent in this proposal was to retain tax-exempt status for isolated, publicly owned facilities, primarily in rural areas that would not served in the grid. If that's so, we might either attempt to specify in the legislation this "special case" in a more fundamental way, perhaps with a showing that absent tax-exempt funding for construction of a particular generator, some substantial area and group of consumers would have to pay a "high" price for electricity.

Proposed recommendation: Tax-exempt funding for transmission and distribution should be continued using current procedures. Tax-exempt funding for any new generation investments, including maintenance, should be eliminated, absent a showing by the petitioner for such funding that electricity prices to a substantial group of consumers would be unacceptably high.

"Public benefits" funding

Public benefits in this context refers to a number of subsidy programs supported by state regulation and federal statutes, and funded one way or another from revenues assessed against utilities. These include requirements to use renewable energy sources, "demand side management" energy efficiency programs, research and development into alternative power generation technologies, and low-income "universal service" subsidies. DOE estimates that the current amounts spent on these programs are

Renewable energy use	$3.2 - $4.7 billion
Alternative power R&D	$.7 billion
Energy efficiency/DSM	$1.7 billion
Low income subsidies	$.4 billion
Total	$6.0 - 7.5 billion

In total, these come out to about 3-4% of the roughly $200 billion the nation annually spends on electricity. In addition, transition services for utility employees displaced by retail competition from non-utility power producers has been added to the list.

DOE proposes a 1 mill per kilowatt-hour, or about a 3% tax, on electricity use to support matching grants to states that wish to fund programs along these lines. Treasury is generally opposed to DOE's proposal. I'll get to specifics below, but their main general points are that taxes, by any name, are politically untenable, and that states that have proposed to deregulate generally have adopted "public benefits" spending programs, making a federal mandate unnecessary.

Friday's discussion covered the smallest pieces, low-income subsidies and alternative power R&D, but handouts from Treasury and DOE addressed all of these issues. Each merits analysis, but before getting to that, we need to air a threshold question that I've raised earlier:

Do we use restructuring as a vehicle to either boost or eliminate so-called social programs, or do we adopt a minimalist, "status quo" approach designed to rock the other boats as little as possible?

In thinking about these issues in turn, (as well as EPA's pollution control proposals to be described in a subsequent memo), this overarching policy and political question needs to be kept in mind.

1. Renewable energy use:

Much of this $3.2-$4.7 subsidy for funding renewables is, I think, the result of Federal requirements, implemented by states, to buy power.

This requirement, if justified at all, would be best implemented through DOE's proposed "renewable portfolio standard (RPS)," i.e., marketable requirements to generate X% of power using renewables. The RPS will be discussed on July 1st, including criticisms of the net benefits of renewable support. If RPS covers this portion of the public benefits requirement, it should reduce the proposed tax by about half, to about .5 mil/kWh.

We should also remember that retail competition will facilitate the sale of "green" power to those willing to pay. The magnitude of that market is relatively nontrivial, although the ability to serve it may come more from clean natural gas plants then from windmills or biomass generators. To the extent that people are willing to pay for "green" plants on their own, or to pay for less-polluting power, the economic justification for imposing additional output requirements, subsidies, or taxes becomes less c ompelling. Again, I'll cover this more in the subsequent memo on the RPS proposal, after it comes up in the July 1st meeting.

2. Alternative power R&D

The argument in favor of this proposal is that utilities will no longer fund R&D into renewables if the market becomes competitive. This is not obvious. For example, one might be hard-pressed to make a case that telecommunications has become less innovative since deregulation, or that the computer industry has been too slow to innovate because they have not been protected from competition.

Treasury argues that we don't need a budget here for renewable R&D. The federal government has ways of budgeting and managing R&D programs, and there is no case for setting aside a special fund here for renewables. In addition, the RPS should stimulate whatever demand is appropriate for R&D. Some advocates of renewable power R&D subsidies opined that some forms of renewable power are nowhere close to meeting a market test of profitability. That strikes me as an argument against subsidizing those forms of power, not one in favor of such subsidies.

3. Demand-side management conservation programs

The economic foundation for DSM programs in the regulated electricity sector have always been slightly mysterious. The textbook problem in regulated industries is that prices are typically held above marginal cost, in order to give regulated firms enough revenue to cover the substantial fixed costs that created the monopoly which justified the regulation in the first place. On that theory, consumers consume too little of a regulated product, not too much, because the price is too high. We would be better off at the margin subsidizing complements to electricity, not substitutes.

However, there are four rationales for DSM programs that may be offered:

a. The Averch-Johnson effect: Regulated utilities have too great an incentive to build plants, to expand the rate base. Accordingly, we should institute programs to discourage demand for electricity.

I'm not sure how much data there would be to support this. I suppose the stranded cost problem would not be so large if utilities had been somewhat more reluctant to build new plants. [This DSM justification does suggest that regulators were not as able as they ideally should have been to build new plants, indicating that utilities should bear more responsibility for stranded costs.] With growing competition in generation, the incentive to overbuild plants will be substantially reduced.

b. Regulatory pricing inflexibility: Regulators did not allow utilities to vary prices across seasons and times when electricity use is at peak demand, thus causing overbuilding of plants to meet demand at those times.

This could justify programs to subsidize energy-efficient refrigerators, air conditioners, and office equipment to reflect what would have been installed had consumers faced proper peak-period prices. But with increased competition, generators can undertake the tradeoff themselves between offering consumers a relatively high fixed price for electricity, to cover the cost of peak-demand plants, or a lower average costs but with the ability to charge higher prices during peak periods.

c. Consumer myopia: Consumers don't take future cost savings into proper account when purchasing appliances, so the government has to do it for them by subsidizing energy-efficient appliances or mandating their use.

This is controversial in the economics literature. The implied discount rates in appliance purchases seem high, but I have seen financial economists claim that unwillingness to invest in energy efficiency is a risky investment given the low mean and high variance in energy prices. Be that controversy as it may, competition will allow generators to internalize these gains. They can offering consumers bundles of appliance and power contracts that make money for the presumably less myopic businesses, while keeping the allegedly more myopic consumers content.

d. Externalities: Using electricity creates negative externalities, primarily environmental, that consumers do not internalize. Subsidizing energy-efficient appliances corrects for this market failure.

One could justify DSM programs (and RPS) as policies to institute the investments in energy efficiency (or non-fossil fuels) that we would put in place if we had appropriate taxes on emissions of air pollutants or greenhouse gases. But as the next memo will discuss, EPA is proposing cap-and-trade systems for emissions that "in the judgment of the [EPA] Administrator, endanger the public health or welfare." The idea that there are EPA cannot directly regulate significant externalities in the electric utility industry is untenable.

4. Low-income subsidies

Federal and state programs for low-income energy purchases constitute only about .2% of annual electricity sales ($400 million out of $200 billion). Federal funding for low income heating assistance and weatherization have dropped recently, according to DOE. Treasury argues that we have direct ways of helping low-income individuals. It concedes, however, to address remaining concerns, we might adopt "a floor that all state low-income assistance programs should meet, funded by a small fee on energy consum ption in each state." DOE has no substantive objection, but thinks that it may be coercive, and put the federal government in the difficult position of assessing state-specific taxes.

5. Transition issues for displaced workers

This has not been a big issue in the working group so far. As I'm not particularly expert on the pros or cons of such programs, I'd prefer to wait for more discussion among my interagency colleagues. My very crude instinct is that we ought to take some steps to spread the benefits of programs that promote efficiency, including efforts to minimize costs borne by displaced workers. However, I also understand that excessive efforts to protect economies from change can lead to inflexibility that reduces the well-being of most people. In addition, with a 4.8% unemployment rate, the argument that experienced workers need help finding jobs may not be as compelling as it might be during a recession.

Proposed recommendations on public benefits: Substantively, my positions more or less line up with Treasury's on these issues.

1. Support for renewables R&D probably belongs in general R&D programs or as a reasonable byproduct of a justifiable RPS.

2. DSM efficiency programs may be declining as competition spreads--EPA has supplied data to that effect--but they are harder to rationalize in a competitive environment, especially given EPA's recently manifested ability to impose stringent air quality standards.

3. Low-income support seems to be a relatively small in financial magnitudes. While economics would support folding energy programs into general income support, the specter of unlit or freezing residences perhaps warrants targeted programs to address this particular need.

4. It may be cleaner and easier policymaking, however, to separate electricity restructuring from a reassessment of the design magnitudes of social benefit programs, pro or con, unless the need for such reassessment is clearly tied to retail competition.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:30-JUN-1997 17:11:00.00

SUBJECT: Re: Per our conversation yesterday

TO: Joseph J. Minarik (CN=Joseph J. Minarik/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

TEXT:
Many thanks for the suggestion. We would appreciate having the chance to collaborate and turn to you for help on occasion.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 1-JUL-1997 15:28:50.00

SUBJECT: Electricity #3: Renewable Portfolio Standards

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Kathleen M. Wallman (CN=Kathleen M. Wallman/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Daren K. Wong (CN=Daren K. Wong/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: Jonathan.gruber (Jonathan.gruber @ treas.sprint.com @ inet [UNKNOWN])
READ:UNKNOWN

CC: Thomas A. Rhoads (CN=Thomas A. Rhoads/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: James Mietus (CN=James Mietus/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: Douglas.w.smith (Douglas.w.smith @ hq.doe.gov @ inet [UNKNOWN])
READ:UNKNOWN

CC: Sarah J. Reber (CN=Sarah J. Reber/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Cristian J. Santesteban (CN=Cristian J. Santesteban/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Renewable portfolio standards -- marketable requirements that each seller of electricity supply X% of its power with "renewable" fuels -- were the main topic of the July 1 interagency group meeting. Under current laws requiring regulated utilities to purchase renewable power at what their state regulators determine to be "avoided cost," about 1.6% of power is produced by renewables. The DOE proposal would replace these laws, which most regard as untenable with competition in generation, with a RPS of 2% f rom 2001 to 2004, 3.5% to 2009, and 4.5% from 2010 until fifteen years after the legislation is enacted. If legislation is enacted in this session of Congress, e.g., before the end of 1998, the RPS would expire in 2013.

Some of the discussion dealt with the definition of "renewable" power. Hydroelectric power does not count in DOE's proposed definition, probably because no one believe that there is insufficient demand for hydroelectric power. EPA also wants to exclude municipal solid waste, because such waste often includes non-renewable items (tires, plastic).

Most of the discussion, however, centered on contentions expressed primarily by Treasury, with some help from me, as to whether the increased RPS standards after 2004 were justified. Kathy Wallman asked me to write the "doubting Thomas" memo expressing arguments against expansion, and perhaps retention, of the RPS. With some modification, this email will be a first take on that. I'll provide four justifications I've heard expressed for renewables policy generally, and offer some criticisms. My impression is that these views will then serve as a tackling dummy for the renewables supporters in the group. Still, if CEA, Treasury, or others want dispute these issues up the chain, we and they will be free to do so.

To all readers: Please give me any suggestions you have before this is converted to something Kathy Wallman can circulate for interagency group distribution and target practice.

Three initial observations

Efficiency of RPS: If one believes that the right policy is to set targets for renewable power generation, then an RPS seems to be the most efficient way to go. Therefore, the policy debate should primarily be based on what the RPS should be--including zero, perhaps--rather than on whether there are better means to that end. However, the proper focus could be on price, not quantity. If one believed that fossil fuels are undertaxed by z cents per kWh, one might want a renewable use subsidy equal to z cents, and let quantities sort themselves out that way.

Status Quo: One could view a 2% RPS as an efficient way to maintain the government's previous commitments to renewable technologies, but using market-based mechanisms affecting all suppliers rather than the prescriptive methods applied just to incumbent franchised utilities. Were we to adopt the view that we should do as little as possible in electricity restructuring legislation, except to adapt prior policies to a competitive environment, a 2% RPS would be reasonable. However, this "status quo" perspective would not support expanding the RPS in later years.

Sunset at high noon: In DOE's proposal, the RPS increases over time, and then plummets to zero. This seems an odd policy time path. One would think that if a sunset is a good idea, that the RPS would decline to zero by the sunset period, not increase until that point.

Four arguments, pro and con

The first of these arguments had occurred to me; the others arose during the course of the July 1 meeting.

Substitute for environment policy:

Pro-RPS: Suppose that, for one reason or another, the ability to regulate or tax emissions from using fossil fuels was attenuated, e.g., because of political inability to impose an optimal carbon tax. One would then get too much fossil fuel use in electricity generation, relative to other fuels. A reasonable response might be to ask what fraction of power would be generated by non-fossil fuels were there an efficient tax or emissions quota, and then order the industry to use that fraction of non-fossil fuels.

Con: The premise that EPA cannot effectively regulate emissions seems somewhat untenable, particularly in light of its success in instituting strict ozone and PM standards. The case for RPS would perhaps be stronger if electricity legislation did not extend EPA's authority, but with the possible (significant) exception of carbon dioxide, EPA appears to have authority to regulate other electricity-related pollutants.
Moreover, an optimal response to an optimal tax might result in added use of non-fossil fuels sources such as hydroelectric and nuclear power, or as DOE pointed out in the July 1st meeting, natural gas, a low-emissions fossil fuel. Finally, I gathered from the meeting that DOE has yet to do research to justify its high and increasing RPS standards.

Renewables as infant industry:

Pro-RPS: One participant argued that it was important to ensure a U.S. presence in future international markets, and that doing so required stimulating domestic demand now.

Con: I'm not an expert in this "infant industries" argument, but in general I think a skeptical attitude is appropriate. Markets, not governments, are the social institutions best suited for eliciting and transmitting information about future profit opportunities. Moreover, the renewables industry in the United States has received Congressional nurturing since the passage of the Public Utility Regulatory Policy Act in 1978. At some point, an infant industry is better regarded as immature if it cannot survive on its own.

Finally, it may be worth remembering that retail competition will allow consumers to choose power that is generated in a more environmentally-friendly manner. If renewables do as well in the market as their advocates promise, the need for added promotional incentives via an RPS is less compelling. [On the other hand, if demand for renewables were sufficiently strong to lead to, say 5% renewable-based generation, DOE's RPS would not be a binding constraint even at its most stringent level.]

Utilities control the market:

Pro-RPS: The renewables industry cannot break into the market, because entry is controlled by investor-owned utilities that are committed to fossil fuels and nuclear power.

Con: Utility control over entry into the industry is based on the ability to deny transmission grid access to non-utility generators. A major step to eliminating that ability was FERC's Order No. 888, which granted open access rights to independent power producers. This Order may not suffice if utilities have the ability to discriminate against non-utility producers in other ways. However, if market power is a perceived problem, there are more direct solutions, including formalized ISO requirements or divestiture--not to mention continuing oversight by the Department of Justice and FERC.

Finally, even if a utility has market power, it has no reason to refuse to use renewable power sources if they cost less than fossil fuels or nuclear, or if consumers are willing to pay the extra cost for them. A monopolist makes more money by meeting consumer demands or by using the cheapest fuels sources. If fossil fuel prices do not take environmental cost into account, a monopolist will be less willing to use renewables than it should, but that is equally true if the utility industry is perfectly competitive. The argument for RPS then reverts to the first item in this list, with those pros and cons.

Gather political support for restructuring:

Pro-RPS: To pass legislation to promote retail competition in electricity, it will be necessary to include pro-renewable constituencies in the coalition, even if such policies are economically wasteful in and of themselves.

Con: This isn't much of a con, as I have no expertise on this question. I do refer back to the "status quo" point above. Given aversion to political losses, the pro-renewable community may have enough clout to prevent a rollback of current practices, suggesting a case for a roughly 2% RPS. But the same perspective suggests that significant increases in renewable use beyond current practice could generate the same political activism by those on the other side of the issue. If passing retail competition legislation quickly is important, we perhaps should consciously and publicly design a policy to vary current practices as little as possible, except to make their implementation more efficient and consistent with such competition.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Lisa M. Kountoupes (CN=Lisa M. Kountoupes/OU=OMB/O=EOP [OMB])

CREATION DATE/TIME: 1-JUL-1997 19:25:22.00

SUBJECT: URGENT REVIEW OF BUDGET LETTER NEEDED

TO: Bruce N. Reed (CN=Bruce N. Reed/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TO: FOLEY_M (FOLEY_M @ A1 @ CD @ LNGTWY [UNKNOWN]) (WHO)
READ:UNKNOWN

TO: Gene B. Sperling (CN=Gene B. Sperling/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TO: John Podesta (CN=John Podesta/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TO: Elena Kagan (CN=Elena Kagan/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TO: Barbara Chow (CN=Barbara Chow/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TO: John L. Hilley (CN=John L. Hilley/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Sylvia M. Mathews (CN=Sylvia M. Mathews/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

CC: Melissa Green (CN=Melissa Green/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Christopher C. Jennings (CN=Christopher C. Jennings/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Lawrence J. Haas (CN=Lawrence J. Haas/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: Ellen S. Seidman (CN=Ellen S. Seidman/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Charles R. Marr (CN=Charles R. Marr/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Cynthia A. Rice (CN=Cynthia A. Rice/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Elisa Millsap (CN=Elisa Millsap/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

CC: Jeanne Lambrew (CN=Jeanne Lambrew/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Mark J. Mazur (CN=Mark J. Mazur/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Emil E. Parker (CN=Emil E. Parker/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Diana Fortuna (CN=Diana Fortuna/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Janet Murguia (CN=Janet Murguia/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TEXT:
FYI - you should have received in hard copy the following memo delivered
to your offices
with followup phone calls.

July 1, 1997

MEMORANDUM TO SYLVIA MATHEWS
JOHN PODESTA
JANET YELLEN
GENE SPERLING
JOHN HILLEY
MARTHA FOLEY
BARBARA CHOW
BRUCE REED
ELANA KAGAN

FROM: Larry Haas
Lisa Kountoupes

RE: URGENT -- Budget Conferees, Letter

Enclosed is the draft conference letter. Unfortunately, we need
you to turn this around
in short order. Congress has requested that we deliver it as soon
as possible, and we
want to do so by mid-day. Please provide us with any mark-ups of
hard copy by 9 a.m.
tomorrow (Wednesday) -- at the latest. Unfortunately, we won,t
be able to use electronic
comments. Larry is in Room 253 or at fax 5-6818. Lisa is in Room
249 or at fax 5-3729.

We apologize for the short turn-around, but our staffs have been
crashing all day just

to get this draft done for your perusal and, for many reasons, we believe it will help our efforts to deliver our views as specifically and as quickly as possible.

Thank you for your help.

CC: Jack Lew
Josh Gotbaum

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 1-JUL-1997 11:49:19.00

SUBJECT: Boeing/MD

TO: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
#1 of two short notes to Dorothy Robyn on Boeing/McDonnell Douglas

Tim
---------------------- Forwarded by Timothy J. Brennan/CEA/EOP on 07/01/97
11:48 AM ---------------------------

Timothy J. Brennan
05/28/97 04:37:36 PM
Record Type: Record

To: Dorothy Robyn/OPD/EOP
cc: Jeffrey A. Frankel/CEA/EOP, Cristian J. Santesteban/CEA/EOP
Subject: Boeing/MD

I've looked over that EU and Boeing stuff quickly. Because I have to leave in not too long to rescue the car from the shop, I have to be brief right now. If need be, I'll pass along more comments tomorrow.

I may be missing a crucial couple of pages, as noted below. But for that, my quick read is that many of the EU's complaints about exclusive deals with American and Delta, technology transfers from defense research, and cross-subsidized predatory pricing of mid-sized aircraft, are not convincing on their face. However, the documentation lays out a reasonable prima facie case against the merger in markets for commercial aircraft, and possibly in markets for government R&D contracts and for aerospace related intellectual property. The sunk costs of entering this market do appear substantial (EU at 51).

The main argument in support of the merger seems to be that McDonnell-Douglas is a "failing firm." However, the question should then be not whether MD would go out of business, but whether the productive assets--factories, parts manufacturing, patents, R&D facilities, would disappear or "exit the market," as the Merger Guidelines phrase it. The answer to this question depends upon facts not at my disposal, although it is noteworthy that MD's share has apparently shrunk to about 2% in commercial aircraft sales (EU at par. 38). The EU opinion addresses this question only briefly, claiming that MD's competitive significance exceeds its small share. Unfortunately, some potentially crucial paragraphs on this subject (61 through 69) were not included in my copy.

Talk to you tomorrow.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 1-JUL-1997 11:49:45.00

SUBJECT: Re: Boeing - MD

TO: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
#2 of 2. -- Tim
---------------------- Forwarded by Timothy J. Brennan/CEA/EOP on 07/01/97 11:49 AM ---------------------------

Timothy J. Brennan
05/29/97 10:27:46 AM
Record Type: Record

To: Dorothy Robyn/OPD/EOP
cc: Jeffrey A. Frankel/CEA/EOP
Subject: Re: Boeing - MD

Gay just brought the missing pages from the EU's Boeing-MD decision. I'd be happy to sit in on the call, but I've got a USEC meeting at 1:30 this afternoon, I think at NRC, so I may be out of the office for a while. All of Friday morning is tied up with electricity, followed by a lunch talk at CEA from 12:30-1:30. Basically, late this afternoon and tomorrow afternoon should be OK.

[takes a second to skim the newly brought pages]

The EU's opinion here is troubling. On the one hand, they dispute some of the facts regarding the continued presence of MD and its productive assets in the market. On the other hand, the EU seems to find that Boeing would make MD a stronger competitor, which is an argument in favor of the merger.

I guess my not-so-bottom lines here are that:

1) Much of the EU's analysis is not particularly good. In many cases, the analysis is so obviously predicated on protecting Airbus rather than competition to make some of the factual findings less than trustworthy.

2) But there is a strong prima facie case that this merger would reduce competition in commercial aircraft production, and perhaps in some

ancillary markets.

3) The key factual question is what would happen to MD's assets but for the merger. Even if MD itself might fail, could its plants, inventories, and backlog claims be transferred to someone other than Boeing or Airbus? Answering this question takes a lot of investigation, which I assume is taking up a large amount of time of many competent economists and attorneys at the FTC.

4) The last point suggests to me that any dealings EOP and USTR has with the EU on this should be limited to protecting the FTC's right to make an independent decision, or one coordinated with the EU, rather than having it's analysis preempted. But we probably ought not get into an argument with the EU on its analysis as such.

Tim

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 1-JUL-1997 10:57:37.00

SUBJECT: Keith Fuglie

TO: Charles F. Stone (CN=Charles F. Stone/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Alicia H. Munnell (CN=Alicia H. Munnell/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Keith, who is replacing Dave Sunding, is scheduled to start on July 14.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 1-JUL-1997 10:49:04.00

SUBJECT: Shackleton

TO: Alicia H. Munnell (CN=Alicia H. Munnell/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Jason Shogren (CN=Jason Shogren/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
As I mentioned, Bob Shackleton (an economist at EPA; he is the local keeper of the G-cubed model) yesterday volunteered to me an interest at working at CEA on global climate change. The language he used seemed to imply he might even be a free loan, tho that would certainly have to be checked out. I believe that Jay and others have a very high opinion of him. If Jay is not staying in the Fall -- or even if he is -- I think we should explore this possibility.
JF
JF

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 2-JUL-1997 09:34:33.00

SUBJECT: Boeing

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Dorothy Robyn sent this clarification. I tend to err on the side of caution, but I'm inclined to go along with Tarullo on this.

Tim
---------------------- Forwarded by Timothy J. Brennan/CEA/EOP on 07/02/97 09:30 AM ---------------------------

Dorothy Robyn
07/01/97 08:12:11 PM
Record Type: Record

To: Timothy J. Brennan/CEA/EOP
cc:
Subject: merger

The Administration is hardly thinking of concluding "that the EU's decision was nothing other than a poorly disguised effort to handicap Boeing in its competition for contracts with Airbus." To the contrary, Dan's inclination is to say nothing, so as not to jeopardize the 1991 comity agreement and inspire reciprocal treatment from the EU in the future. He is chairing a principal's mtg. next week to debate the wisdom of various options.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Peter R. Orszag (CN=Peter R. Orszag/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME: 2-JUL-1997 16:03:05.00

SUBJECT: Commission memo

TO: Jacob J. Lew (CN=Jacob J. Lew/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Franklin D. Raines (CN=Franklin D. Raines/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: Joshua Gotbaum (CN=Joshua Gotbaum/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Jill M. Blickstein (CN=Jill M. Blickstein/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

TEXT:
Gene wanted you to look over the attached memo, which reflects our
discussions on Medicare and Social Security commissions. Please give
comments to Gene or to me. Thanks.=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D78]MAIL44968528K.116 to ASCII,
The following is a HEX DUMP:

CLOSE HOLD

July 2, 1997

MEMORANDUM TO THE PRESIDENT

FROM: **GENE SPERLING**

SUBJECT: **Long-term entitlement reform**

As you know, our original game plan on long-term entitlement reform was first to pass the balanced budget agreement and then to turn our attention to the longer-run challenges. But we no longer have the luxury of waiting until after the budget agreement is implemented: both the House and Senate reconciliation bills set up Medicare commissions. We must therefore decide immediately whether to accept a commission on long-term Medicare reform. We must also decide whether we want to set up a commission on Social Security -- probably separately from the Medicare commission -- within the budget legislation.

The purpose of this memorandum is to explore three related questions. First, should our long-term entitlement strategy put more priority on Social Security reform or Medicare reform? Second, even if we believe that our best strategy is to focus on Social Security, should we still support a Medicare commission, and, if so, should we try to change the congressional proposals to ensure that the commission neither interferes with our efforts on Social Security nor produces problems for Medicare? Third, should we support the creation of a Social Security commission now, or should we allow ourselves more time to analyze the best way to proceed?

Where should we focus our efforts on long-term entitlement reform?

A first step in addressing our immediate concerns is that we must decide where to place our emphasis in long-term entitlement reform. Senator Lott and other Hill leaders have indicated that they want to tackle long-term Medicare reform first. *But your economic and health advisers believe that we should concentrate our initial political capital primarily on*

Social Security. The basic argument is that the various options for tackling Social Security are — at least by comparison with Medicare — well-researched and relatively well-understood. Our understanding of how to address Medicare in the long term is limited. Indeed, your four top health advisers -- Donna Shalala, Chris Jennings, Bruce Vladeck, and Nancy-Ann Min -- believe that the budget agreement embodies all the obvious steps in reforming Medicare, and that we need much more analysis before considering which additional long-term policies are sensible. Medicare combines Social Security ' s demographic challenges with those posed by a health care delivery system characterized by generally rising health costs per beneficiary but much uncertainty over the dynamic evolution of those costs, making effective reform particularly complicated.

Chris Jennings will be submitting a separate memorandum to you explaining why long-term Medicare reform is difficult.

How should we respond to the Medicare commission proposals?

If you agree that we should focus our efforts on Social Security first, it is important that a Medicare commission not hinder or undermine that objective. For example, an over-hyped commission on Medicare with key officials from both sides and an early reporting date could divert attention away from Social Security reform. It could also lead to ill-conceived and possibly harmful recommendations for Medicare.

Our immediate concern is that both the House and Senate reconciliation bills create Medicare commissions. Under both plans, the commission would comprise 15 members (eight Republicans and seven Democrats): six chosen by the Senate Majority Leader in consultation with the Senate minority leader, six chosen by the Speaker in consultation with the House minority leader, and three Administration representatives. Under the House bill, you are not granted any discretion in choosing your representatives, who would be the Secretary of Treasury, the Secretary of Labor, and the Secretary of HHS. Thus, under the House bill, the Hill leadership could choose their own representatives, but we are forced to put three Cabinet secretaries on the commission. Unlike almost all previous commissions, neither the House nor the Senate proposal would give you the right to choose the chair. The reporting date for the commission would be May 1, 1999 under the House bill and one year after passage of the act -- implying a likely deadline of August 1998 -- under the Senate bill.

You could of course oppose the creation of any Medicare commission. However, your advisers would be concerned that opposition to a Medicare commission may be incorrectly viewed as indicating a lack of interest on our part in tackling entitlement reform.

Instead of opposing a Medicare commission, we could try to ensure that any such commission is not over-hyped, forced to follow a face-track decision-making process leading to an up-or-down vote on a package, or in other ways crowd out your ability to put your initial focus on Social Security. There is enough uncertainty over the substance of Medicare reform, even among your top health advisers, that an intelligent analysis of the issues by a commission could prove extremely beneficial. A commission comprising serious, top-flight people could thus advance the cause of Medicare reform by illuminating possible options, much like the Gramlich commission did for Social Security. To ensure that a Medicare commission is beneficial and does not detract from Social Security reform, we would recommend several changes to the congressional proposals:

- **Membership.** We should not be required to name top Administration officials to the commission, which would preferably also not include Senators and Representatives. If its membership includes top policy-makers, the commission may be constrained by possibly premature policy statements and would seem unlikely to engage in the type of wide-ranging analysis most beneficial on the Medicare front. A commission comprising outside specialists and academics seems more auspicious. As mentioned above, the House version currently appoints to the commission the Secretaries of Treasury, Health and Human Services, and Labor, but grants flexibility to the congressional leadership over appointments. We could fight to remove the Cabinet members from the commission and provide you with full discretion over your appointments.

- **Party balance.** We should also insist on a truly bipartisan commission, with equal numbers of Republicans and Democrats. The current proposals would have eight Republicans and seven Democrats.

- **Chair.** The chair of the commission could set the tone for the entire exercise. Unlike almost all previous commissions, the congressional proposals do not allow you to appoint the chair of the commission. We could insist that you appoint the chair.

- **Consensus voting rules.** We could insist on super-majority (3/5 or 2/3) voting for any of the commission's recommendations -- making it more likely that a diversity of views would be represented in the commission's work. Unfortunately, even super-majority voting may not be able to prevent bad outcomes, given the most likely makeup of the commission. (A super-majority could likely be achieved even if only two of the four congressionally-appointed minority members vote with the majority.)

- **Reporting deadline.** The House proposal includes a May 1, 1999 deadline. The Senate proposal sets a deadline of one year after passage of the act -- implying a likely deadline of August 1998. An August 1998 deadline is likely to be too soon to permit the commission to conduct a careful analysis. And the May 1999 deadline would allow us time to make proposals on Social Security before the Medicare commission reports.

- **Analysis.** The House proposal requires the commission to use CBO rather than HCFA estimates. HCFA has produced the numbers for previous commissions, and -- while we hope that few specific estimates are required -- HCFA should produce them here as well.

Should we support a Social Security commission now?

As noted above, your advisers believe that we should focus our long-term entitlement efforts on Social Security. Although it will not be easy to obtain, true Social Security reform would ease the burden from expected increases in the elderly dependency ratio over the next several decades, and would represent a substantial and lasting achievement of your second term. Regardless of the process, *the Administration would need to spend much of next year -- perhaps starting as early as this fall -- educating the American public and reaching out across the political spectrum to build support for reform.* *Historically,* a short-term crisis has been necessary for change. (Scholars argue, for example, that the success of the 1983 Greenspan commission was due in large part to the imminent exhaustion of the Trust Fund.) We do not face such a short-term crisis now, making it more difficult to motivate reform. However, public understanding of these issues – though still inadequate – is far greater than it has been before. And early action would permit time to implement changes gradually -- and slowly phased-in changes may be more feasible than sudden ones.

The immediate question before us is whether creating a Social Security commission now to provide some bipartisan political cover for reform later will help our chances for achieving long-term reform. Some think the best way to proceed on Social Security is to include a commission in the budget legislation. Others think that we should take more time before pushing for a commission, so that we can more carefully consider our options. Then if we decide that we want a commission later, we could always create one by executive order (as with the Greenspan commission in the early 1980's) or by a separate statute.

Try to negotiate a bipartisan Social Security commission now

Under the first option, we would engage the Republicans immediately to create a bipartisan Social Security commission within the omnibus budget legislation. The goal would be to make the commission credible and specific: It would be charged with issuing its recommendations within a relatively short time period, perhaps by next summer.

- Under one approach, the commission's membership could include all key policy players from the beginning. This approach would facilitate rapid implementation of proposals.
- An alternative approach would have the commission represent a broader array of relevant groups: older Americans, younger Americans, the unions, corporate leaders, etc. The commission's proceedings would then be used as part of our public education effort. Following the commission's report, we could hold a smaller high-level negotiating process

or look to another process -- perhaps including announcing our own proposals -- to implement reform.

While a commission was undertaking its work, an inter-agency team within the Administration would put together our own proposals. The Administration would then work with the commission and the Hill to reach consensus on an acceptable package that would carry bipartisan support, and to translate the commission ' s proposals into legislation.

The benefit of this approach is that it dissipates some of the focus away from a Medicare commission, maintaining momentum behind Social Security reform. Secretary Rubin and John Hilley also feel that we have a short window of opportunity to engage in a bipartisan process, and that opportunity will be lost if we wait to analyze our options further.

Do not create a Social Security commission within the budget legislation – instead act later, either with or without a commission

The alternative is not to create a commission now, but rather to engage with the Republicans -- either with or without a commission -- later. The benefit of this approach is that it would allow us more time to consider our options and to consult with the Republican and Democratic leadership, Senator Moynihan, the AARP, and others on how best to proceed. The basic logic is that we should not engage in a bipartisan process before we have fully developed our own strategy for Social Security reform and considered what bipartisan processes would best advance that strategy. After we reached internal consensus on the right approach, we would be able to present a coherent, unified front and would be more likely to achieve success. And after we evaluate our options, it may turn out that we do not even need a commission: Frank Raines points out that President Carter was able to reform the Social Security system without one.

DECISIONS

Medicare commission

____________________ Support changes to proposals outlined above

____________________ Do not support changes to proposals outlined above

____________________ Discuss

Social Security commission

____________________ Create Social Security commission within budget legislation

____________________ Do not create Social Security commission now to allow more time to consider strategy

____________________ Discuss

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 2-JUL-1997 11:36:42.00

SUBJECT: Electricity #4: EPA's legislative proposal

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Kathleen M. Wallman (CN=Kathleen M. Wallman/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Daren K. Wong (CN=Daren K. Wong/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: Jonathan.gruber (Jonathan.gruber @ treas.sprint.com @ inet [UNKNOWN])
READ:UNKNOWN

CC: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Jason Shogren (CN=Jason Shogren/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Thomas A. Rhoads (CN=Thomas A. Rhoads/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: James Mietus (CN=James Mietus/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: Randall W. Lutter (CN=Randall W. Lutter/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: Douglas.w.smith (Douglas.w.smith @ hq.doe.gov @ inet [UNKNOWN])
READ:UNKNOWN

CC: Sarah J. Reber (CN=Sarah J. Reber/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Cristian J. Santesteban (CN=Cristian J. Santesteban/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
DRAFT -- FOR USG USE ONLY

Perhaps the most potentially contentious issue to be resolved in formulating a position on electricity restructuring legislation is the extent to which such legislation should include changes in the rules for environmental protection, specifically regarding air pollutants emitted by generators. In earlier memos, I'd suggested that we take a "status quo" position, in which we

1) avoid changing the substantive authority EPA has to regulate pollutants, up or down, but

2) adopt measures to make EPA's implementation of its authority more efficient and consistent with competition among generators.

Putting these principles together, with the general view that retail competition in and of itself is not predicted to affect aggregate emissions very much in either direction, led me to endorse EPA's recommendation to extend its ability to construct "cap-and-trade" emissions permit markets from sulfur dioxide, where it has been notable successful, to other pollutants EPA regulates.

Whether this was EPA's entire proposal, or a small subset, had not been very easy to determine. However, at the June 27th interagency meeting, EPA distributed a draft legislative proposal. We should examine that proposal and see where, if at all, it diverges from this "cap-and-trade" recommendation. A second reason for looking at EPA's proposal is that the more pollutants it covers, the less justification there is for renewable portfolio standards, demand side management programs, and other policies for which a primary justification is that electricity producers and consumers do not bear all significant environmental costs.

On to EPA's draft, with comments by section. At the outset, I should say that while there are some parts of EPA's proposal that I would like to change, my current reading is that it is generally well targeted and not impossibly far from the economists' reservation.

Findings: Not much controversial here. The link between retail competition legislation and environmental protection is fairly subtle.

Definitions: The subsequent cap-and-trade and regulatory provisions would apply only to "fossil-fuel fired generators." To the extent that emissions permits are issued to such generators on an annual basis and without paying, this would constitute a subsidy of those kinds of generators. The best way to issue permits is via an auction, whereby the government can use the revenues to cut taxes or fund programs. If political constraints force us to give away permits, we should issue them to companies on a fixed annual amount, independent of the size and mix of generation capacity they have in any year. This will eliminate incentives to operate polluting plants just to receive future permits.

Emissions caps: This section gives EPA broad authority to establish national cap-and-trade systems. The proposal leaves open all ways in which permits may be distributed, so auctions or fixed allocations would still be permissible.

Permit trading programs could apply to any pollutant that "in the judgment of the [EPA] Administrator, endanger the public health or welfare." The tonnage limits would be set at levels "that, in the judgment of the

Administrator,

(1) prevents such admissions from interfering with the attainment or maintenance of any national ambient air quality standard in any area ...;

(2) adequately protects public health and welfare from any other adverse effects, and

(3) meets any other applicable legal obligations."

Neither "endanger" the public health nor "any other adverse effects" are qualified in any way, e.g., to be significant, much less proportionate to the costs associated with the regulations. Consequently, the draft proposal has the clear potential to go too far. Protecting "from any other adverse effects" would, I'd imagine, warrant a zero emission standard, which I suspect would be prohibitively costly with current technology. A substantively (and perhaps politically) better option would be to follow the phrase in President Clinton's regulatory reform Executive Order 12866, which imposes a requirement that the benefits "justify" the costs of a regulation.

A "minimalist" response would be to argue that proposed criteria for regulating a pollutant and setting tonnage limits should match definitions already in the Clean Air Act. Because EPA's staff has suggested that they may need statutory authority to clarify their right to regulate carbon dioxide as a pollutant, I am not sure that there is a minimalist defense this proposed statutory language. I'm not opposed to regulating CO2, only that to do so would run against a "status quo" approach to electricity legislation overall.

Nitrogen oxide limits: EPA proposes an emissions trading program for NOx allowances specific to states where such emissions create problems. The legislation would specify the affected states and NOx tonnage limitations . It would also require that, after the initial period, NOx permits would be distributed on the basis of power generated in the previous year by sources that include fossil-fuel generators. These permits could be "banked," i.e., those not used in one year could be used in later years.

The optimal geographic market for NOx permits is probably smaller than the U.S. as a whole, because NOx emissions have a somewhat limited range over which they can cause harm. But it seems a bit inconsistent, and probably unnecessarily complicated, to force (a probably reluctant Republican) Congress to identify affected states and set tonnage limits. Moreover, new science could determine that optimal trading areas for other pollutants are smaller than the U.S., or that NOx harms extend farther from the smokestack than we had thought.

Therefore, rather than single out NOx, I would recommend deleting this section, and adding to the previous section authority under which EPA could set up cap-and-trade regions smaller than the U.S. Legislation could specifying some qualitative findings regarding the geographic breadth of harm necessary to institute subnational trading programs. EPA could determine tonnage limits using the (amended?) standards in the general emissions trading section. It would also retain the authority granted in that section to set up less distortive permit allocations mechanisms than those based upon output.

A last issue is banking. The merits of banking depend in large measure upon whether the harms from pollution are based on flows--how much comes out at any given moment or within any given year--or stocks--how much comes out cumulatively over time. Banking makes more economic sense when harm is based on cumulative emissions, e.g., greenhouse gases (as I understand it). EPA's staff suggested that banking may be less appropriate for NOx, despite including a banking provision in the NOx section of their draft. They may be right, but the best way to handle banking would be to leave the "to bank or not to bank" decision to the Administrator (qua Hamlet), rather than to Congress (the gods).

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 2-JUL-1997 16:46:01.00

SUBJECT: Products memo

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Ellen S. Seidman (CN=Ellen S. Seidman/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
I just received this draft memo from Ellen Seidman. It's being circulated for comment by principals, with comments due by noon tomorrow (July 3), so a final version can be given to the President tomorrow evening. I have to leave fairly early tonight, but I'll take it home with me and read it this evening.

In the unlikely event I believe that have something to add, I'll send comments to you tomorrow morning. Again, keep in mind that the feasible set of positions on this issue is severely limited. In particular, observing that product liability may force people to purchase insurance they do not want from inefficient providers is not likely to go too far. However, in case the draft doesn't make it clear--and I haven't looked at it yet--maybe a sentence on the fundamental economics could be of some use. It might be useful in the long run if it were more broadly realized that product liability laws do NOT simply transfer money from corporations to consumers, but rather raise prices to all in order to deter unsafe conduct and provide insurance to injured consumers.

Tim
---------------------- Forwarded by Timothy J. Brennan/CEA/EOP on 07/02/97 04:38 PM ---------------------------

Ellen S. Seidman
07/02/97 03:54:30 PM
Record Type: Record

To: See the distribution list at the bottom of this message
cc:
Subject: Products memo

These are the cover memo for the products memo and the memo itself.
Melissa (Gene's assistant) is sending the memo directly to the
addressees. PLEASE NOTE THE TIGHT TIMEFRAME. I'd really appreciate your continued help in moving this along. You've all been great so far.
Thanks so much.

Ellen

Message Sent
To:____
Lisa M. Brown/OVP @ OVP
Timothy J. Brennan/CEA/EOP
Peter G. Jacoby/WHO/EOP
Tracey E. Thornton/WHO/EOP
Steven D. Aitken/OMB/EOP
Michael Deich/OMB/EOP
William P. Marshall/WHO/EOP
Jennifer D. Dudley/WHO/EOP
Elena Kagan/OPD/EOP

=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D15]MAIL46931628J.116 to ASCII,
The following is a HEX DUMP:

July 2, 1997

MEMORANDUM FOR SECRETARY RUBIN
SECRETARY DALEY
SECRETARY SHALALA
ADMINISTRATOR ALVAREZ
DIRECTOR RAINES
CHAIR YELLEN
CHAIR BROWN
DEPUTY SECRETARY SUMMERS
JOHN DWYER
JOHN HILLEY
CHARLES RUFF
BRUCE LINDSEY
BRUCE REED
ELENA KAGAN
ERSKINE BOWLES
JOHN PODESTA
SYLVIA MATTHEWS
RON KLAIN
CHARLES BURSON

FROM: GENE SPERLING

SUBJECT: Draft product liability memo

Attached is a draft memo to the President on federal product liability law, based on our discussions last week. We ask two things: (i) your comments, edits and thoughts; and (ii) your choice among the three recommendations set out.

Ideally, we would like your response by noon tomorrow, July 3. Please forward comments to Ellen Seidman of my staff, who can be reached at 456-5359 or by fax at 456-1605. We apologize for the short timeframe, but we are attempting to get this memo in to the President before he leaves Washington tomorrow evening. Even noon is going to be hard; we hope the memo is sufficiently reflective of our discussions that turning it around in time is feasible. Please call me if you have any serious problems with this time frame.

Thank you all for your help, and for that of your staffs, in getting through this process.

cc:
Andrew Pincus
Jeffrey Hunker
Fran Allegra
Donald Remy
Tom McGivern
Ed Murphy
Ron Matzner
Pam Gilbert
Michael Deich
Steve Aitken
Tim Brennan
Tracey Thornton
Peter Jacoby
Bill Marshall
Lisa Brown

SUBJECT: **Product liability legislation**

I. ACTION FORCING EVENT: On May 1, on a strict party line vote, the Senate Commerce Committee reported out S.648, Senator Gorton's revision of the product liability bill you vetoed last year. Senator Rockefeller not only voted against S.648, but has made it very clear that he will not join until your concerns are satisfied, and Senator Gorton understands that without Senator Rockefeller's support, the bill cannot pass. On the other hand, Senator Lott has been pushing to bring the bill to the floor, leading Senator Rockefeller (together with Mr. Dingell) to press us to negotiate changes in the bill to meet your concern. Senator Lott may well want to move soon after the July 4 recess. Meanwhile, Senator Breaux is urging us to work with him on an alternative to the Gorton bill.

II. BACKGROUND: The 104th Congress passed product liability reform law -- a part of the Contract with America -- by a vote of 259 to 158 in the House and 59 to 40 in the Senate. The bill would have partially preempted state law as to both standards of liability for sellers and manufacturers of products that cause bodily harm and measures and allocation of damages. On May 2, 1996, you vetoed the bill, citing eight issues:

- Interference with state prerogatives in tort law
- One-way preemption, where pro-consumer state laws were preempted, but laws that limited consumer rights were not
- The cap on punitive damages, particularly in light of the Statement of Managers, which virtually directed judges not to use the "additur" provision included in the bill under which caps could be superseded
- Several -- not joint -- liability for non-economic damages
- A too-short (15 years), too-broad (all products) statute of repose
- Preemption of state negligent entrustment statutes, which make sellers of dangerous goods (e.g., firearms and liquor) responsible for certain actions of the buyers
- Failure to toll the statute of limitations during the period of a stay issued by a bankruptcy court
- Application of the limits on liability of biomedical materials suppliers to negligent suppliers

The House failed to override your veto by a vote of 258 to 163 to override. The House having failed to override, the Senate never took a vote.

III. CURRENT CONGRESSIONAL ACTIVITY

A. S.648

S.648 fixes the bankruptcy tolling problem, and makes an honest -- although not complete -- attempt to respond to the negligent entrustment issue. Moreover, it lengthens the statute of repose to 18 years, and establishes two-way preemption for the statute of repose, so that shorter state statutes would be lengthened (all state statutes that are set in years are shorter than 18 years). The bill does not respond to the two major problems you cited -- the cap on punitives and several liability for non-economic damages -- nor does it change the biomedical materials provision.

B. Senator Rockefeller and Mr. Dingell

Senator Rockefeller and Mr. Dingell are clearly looking for guidance on how to resolve the remaining issues (punitive damages, several liability for non-economic damages, statute of repose and biomedical materials) to meet both the concerns and fact patterns in your veto message. They have said they will engage in negotiations with us (clearly they do not expect to be able to accept our initial proposal) to develop legislation that will pass and will not be vetoed. Senator Rockefeller, in particular, has said he has no interest in another veto.

C. Senator Breaux

Senator Breaux would like to deal with this issue in an entirely different way. He has developed a bill focused far more on reducing frivolous lawsuits and less on substantive product liability standards. Senator Breaux/s bill would include a statute of repose that is more flexible than that in S.648, would establish uniform federal standards for punitives damages but no cap, and would do nothing to change state law concerning joint and several liability for non-economic damages.[1] His bill would also set stricter pleading standards for federal and state court product liability actions, restrict multi-state product liability class actions, enact a very weak form of alternative dispute resolution, and require a study by the Attorney General of the product liability system. It is unclear how far Senator Breaux can get in moving support off the Gorton bill without the Administration's support for his approach.

D. Consumer groups and other advocates

Consumer groups and others are strongly opposed to any legislation in this area, and have stated that they view you as "the last bastion against tort deform." The American Bar Association has written you in opposition to any federal legislation primarily on federalism grounds, but also raising concerns that overlaying partial tort law preemption on the legal systems of fifty states will cause more confusion and uncertainty, not less.

III. MAJOR ISSUES PRESENTED:

[1] As discussed below, many states, including California, already have several liability for non-economic damages.

Over the past eight weeks, we have jointly run an interagency process to consider whether there might be ways to alter S.648 to respond to the concerns in your veto message in a manner that could be acceptable to at least Democratic proponents of the legislation. Participants in the process included: OVP, NEC, DPC, OMB, CEA, White House Counsel, White House Legislative Affairs, Justice, Treasury, Commerce, and SBA and the Consumer Product Safety Commission as an advisor. FDA is participating in the discussion of biomedical materials. The working group surveyed the law in all the states on the critical issues of punitive damages, joint and several liability and statute of repose, and developed a number of alternatives in each area that we believe could move the bill closer (and in some cases, all the way) to your goals but may have a chance of not being rejected out of hand by proponents.[2] Two meetings of the NEC principals were held, on June 24 and 26.

A. Whether there should be federal legislation in this area at all

The arguments of the business community in favor of national legislation rest on three propositions:

- Concern about product liability litigation, and particularly concern about disproportionate awards for non-economic damages and punitive damages, is sapping American productivity by misdirecting management time and energy and capital and by putting an excessive -- and frequently non-insurable tax -- on innovation.
- In a national economy, subjecting products and manufacturers to 50 different liability regimes is not only inefficient but also -- because of the opportunities for forum shopping by plaintiffs, particularly in class actions, unfair.
- Manufacturers are the deep pocket focus of liability suits that are in fact generated by the activities of those who repair and service products; making manufacturer liability more limited an predictable -- as occurred when the 18-year statute of repose was instituted for aircraft -- will put the burden of care of those most responsible for and able to accomplish it.

Consumer groups, as well as lawyers (the ABA as well as ATLA), argue against the need for federal legislation based on:

- The lack of any explosion of product liability suits, and in particular, excessive punitive damage awards that survive judicial remittitur, suggesting there's no problem to be fixed.
- The fact that all recent proposals in this area would cut back on traditional principles of tort law that benefit plaintiffs, suggesting that what the manufacturers want is not uniformity but a tilt in their direction
- The traditional role of the states in tort law, combined with the fact that all existing proposals would only partially preempt state tort law, leading to even more non-uniformity and uncertainty as this law is overlaid on, e.g., state medical malpractice law.

[2] Based on discussions with the Center for Violence Policy, we have also crafted a more complete fix to the negligent entrustment provision. We believe there will be no problem getting the proponents to adopt this.

- Whatever limitations are initially included in federal product liability legislation will be vulnerable to cutbacks in future Congresses; the time to stop erosion is before it starts

B. One-way or two-way preemption

One of the most contentious issues that runs through the legislation is whether federal standards should preempt all state laws ("two-way preemption") or whether they should function solely as a floor, with states free to establish more defendant-friendly standards ("one-way preemption"). For example, if the federal statute of repose were 18 years, two-way preemption would both lengthen shorter statutes and impose the 18-year limitation in states that have no statute of repose; one-way preemption would only lengthen shorter statutes. Similarly, if the federal government were to enact standards for awarding punitive damages, two-way preemption would both tighten the standard in states that, for example, allow punitives to be awarded for reckless behavior and require states that do not allow punitives at all to allow them according to the federal standards. One-way preemption would only tighten standards in some states, leaving others free to bar punitives entirely.

The bill you vetoed last year was almost entirely one-way preemptive. In your veto message you said, "As a rule, this bill displaces State law only when that law is more favorable to consumers; it defers to State law when that law is more helpful to manufacturers and sellers. I cannot accept, absent compelling reasons, such a one-way street of federalism. As noted above, S.648 is two-way preemptive as to the statute of repose (as well as with respect to the general standards of manufacturer and seller liability and the statute of limitations) but retains one-way preemption on punitive damages.[3]

While one of the arguments manufacturers and sellers make in favor of national legislation is the desire to create uniform federal standards, which would support uniform two-way preemption, on the two issues where they have made serious headway in the states -- limitations on punitive damages and imposition of several liability -- <u>they are far more interested in a federal floor than in uniformity</u>. We have been told, for example, that establishing the right to punitive damages in states where it does not exist, or limiting several liability for non-economic damages where state law has established it, would be totally unacceptable.

Consumer groups argue in favor of two-way preemption, ostensibly on the ground that the only good reason for federal standards is uniformity. However, many of these same groups regularly argue that federal environmental and consumer protection standards should function only as a floor, allowing states to impose more rigorous rules. It is conceivable that the consumer argument for two-way preemption is more an effort to highlight the inconsistency in the manufacturers' position -- and perhaps to raise an insurmountable barrier to legislation -- than a firmly held constitutional principle.

[3] In form, S.648 is two-way preemptive on several liability for non-economic damages. However, since it imposes the least plaintiff-friendly rule possible (totally several liability), it is effectively one-way preemptive.

C. Several liability for non-economic damages

Over the last several years, tort reform at the state level has essentially done away with the traditional rule of no comparative fault and full joint and several liability. (Only Alabama, Maryland, North Carolina and Virginia retain this combination.) Nine states[4] have full joint and several liability, but include comparative fault, thereby reducing the defendants' joint responsibility by the measure of the plaintiff's responsibility. Thirteen states[5] have pure several liability, for both economic and non-economic damages, and 24 states have various hybrid forms.

Both last year's vetoed bill and S.648 limit a defendant's responsibility for non-economic damages "in direct proportion to the percentage of responsibility of the defendant for the harm to the claimant." The trier of fact is required to assign this percentage taking into account the responsibility of all persons responsible, including those not before the court, such as settling defendants.

In vetoing last year's bill with respect to this issue, you cited the provision's general effect of preventing "many persons from receiving full compensation for injury," noting in particular the problems created by insolvent defendants. You also cited the particular impact of a several rule for non-economic damages as unfairly discriminating against "the most vulnerable members of our society." You said, "Noneconomic damages are as real and as important to victims as economic damages."

Manufacturers assert that the problem with joint liability for non-economic damages is that such damages -- unlike economic damages -- are totally unpredictable and subject to the whim of the jury, thereby making any assessment of the risk, or the purchase of insurance against the risk, virtually impossible. They are particularly concerned about the potential for a large award against the only solvent defendant in a case in which that defendant is only marginally at fault. Opponents make the argument that non-economic damages are as real and as important -- particularly to the poor, the young and the old -- as economic damages, and should not be treated differently. Some also contend that the different state standards represent the innovation and experimentation that is the role of the states, and this should not be preempted.

D. Punitive damages

[4] Arkansas, Delaware, Maine, Massachusetts, Michigan, Pennsylvania, Rhode Island, South Carolina and West Virginia

[5] Alaska, Arizona, Colorado, Illinois, Indiana, Kansas, Kentucky, North Dakota, Tennessee, Utah, Vermont and Wyoming

The process of awarding punitive damages and the amount of such damages have been the subject of some of the most intense controversy. Both last year's vetoed bill and S.648 cap punitive damages -- at the **greater** of two times compensatories (including non-economic damages) or $250,000 for most companies and the **lesser** of these two amounts for individuals and small businesses. Upon consideration of a list of eight factors[6], a judge could award damages in excess of the large business cap (but not the small business cap), up to the amount awarded by the jury, which would not be informed of the cap.[7] The "additur" provision explicitly constitutes one-way preemption -- it does not permit additur where state law otherwise limits punitive damages.

The bills would also: (i) establish a uniform federal standard of proof of "clear and convincing"; (ii) establish a uniform standard for award that conduct "carried out with conscious, flagrant indifference to the rights or safety of others was the proximate cause" of the harm; and (iii) authorize any party to request that punitive damages be considered in a separate proceeding (generally so that evidence of the defendant's financial condition would not be allowed into evidence during the liability and compensatory damages phase of the trial). While these rules are meant to apply in all states that have punitive damages, they would not apply in states where punitive damages are prohibited by law.[8]

In vetoing last year's bill, you stated that you "oppose arbitrary ceilings on punitive damages, because they endanger the safety of the public. Capping punitive damages undermines their very purpose, which is to punish and thereby deter egregious misconduct." You noted that the additur

[6] The factors are: "(i) the extent to which the defendant acted with actual malice; (ii) the likelihood that serious harm would arise from the conduct of the defendant; (iii) the degree of the awareness of the defendant of that likelihood; (iv) the profitability of the misconduct to the defendant; (v) the duration of the misconduct and any concurrent or subsequent concealment of the conduct by the defendant; (vi) the attitude and conduct of the defendant upon the discovery of the misconduct and whether the misconduct has terminated; (vii) the financial condition of the defendant; (viii) the cumulative deterrent effect of other losses, damages, and punishment suffered by the defendant as a result of the misconduct, reducing the amount of punitive damages on the basis of the economic impact and severity of all measures to which the defendant has been or may be subjected . . ."

[7] The judge would be required to hold a separate proceeding on awarding an additional amount, consider each of the items, and state the court's reasons for an award above the cap in findings of fact and conclusions of law. A separate finding on each factor is not explicitly required. The conference report on last year's bill, of course, virtually directed judges not to use this authority.

[8] In seven states punitive damages are generally forbidden; in 16 others, they are capped in one way or another. Twenty-seven states allow unlimited punitive damages in product liability cases. Most states that allow punitive damages have adopted the "clear and convincing" evidentiary standard. While the liability standards are less uniform, only a few states allow the award of punitive damages for reckless behavior without some other aggravating factor. We have not found any state that requires that the conduct leading to the punitive damages be the "proximate cause" of the plaintiff's harm, although the words "cause" and "result" are used. Bifurcated trials -- at least on the issue of the defendant's financial condition -- are allowed or required in 15 states.

provision might have mitigated this concern, but the Statement of Managers virtually directing it not be used made it ineffective in that respect.

Manufacturers assert that unpredictable and unjustifiably large punitive damage awards have driven them out of markets and impinged on innovations. Consumer advocates assert that only potentially unlimited punitive damages can deter harmful misconduct by large companies. Surveys suggest that neither the award of punitives nor the amount is skyrocketing in products cases.[9]

E. Statute of repose

At its starkest, a statute of repose bars litigation after a product has been in service a specified period of time. Twenty-two states and the District of Columbia currently have statutes of repose for product liability; 17 of the states and the District restrict lawsuits after a specified number of years (ranging from 5 to 15) and the remainder use some variation of "useful life" as the bar. In 1994, you signed legislation establishing a preemptive 18-year statute of repose for general aviation.

The bill you vetoed last year included a preemptive 15-year statute of repose for all products. The statute would, however, only have preempted states without any statute of repose, or with a statute **longer** than 15 years. Shorter state statutes would have remained effective. Your veto message referenced the length of the statute, the fact that it was broadly inclusive (you cited handguns), and the fact that the preemption was only one way. The Senate bill from the 104th Congress had covered only durable goods in the workplace and had an 18-year one-way preemptive statute.

S. 648, as reported out of the Senate Commerce Committee on a voice vote, includes a fully (two-way) preemptive 18-year statute of repose, covering all products except: (i) motor vehicles, vessels, aircraft and trains used to transport passengers for hire; (ii) products that cause toxic harm; and (iii) products with express written warranties that exceed 18 years.

Manufacturers assert that a firm, and broad, statute of repose is necessary not only to provide them some certainty, but also to put the risk of injury from long-lived products on those most able to prevent it -- owners, upgraders and servicers. They argue that the 18-year statute of repose for general aviation you signed in 1994 has not only increased the willingness of manufacturers to produce the aircraft, but has made owners and servicers far more careful, because they understand the deep pocket of the manufacturers will not be available to bail them out.

[9] A recently-released Rand study has found an increase in the number and amount of punitive damage awards in financial fraud cases, such as cases involving insurance or financial products misrepresentation. This does not appear to extend to cases involving products as defined in the bill, which is limited to physical goods.

Consumers, on the other hand, argue that injuries from long-lived products -- including those that have not been altered or do not need service -- are common, and often the manufacturer should have foreseen and prevented the problem that caused the injury. They argue it is particularly important that those injured by long-lived consumer goods (such as camping equipment and cedar chests) not be barred from court completely by a strict statute of repose. Workers, they note, at least can collect worker's compensation for injuries caused by long-lived defective goods in the workplace.

IV. ALTERNATIVES

Working from the alternatives developed by the working group in each of the three major areas identified, your advisors concluded that the choice of alternatives really depends on another decision, whether the Administration should:

- take the position that state law developments and the lack of strong evidence of major problems in this area that are caused by lack of national standards leads us to conclude no federal legislation is appropriate at this time;
- put forward a series of proposals that are fully consistent with both your veto statement and the principle of promoting national uniformity, even if such proposals have little or no chance of leading to a bill that can be enacted; or
- put forward a series of proposals that product liability legislation proponents will regard as an acceptable place to **start** negotiations and that can, albeit with some difficulty, be squared with your veto message.

Some of your economic advisors believe the business community may be correct in asserting that the current tort liability system, and in particular the issues raised in this legislation, over-deter businesses in their development and production of innovative products. In our discussions with the business community, we have asked them to provide empirical evidence that innovation has been stymied by litigation in general or the issues that particularly concern us: punitive damages and several liability for non-economic damages. Unfortunately, empirical evidence is not available, and the anecdotes relate to pharmaceuticals or related products, and often to the issues raised by mass tort claims for **economic compensatory** damages, not non-economic damages or punitive damages..

As your advisors looked into the issue, we came to the following conclusions:

- While logically there might be some impact on manufacturing innovation and productivity from the tort system,
    - there is no empirical evidence
    - all the anecdotal evidence is from one sector -- pharmaceuticals, including vaccines -- but the legislative proposals are far broader
    - there is no explosion of either litigation or punitive damages
    - the economy is booming and productivity is rising
- Over the past several years -- indeed, even since the start of the 104th Congress -- the states have made major moves toward making the tort system more defendant-friendly, ranging

from the virtual abandonment of traditional principles of joint and several liability to the imposition of caps on punitive damages

- If federal legislation is not to lead to uniform national standards, there is little justification for it; there is little or no justification for one-way preemption
- Overlaying limited product liability preemption on the tort law and civil procedure of 50 states will likely increase confusion and uncertainty, not decrease it
- Recent Supreme Court decisions, including the Brady bill decision, may call into question the constitutionality of federal legislation that attempts to mandate changes in state law and judicial procedure

Thus, while there continues to be sentiment among your economic advisors for "doing something" to improve the tort system, it is mild and tempered by the recognition that current proposals may do as much harm as good. Your legal advisors do not believe the current proposals should be supported. Both groups of advisors feel strongly that if there is to be any federal legislation, it should establish uniform national standards, and should -- in the areas explicitly covered -- completely preempt the field. There is no justification for one-way preemption in this area.

This position can be manifest in two ways: taking a strong against any legislation, or developing an Administration bill that is consistent with both the veto statement and the current state of the law, even if that bill cannot be reconciled with the prime tenets of the Gorton bill.

A. Oppose federal product liability legislation at this time

____[names of advisors] recommend that you take a firm and overt stance against any federal product liability legislation at this time. Recent changes in state law as well as in federal constitutional law, combined with the lack of evidence of serious widespread problems suggest that the burden of showing why traditional state prerogatives in this area should be overruled and state law overlaid with potentially incompatible federal law has not been met. If legislation is needed in the area of pharmaceuticals (including vaccines), then it should be pursued on a targeted basis, taking advantage of -- and protecting -- the strong federal regulatory system for drugs.

B. Develop an Administration bill we can support, consistent with both the veto statement and the current state of the law

The hallmarks of this option are: (i) full two-way preemption, such that states with currently more defendant-friendly laws would be brought to a uniform national level as well as states whose laws are currently more pro-plaintiff; (ii) consistency with your veto message in all respects; and (iii) inclusion of items that were not part of either the vetoed bill or S.648 that can enhance the effectiveness of the legal system for injured plaintiffs.

This option does not include any provision on joint and several liability for non-economic damages. Since part of the focus of your veto message was on the unfairness of distinguishing between economic and non-economic damages, no provision that deals only with non-economic damages can be fully consistent with the veto message. Moreover, we have reason to believe some proponents of legislation would be willing to put forward an alternative without any change in joint and several liability. However, we also know the business community regards this as an important issue but, given current trends in state law toward several liability, they will be extremely unlikely to accept two-way preemption in this area. Appendix A contains alternative formulations of joint and several liability for non-economic damages that were developed by the working group, together with pros and cons.

This option would consist of the following:

Punitive damages - Advisory jury opinion with judicial determination and a breachable cap for small businesses, two-way preemption

- The jury would render a solely advisory opinion on punitive damages
- The actual determination of punitive damages would be made by the judge
- The judge would be required to consider the factors in S.648, and would be required to explain why the judge's award differs (either higher or lower) from the jury's advice
- The judge could allocate a portion of punitive damages to the state rather than to the plaintiff
- Cap punitive damages at the lesser of twice compensatories or $250,000 for firms that have 10 or fewer employees **and** annual revenues of $1 million or less. The jury would not be told of the cap, and the judge could award damages in excess of the cap only upon a specific finding that damages in excess of the capped amount were not only needed "to punish or deter," but also that the financial impact of the higher award had on the defendant and its employees had been explicitly considered by the judge.
- Couple this with procedural changes to set the evidentiary standard at "clear and convincing evidence," the substantive standard at "willful and wanton" (excluding recklessness), and to require bifurcation of the damages determination if requested by any party

<u>Pros</u>

- Is analogous to criminal law, by keeping the jury involved but placing the decision on what is essentially a punishment in the hands of the person most experienced in deciding such issues, the judge
- Since historically, punitive damage awards that seem unjustified have stemmed from jury decisions, may increase rationality in the system
- Provides some protection for truly small businesses, responding to one of the complaints about the capriciousness of punitives
- Since businesses of the size described are rarely hit with significant punitive damages, since in most states the defendant's financial condition is already taken into consideration, there may be little practical negative effect.
- Allows the Administration to agree with some sort of cap
- By adopting the S.648 factors, may be seen as a good faith offer

<u>Cons</u>

- Agreeing to any cap at all breaks through a clear line we established last year of "no caps on punitives"; it may be very difficult to hold the line against expansion of this cap, either to larger businesses, or by limiting the judge's discretion

- Any proposal that limits punitive damages in any way may be seen as tipping our hand -- or limiting our options -- with respect to the tobacco settlement
- Takes away from the jury what has been regarded as a traditional jury function
- While judges may determine punitive damages in many states in cases where they are the trier of fact, only Connecticut and Kansas provide for initial judicial determination (in contrast to appellate review or remittitur) where a jury has sat
- Unlikely to solve concerns of either proponents or opponents of caps; consumer groups and lawyers have not favored judicial determination
- May raise difficult Seventh Amendment issues ("no fact tried by a jury shall be otherwise reexamined in any court of the United States than according to the rules of common law")
- Making it fully two-way preemptive, thus forcing some states to allow punitive damages that do not currently do so, is likely to be regarded as both unacceptable and inflammatory by the business community

Statute of repose
- Two-way preemption of state law (as in S.648)
- 18 year statute of repose (as in S.648)
- Which a plaintiff may overcome by clear and convincing evidence that the product had a longer useful safe life (not included in S.648, and responsive to the victim of the hay-baler accident cited in the veto message and to accidents involving products clearly intended to be longer-lived, such as elevators and most firearms)
- Covering only durable goods in the workplace (narrower than S.648, retaining plaintiff rights concerning consumer goods in states without any statute of repose and responding to your concern about handguns)
- With further exceptions for toxic substances, vehicles used in transportation for hire, and express warranties (as in S.648)
- And with a provision that extends the statute to allow full benefit of the two-year statute of limitations after injury or discovery of harm in, for example, year 17 (not in S.648, but not expected to be a problem)

<u>Pros</u>
- By building on S.648, demonstrates good faith to proponents of that legislation
- Two-way preemption is responsive to principles of veto message, and also lengthens statute in the 22 states that have them
- Number of years is longer than in any current state statute
- Rebuttable presumption protects workers injured by products clearly intended to be longer-lived
- Bright line number of years, combined with clear and convincing standard, means manufacturers will be free from arguments about whether something was intended to have a useful life slightly longer than 18 years
- By restricting statute to durable goods in the workplace, consumers in states without statutes of repose retain their access to court for injuries from long-lived or intermittently-used consumer goods such as cedar chests and camping and baby products

- Until late last year, all formulations of this statute had been limited to durable goods in the workplace, in part because those injured in such accident will at least have received some compensation through workers compensation
- Expands on an already-existing federal liability scheme -- workers compensation
- Exceptions protect access to court in latent defect cases

<u>Cons</u>

- Opponents of product liability reform will oppose any statute of repose as limiting plaintiffs' rights in states without such statutes
- Combination of two-way preemption and bright line (even with rebuttable presumption and limitation only to durable goods in the workplace), will restrict the access of some injured parties to court
- Proponents of S.648 may regard rebuttable presumption and limitation to durable goods in the workplace as unacceptable limitations, particularly given that they extended the statute from 15 to 18 years and made preemption two-way in response to the veto message

In addition to these proposals, we recommend that option 1 include items plaintiffs believe could make a real difference in their ability to recover, as well as provisions in the Breaux draft:

- Provision for alternative dispute resolution for small claims that both defendants and plaintiffs would find appealing
- Limitations on the use of protective orders where disclosure of the information is relevant to the public health or safety unless disclosure is clearly outweighed by a substantial interest in maintaining the confidentiality of the records
- Stricter pleading requirements and limitations on multi-state class actions where parties allege different types of damages
- A requirement for a study of the product liability system by the Attorney General

The first of these items might -- depending on how it is drafted -- gain the support of both plaintiffs (who cannot find lawyers to take small claims through the traditional legal system for a contingency fee) and defendants. The second (based on a bill that has been introduced by Senator Kohl) would be strongly supported by consumer groups and -- in light of the tobacco revelations probably could generate strong public support -- but would certainly be opposed by defendants and perhaps even by the plaintiff bar. The third and fourth provisions are from the Breaux draft. The class action may not be giving up much from the plaintiffs' perspective given the Supreme Court's recent decision overturning the asbestos settlement.

This option is recommended by ________________________________[names of advisors]

<u>C. Make a proposal that has a viable chance of starting negotiations with proponents</u>

As described in the specific pros and cons below, the items in this option cannot be completely squared with your veto statement. On the other hand, they represent real movement toward responding to your objections. However, it is critical to recognize that **once these options are on the table, negotiations may take them even farther afield, and lead to a negative dynamic in which bill supporters think they've come "most of the way" toward your position and assert**

that refusal to support their bill amounts to "moving the goalposts." The danger with this option rests far less in its particular parameters than in the slippery slope it sends us down. Again, no provision on several liability for non-economic damages is included, based on indications some proponents may be willing to move without such a provision. Appendix A contains options developed by the working group, of which only Proposal 2B is likely to be acceptable at all to the business community.

This option would consist of:

Punitive damages - Cap with easier breakthrough, one-way preemption

- Cap punitive damages at the greater of $250,000 or twice compensatories (the lesser of the two for small businesses)
- Do not tell the jury of the cap
- Allow the judge to award punitive damages above the cap (for both small and large businesses) without an additional proceeding and on a simple finding that the capped amount is "insufficient to punish or deter," the standard in S.648, with no consideration of specified factors
- Insist that there be no legislative history suggesting this authority is to be used any more sparingly than implied by the statutory standard
- Couple this with procedural changes to set the evidentiary standard at "clear and convincing evidence," the substantive standard at "willful and wanton" (excluding recklessness), and to require bifurcation of the damages determination if requested by any party
- This would be two-way preemptive, except with respect to states that do not allow punitives in products cases at all

Pros

- Closest to both S.648 and earlier versions of bill, and thus likely to be most easily regarded as acceptable by proponents
- Particularly given that there are few punitive damage awards in excess of the cap and that judges now have remittitur authority, this would likely have little practical impact on actual awards
- The procedural changes may produce more uniformity across the country
- Making the additur provision two-way preemptive is a real improvement for plaintiffs compared to S.648

Cons

- This looks like a cap on punitive damages, which you said you opposed; "no caps on punitives" has been used as a shorthand description of the Administration's firmest position
- It may actually be a cap with judges reluctant to award punitives
- Holding the line on the legislative history can be very difficult, particularly if the statute is acceptable in all other respects

Statute of repose

The proposal would be the same as under option 1, which we believe will be regarded as a good faith offer to negotiate.

The primary dangers with this strategy are the likelihood that opponents will not believe even the initial positions are consistent with the veto statement, and that it will be relatively easy for the other side to make what look like cosmetic changes that may in fact be quite significant. For example, deleting the plaintiff's option to breach the 18-year statute of repose by a clear and convincing showing that the useful safe life was intended to be longer -- a likely demand of the manufacturing community -- would look minor, but in fact would work a major change in that it completely shut the courtroom door on plaintiffs in the many states with no statute of repose.

This option is recommended by ______________________________[names of advisors]

V. DECISIONS:

____ Let's take the offensive against any federal product liability legislation

____ Propose option B to Senator Rockefeller, understanding he will not regard it as a serious offer.

    ____ Discuss the offer with Senator Breaux before making it public, and make common cause with him if he's interested

    ____ Make the offer public to head off claims by bill proponents that we did not have anything to offer

____ Propose option C to Senator Rockefeller, making explicit that this is a best and final offer and any further movement will result in a veto

____ Propose option C to Senator Rockefeller, being prepared to negotiate

____ None of the options is good. We need to talk.

APPENDIX A
Options on Joint and Several Liability for Non-Economic Damages

The formulations described below reduce the negative impact of imposing several liability for non-economic damages. However, any formulation that does not guarantee the plaintiff 100% of non-economic damages (where there is any solvent and available defendant) is discriminatory against non-economic damages in those states that retain joint liability for economic damages. Assuming you do not want to put several liability for **economic** damages into play, you should be aware that all of the options described -- except pure reallocation -- have this flaw.

Informed by various state law provisions concerning joint and several liability, your advisors considered formulations for federal preemption involving the following concepts:

- Several liability with reallocation among remaining defendants (and plaintiff if the plaintiff is at fault) in the event the amount allocated to any defendant is uncollectible (thus guaranteeing plaintiffs 100% recovery for the portion of the damage not their fault, but sparing low-fault, deep-pocket defendants the need to sue for contribution)
- Setting a level of fault below which only several liability will apply (thus responding to the concerns of low-fault deep-pocket defendants)
- Setting a threshold of fault below which several liability will apply, but with a multiplier (thereby guaranteeing the plaintiff some recovery where only the low-fault defendants are solvent)
- Guaranteeing the plaintiff a specified percentage of recovery of non-economic damages
- The extent to which plaintiff fault will be taken into account to reduce recovery for non-economic damages
- Special rules for small businesses, particularly as to responsibility for more than their share of damages
- Two-way preemption, which would be meaningful if federal law were less pro-plaintiff than some state laws

Working on the assumption that you wished us to develop proposals that include several liability for non-economic damages -- so as to be able to convince those favoring product liability of our good faith, but that are least restrictive of the rights of plaintiffs, your advisors developed the following alternative formulations relating only to non-economic damages:

Proposal 1 - Reallocation[10]

- Joint and several if the plaintiff is fault-free

[10] This is based on the statute currently in effect in Missouri.

- If the plaintiff is at all at fault, liability is several, but if the plaintiff cannot collect from one or more defendant after a specified period of time[11], the plaintiff can petition the court for reallocation of damages not attributable to the plaintiff among the remaining defendants, but no defendant less at fault than the plaintiff may be charged with more than twice his proportionate share of damages
- This would be two-way preemptive

Pros

- Preserves balance between faultless plaintiff and defendant with any fault in favor of the plaintiff
- Is generally consistent -- or at least not less pro-plaintiff -- with the laws of most states[12]
- Where plaintiff is at fault, less culpable defendants -- even if they are deep pockets -- will have their damages limited
- Of all the potential limitations, is most likely to retain 100% recovery for non-economic damages
- By retaining joint and several liability in many situations, should encourage settlement

Cons

- May be viewed as excessively pro-plaintiff, and thus not a good-faith offer, particularly if it is two-way, thus increasing defendants' responsibility in states, such as California, with several liability for non-economic damages
- May limit plaintiff's recovery where plaintiff is at fault and there are multiple defendants
- Requires fact-finders in (the 13) states that currently do not have comparative fault or several liability to assign degrees of responsibility
- Shifts from defendants to plaintiffs the responsibility for collecting from each defendant, potentially adding to delay in recovering and increased expense
- As among defendants, it is unclear why the extent of the plaintiff's responsibility should have an impact on defendants' responsibility to pay the judgment

Proposal 2A - Guaranteed recovery, two-way preemption

- Joint and several liability of any defendant is than 30% at fault (taking into account the fault of the plaintiff and settling defendants)
- If any defendant is less than 30% at fault, that defendant's responsibility would be limited to a maximum of twice the defendant's proportionate share of non-economic damages except where a greater multiplier was needed to ensure the plaintiff recovery of at least 50% of the assessed non-economic damages.

[11] In Missouri it is 30 days, which may be too short to actually encourage the plaintiff to try to collect; in Connecticut it is one year, which may be too long.

[12] Only plaintiffs with some degree of fault in the four states that retain traditional no comparative fault/joint and several liability would be significantly disadvantaged; plaintiffs in the nine states with comparative fault and joint and several liability could be somewhat disadvantaged. Plaintiffs in states with any further restrictions would likely benefit.

Proposal 2B - Guaranteed recovery, one-way preemption

- Joint and several liability of any defendant is than 10% at fault (taking into account the fault of the plaintiff and settling defendants)
- If any defendant is less than 10% at fault, that defendant's responsibility would be limited to a maximum of twice the defendant's proportionate share of non-economic damages except where a greater multiplier was needed to ensure the plaintiff recovery of at least 60% of the assessed non-economic damages.

<u>Pros</u>

- Should be seen by proponents of limitation as a good-faith offer, with real limits
- Preserves joint and several liability for defendants with significant degree of fault
- Ensures that no low-fault defendant will have to pay more than 50% (or 60%, if one-way) of total non-economic damages, and that in most cases they will be limited to their proportionate share
- Although it limits responsibility of low-fault defendants, it guarantees that plaintiff will collect substantial portion of assessed non-economic damages (if there are any solvent and available defendants)
- The two-way preemption version would increase plaintiff's guaranteed level of recovery in states with several liability for non-economic damages (such as California and Illinois), and thus might be considered an acceptable tradeoff for limitation on guaranteed recovery in other states

<u>Cons</u>

- Setting the guaranteed recovery level at 50% or 60% (or, in fact, any level lower than 100%) may be viewed as non-responsive to both the objections in the veto statement -- not full recovery, and discrimination against non-economic damages
- Will require fact-finders in the 13 states that don't have both comparative negligence and several liability to make additional determinations
- Defendants who view themselves as likely to be low-fault deep pockets will object that their potential for payment of non-economic damages is so high that they cannot take limitations into account in either settlement discussions or purchase of insurance
- Small degrees of differentiation of fault -- e.g., between 9% and 11% -- could have major repercussions on responsibility to pay damages

Your advisors recommend that proposal 1 be the first one we explore with proponents of product liability. It is by far the most consistent with the veto statement. If, however, it is rejected out of hand by product liability proponents, and you believe it is essential that we continue to negotiate, we would recommend Proposal 2A, which includes two-way preemption. We should make it very clear that if forced to one-way preemption, we would only accept a proposal with a significantly higher level of guaranteed recovery for the plaintiff (e.g., 60%), and a significantly lower threshold of for imposition of several liability (e.g., 10%).

Areas where we believe some negotiation could be possible include:

- Some decrease in the minimum level of recovery for two-way preemption (we would put an absolute floor at 50% for one-way preemption and 40% for two-way preemption)

- Some increase in the threshold for imposition of joint and several liability (we would put an absolute ceiling of 35% for two-way preemption and 15% for one-way preemption)

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SUBJECT: Correction

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READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
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CC: Joshua Gotbaum (CN=Joshua Gotbaum/OU=OMB/O=EOP @ EOP [OMB])
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TEXT:
We had a slight misunderstanding over here at the NEC. The Medicare/Social Security memo I just sent you does not require your comments, but is instead provided for your information. I apologize for any confusion...

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Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 3-JUL-1997 11:17:30.00

SUBJECT: suggested comments on the NEC product liability memo

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Ellen S. Seidman (CN=Ellen S. Seidman/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
I've looked over the 16 page draft memo Ellen Seidman has prepared for the President. Here are some suggested comments for potential forwarding. As noted many times before, the political exigencies and legal technicalities don't leave a lot of room for a "from square one" economic analysis here. But a few suggestions may be useful.

1) Page 3 begins the overview of whether there should be federal legislation on this topic at all. I'd like to insert there, either in the text of the discussion or as a footnote, the following (perhaps more elegantly stated):

Looking narrowly at any case, it would appear that product liability is a means by which corporate or commercial defendants compensate workers or consumers injured by defective goods. Viewed systematically, however, the costs of the awards and settlements generated under a product liability system will show up in the prices of products supplied by potentially liable suppliers. As CEA and Treasury have note, product liability essentially creates an insurance system in which consumers pay a premium in the price of the product to cover losses suffered by those injured when a product is defective.

This is not necessarily a bad thing. Manufacturers and retailers will have an incentive to reduce their expected damage costs by making safer products. A second, smaller, advantage is that forcing manufacturers and suppliers to offer this insurance may allow consumers and workers to obtain insurance they would want but, for some reason, cannot obtain from ordinary insurance companies. From an economic perspective, the primary question to ask in evaluating changes to product liability law is whether the system provides too little insurance, with too little incentive to produce safer products, or too much insurance, where consumers would rather have less expensive products than added liability protection.

I could add more, but this is probably too much as it is.

P. 4, insert as a footnote after the reference to manufacturer interest in "a federal floor, not uniformity:"

It is logically possible that costly uncertainties and abuses in state product liability systems fall solely in the favor of plaintiffs that setting a ceiling on joint liability, punitive damages, and exposure to suits would be good policy. However, the NEC's reading of the data do not support this claim.

P. 7, bottom -- This is not a comment to add, but a note that the memo refers to a review of the evidence on punitives that I haven't seen. I don't doubt that Ellen's conclusions are correct, but I wouldn't want to say that CEA came to those conclusions independently. If the "we" at the head of this bottom section refers to NEC rather than everyone, it's fine.

P. 8 -- Here, and elsewhere, Ellen is asking agencies to decide if they support (a) opposing legislation, (b) developing a bill we can support but would not make it through Congress, and (c) making a proposal that might lead to a bill that would pass but could well be unacceptable to the Administration as the negotiating process plays out. From the Principals' meetings I attended, it looks to me like that most of the costs and benefits of these options have to do with political strategy rather than policy substance. I'd recommend that we tell Ellen that CEA has participated in the process and is satisfied that it has been able to make appropriate contributions, without endorsing a particular option. If we do have to choose an option, I guess I'd recommend (b), only because on "ivory tower" grounds we might be slightly better able to start from scratch and incorporate economic analysis more firmly in the process. [Having a law and economics specialist coming to CEA in late August also may be an argument for (b).]

P. 8, heading B. -- Is it odd to describe an option to develop a bill "consistent ... with the current state of the law?" It seems like any new bill creates a change from current state of the law, by definition.

P. 9 -- In the fifth bullet describing the punitive damages proposal, insert a footnote after the small business cap:

CEA, CPSC, and others [?] argued that the case for reducing punitive damage awards for small businesses is not compelling when those awards are intended to punish "willful and wanton" misconduct, established with "clear and convincing "evidence

P. 9, same bullet -- I know I've lost this before, but I'd like to change "The jury would not be told of the cap" to "The jury would be instructed to ignore any cap in determining what punitive damages would be appropriate in this case." This has two virtues--it does not demand that judges keep citizens in the dark about the law, and it provides a proper instruction in case citizens in a democracy, by some admitted fluke, actually happen to know this aspect about the laws their elected representatives pass.

P. 9, next bullet -- The description of the substantive and evidentiary standards should be first in the list, not last.

I hope these are helpful. I apologize for not having them to you sooner.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: John D. Montgomery (CN=John D. Montgomery/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 3-JUL-1997 12:13:33.00

SUBJECT: Treasury's IMF policy

TO: FRANKEL_J (FRANKEL_J @ A1 @ CD @ LNGTWY [UNKNOWN]) (CEA)
READ:UNKNOWN

TO: Alicia H. Munnell (CN=Alicia H. Munnell/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: THOMPSON_CM (THOMPSON_CM @ A1 @ CD @ LNGTWY [UNKNOWN]) (WHO)
READ:UNKNOWN

CC: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Jeremy B. Rudd (CN=Jeremy B. Rudd/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
I just talked to Jim Lister at Treasury. They are going to the Hill next week to explain their plans on negotiating an IMF quota increase. At the Denver summit, the 7 (not 8) agreed to negotiate on the quota increase issue before the IMF-World Bank annual meetings in Hong Kong in late September.

Treasury's plan is to work toward a deal with a 35-45 percent total increase in IMF quotas (against IMF managing director's request of 55-60 percent), with the U.S. quota rising somewhat less. This would result in a $14-16 billion increase in the U.S. quota, and a slight dimunition of U.S. voting power at the IMF (from 17.8 percent to about 17 percent, but still well in excess of the blocking voting share of 15 percent). Because this would not be decided until late September, there would be no change to the FY 1998 budget request.

The Treasury's previous line had been less definite about the Administration's intent to negotiate any increase.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: John D. Montgomery (CN=John D. Montgomery/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 3-JUL-1997 11:37:26.00

SUBJECT: New NAFTA drafts

TO: FRANKEL_J (FRANKEL_J @ A1 @ CD @ LNGTWY [UNKNOWN]) (CEA)
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: THOMPSON_CM (THOMPSON_CM @ A1 @ CD @ LNGTWY [UNKNOWN]) (WHO)
READ:UNKNOWN

CC: BRAINARD_L (BRAINARD_L @ A1 @ CD @ LNGTWY [UNKNOWN]) (WHO)
READ:UNKNOWN

TEXT:
Janet and Jeff,

I just finished reading through the drafts of the President's transmital letter and of the Economic Effects chapter. Let me flag several issues in the Effects chaper for you:

1. The chapter asserts (pp. 3-4) that the U.S. bilateral trade balance with Mexico should move in the surplus direction when Mexico cuts tariffs more than the U.S. does (as has happened in the last few years). This is not good economics, and I am not sure the CEA should stand behind such a statement. It incorrectly generalizes from partial equilibrium trade equations.

2. The chapter reports (pp. 7-8) much information on bilateral trade balances, both overall and sector-by-sector. This may encourage the scoreboard view of trade, and could direct attention to areas that may make economic policy more difficult in the future.

3. You may want to review the passages (pp. 12-14) discussing the short-run and long-run effects on U.S. GDP of NAFTA to see if you are comfortable with the disctinctions made between short and long run. I think it is reasonable. Related to this is the discussion (top of p. 14) in which part of the long-run effect is added to the short-run effects (estimated from a macro forecasting model) to express a total short-run effect. This part doesn't make sense to me.

4. The discussion of U.S. employment effects (pp. 14-18) is fine until it starts (middle of p. 15) trying to make sense of the concept of "jobs supported by exports." Jeff has asked that "supported by" be changed to "associated with," but I don't think that solves the fundamental disconnect between the reasonable view that jobs are determined by factors other than trade flows and the Commerce Department methodology on export

jobs. The also failed to delete the first two full paragraphs on p. 16, which Jeff had asked to be deleted and which he felt sound too defensive about the effect of imports.

John

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 3-JUL-1997 11:36:59.00

SUBJECT: strategy on fast-track

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
I attended the first of what will be weekly meetings of a "working group" on communications strategy and outreach on fast-track. As you know, the Administration intends to make a big push to get fast-track passed in September. This working group appears to be tasked with the responsibility of coming up with the press strategy and working with outside groups who are interested in promoting fast-track.
The following is a summary of the main points discussed:
- WHAT HAS BEEN DONE SO FAR? For the most part, USTR is the only agency that has been actively working to promote fast-track. Charlene has been talking to reporters, meeting with editorial boards, talking to Members of Congress, talking to the business community, etc. Sec.s Glickman and Daley and Mack McLarty also have done some work, but their staffs are looking for more direction.
- WHAT IS THE MESSAGE? As you know, the Administration would like to try to separate the NAFTA debate from the issue of fast-track. There appeared to be general consensus at this meeting that this was going to be difficult. But, as much as possible, there is going to be an effort to try to separate the impact of NAFTA discussion from the fast-track debate. Having said that, there are several arguments that the Administration is likely to make in support of fast-track: 1) there is a "risk to inaction" -- that is, if we don't continue to lower trade barriers, progress may be reversed, and our products will be kept out of foreign markets and the US economy will suffer; 2) "terms of trade need to be fair" -- that is, US trade barriers are so much lower than in every other country so we need to continue to work to lower foreign trade barriers; 3) certain sectors(e.g. biotech) stand to benefit greatly -- there are sectors in which we could get trade agreements now but can't without fast-track authority; and 4) expanding trade is critical to the continued health and strength of the economy.
- WHAT ARE THE NEXT STEPS? Certain people in the working group have been tasked with the following: 1) coming up with a NAFTA report rollout strategy (NEC); 2) developing a fast-track message document (USTR); and 3) developing a fast-track strategy document (i.e. what is the timeline, who will be involved, what events will be scheduled, etc.).

I will continue to attend these meetings and report back.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 3-JUL-1997 14:55:55.00

SUBJECT: climate change testimony

TO: Alicia H. Munnell (CN=Alicia H. Munnell/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Mark J. Mazur (CN=Mark J. Mazur/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Mark said that he will have a first draft of the testimony done by end of the day Monday (He has also asked staff at the WH Task Force on Climate Change to come up with Qs & As)
After you make revisions to the testimony, we can then circulate it at the end of the day on Tuesday to the appropriate people around the WH. On Wednesday afternoon, we can do a practice Q&A session.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Richard L. Hayes (CN=Richard L. Hayes/OU=WHO/O=EOP [WHO])

CREATION DATE/TIME: 7-JUL-1997 18:22:33.00

SUBJECT: Affirmative Action

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Richard L. Hayes (CN=Richard L. Hayes/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TEXT:
Janet, I am part of the White House affirmative action working group and need your assistance on a very important manner. The administration is moving forward with implementing new regulations to mend existing affirmative action procurement programs so that they will comport with the Supreme Court's 1995 court decision. When finalized later this calendar year, the regulations will modify the way in which the government uses affirmative action measures to obtain goods and services from minority contractors.

A key aspect of these new regulations is a system of industry-specific benchmarks (currently under development at the Commerce Department) that will be used to establish a series of price and evaulation credits to encourage minority contracting. This work has reached a crucual step and we need your help in moving the process along. Commerce has prepared a paper (it will actually be available on Wednesday) and they are asking for help in addressing a number of technical, legal and policy issues that effect their estimation work, especially since we are lacking crucial data for various parameters of their model. As such, we are seeking the assistance of a neutral third-party such as CEA to help "mediate" the develoment of a final model that Commerce can then estimate. Bill Dickens and others who are no longer with the CEA provided assistance in the past. We are trying to set up a meeting for Friday afternoon with Justice, Commerce and your office (if you are willing to help) to review their paper and decide what issues we can. We will be reporting our findings to Sylvia Mathews as part of a general affirmative action update next Monday. I am available to discuss this issue further with you or a member of your staff if you can help in this regard. I can be reached at 456-5074. This is a very important issue to the President and if we don't get this correct (or as nearly so as possible), we run the risk of having our efforts challenged in Court and possibly thrown out. Thanks much for your consideration of my request.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 8-JUL-1997 17:46:46.00

SUBJECT: Electricity #5 -- Market Power

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Kathleen M. Wallman (CN=Kathleen M. Wallman/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: douglas.w.smith (douglas.w.smith @ hq.doe.gov @ inet [UNKNOWN])
READ:UNKNOWN

CC: Daren K. Wong (CN=Daren K. Wong/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: Randall W. Lutter (CN=Randall W. Lutter/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: James Mietus (CN=James Mietus/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: Thomas A. Rhoads (CN=Thomas A. Rhoads/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Cristian J. Santesteban (CN=Cristian J. Santesteban/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
The July 8th meeting covered legislative issues to deal with two potential issues regarding market power: vertical and horizontal.

Vertical market power -- separating regulated transmission from unregulated generation

The vertical concern is that a utility owning a transmission grid would somehow figure out ways to exploit its market power in transmission to discriminate against its competitors in terms of access, maintenance, or other services. The results could be less efficient generation and higher electricity prices to consumers. A direct analogy was the policy to prevent similar discrimination by forcing AT&T to spin off its regulated local telephone monopolies.

DOE's proposal is to give FERC authority to order utilities to turn over control of transmission facilities to an independent system operator (ISO). DOE and DOJ also advocated conditioning approval of ISOs on whether they are in some sense big enough and powerful enough to prevent anticompetitive conduct. These are good ideas, but two ambiguities remain:

1) As written, the proposals do not give FERC explicit authority to create ISOs. They therefore leave open the possibility that there may be no appropriate ISO to which FERC could order a utility to cede operational control of its transmission facilities. Doug Smith of DOE thought the provision would give FERC the power to create ISOs, but was not sure. FERC argued that it did not want to be in the position of designing ISOs for the industry, preferring instead to leave it to the experts in the business. Roger Fones of DOJ responded that giving FERC authority to create ISOs would not force it to do so, but would only fill the gap that could be there if no satisfactory ISO was forthcoming.

2) There was also some ambiguity about whether FERC could order full divestiture of transmission from generation if an ISO wasn't able to prevent discrimination. DOE argued that the authority would be contained in provisions regarding generation market power, to be discussed below. This issue remained unresolved.

Horizontal market power -- spinning off generators to deconcentrate power markets

Opening generation markets to competition may not instantly create competition, if a utility owned most of the generators that would be competing in a particular area. However, the antitrust laws do not provide a remedy for market power possessed by monopolies that were created legally. Some states, most notably California, have included partial generation divestitures to address this concern.

DOE recommends that FERC be given authority, upon petition from a State, to remedy market power problems first by requiring generators "to submit a plan to mitigate market power," which FERC could approve, and second to order divestitures if necessary. DOJ would request that it have the authority to petition FERC for divestitures. It also wants FERC to undertake a market power study.

There was considerable debate about whether the benefits of the study would exceed its costs. Many times, a study can limit what authorities can do, by making it difficult to use new information that might contradict what is in the study. On the other hand, some advance work could help the industry and regulators discover generation markets where monopoly-like power could be a problem.

Recommendations

I think we should accept the DOE and DOJ recommendations, with the following suggestions and qualifications:

1) Clarify that FERC can order formation of an ISO if none is forthcoming.

2) Clarify that FERC can order divestiture of transmission from generation if there is evidence that doing so is necessary to ensure competition in generation.

3) Grant DOJ authority to petition FERC for generation divestitures.

I would also tentatively recommend that the "study" be given low priority. I'd rather let the information develop as needed within the regulatory process itself. The study could be redefined not as a lengthy review of every possible generation markets, but as a shorter, quick effort to develop a framework. One approach would be to explain how the market definition process in the DOJ-FTC Merger Guidelines should be applied to generation markets. I doubt that we want to put something like this in a legislative proposal, however.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 8-JUL-1997 12:44:38.00

SUBJECT: Affirmative Action

TO: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
---------------------- Forwarded by Janet L. Yellen/CEA/EOP on 07/08/97 12:44 PM ---------------------------

Richard L. Hayes 07/07/97 06:22:06 PM

Record Type: Record

To: Janet L. Yellen/CEA/EOP
cc: Richard L. Hayes/WHO/EOP
Subject: Affirmative Action

Janet, I am part of the White House affirmative action working group and need your assistance on a very important manner. The administration is moving forward with implementing new regulations to mend existing affirmative action procurement programs so that they will comport with the Supreme Court's 1995 court decision. When finalized later this calendar year, the regulations will modify the way in which the government uses affirmative action measures to obtain goods and services from minority contractors.

A key aspect of these new regulations is a system of industry-specific benchmarks (currently under development at the Commerce Department) that will be used to establish a series of price and evaulation credits to encourage minority contracting. This work has reached a crucual step and we need your help in moving the process along. Commerce has prepared a paper (it will actually be available on Wednesday) and they are asking for help in addressing a number of technical, legal and policy issues that effect their estimation work, especially since we are lacking crucial data for various parameters of their model. As such, we are seeking the assistance of a neutral third-party such as CEA to help "mediate" the develoment of a final model that Commerce can then estimate. Bill Dickens and others who are no longer with the CEA provided assistance in the past. We are trying to set up a meeting for Friday afternoon with Justice, Commerce and your office (if you are willing to help) to review their paper and decide what issues we can. We will be reporting our findings to Sylvia Mathews as part of a general affirmative action update next Monday. I am available to discuss this issue further with you or a member of your staff if you can help in this regard. I can be reached at 456-5074. This is a very important issue to the President and if we don't get this correct (or as nearly so as possible), we run the risk of having our efforts challenged in Court and possibly thrown out. Thanks much for your consideration of my request.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 8-JUL-1997 16:55:23.00

SUBJECT: Boeing MD meeting

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
I just wanted to make a few follow-up points:

1) Joel cited the FTC statement as saying they had looked long and hard for a buyer for Douglas Aircraft, and couldn't find one. That may well be true, but it's not in the FTC statement. They do say that "there is no economically plausible strategy that [MD] could follow, either as a stand-alone concern or as part of another concern, that would change that grim prospect [of no longer being a competitive force]." In other words, there might have been a buyer, but it wouldn't make any difference.

2) DoD is right to point out that being able to reap economies of scope creates the appearance of a subsidy in both directions. The point should be that a U.S. firm that can supply a product demanded in the U.S.--defense aircraft--should be able to exploit economies of scope in other markets, and vice versa (as DoD pointed out). In other words, "legitimate" defense contracting is not a subsidy.

3) I have to confess a bit of surprise that there was so much interest in presuming that we needed to "go nuclear" to defend this "crown jewel." Neither positive nor negative name calling seems to me to be a good way of conducting public policy. I was frankly surprised how ready a number of nonantitrust experts were ready to conclude with utter confidence that this merger was a GOOD thing. Can't help wondering if the pot is calling the EU kettle black.

Tim

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 8-JUL-1997 12:35:54.00

SUBJECT: Request for advice on Product Liability

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Ellen S. Seidman (CN=Ellen S. Seidman/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
You received a request for advice from the President's Staff Secretary regarding the lengthy memo on options for what to do about product liability legislation. To recap, the Administration vetoed a bill last year, and is in the middle of negotiations regarding legislation this year. The three options are basically:

A. Do nothing, possibly irritate some friendly Senators, and veto what comes back (which the House should sustain).

B. Develop our own bill, with the resulting consequences similar to Option A., but with a public statement that we support product liability reform, just a different kind.

C. Attempt to negotiate, realizing that once in, it may be hard to get out with a bill acceptable to the Administration.

The choices between these options are largely political, and not something that I feel at all expert on. We have tried, with some success (thanks to Ellen Seidman), to introduce a modicum of economic analysis into a discussion framed largely by legal technicalities and political exigencies.

If you want to review this issue in any detail before COB today, when advice to the Staff Secretary is due, I'd be happy to do that. Otherwise, I'd recommend that we offer either no advice, or limited support for Option B, the "develop our own bill" option, on the grounds that CEA (a) would like to have the time to assess the evidence regarding product liability law, and (b) will have a "law and economics" specialist coming on board in late August who might be able to make particular contributions to such an assessment.

Let me know what else you would like me to do.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 8-JUL-1997 12:01:08.00

SUBJECT: Boeing/McDonnell Douglas Principals meeting

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Dorothy Robyn (CN=Dorothy Robyn/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Background

There's a Principals + 1 meeting scheduled today regarding Boeing's acquisition of McDonnell Douglas. After an extensive review, the FTC concluded by a 4-1 vote that Boeing's acquisition of MD would not hurt competition in the market for commercial aircraft. The fundamental reason was that MD was not making the investments necessary to remain a significant competitor in that market.

The European Union's competition authority, however, has expressed opposition to this merger. The strong suspicion is that the EU's decision was an effort to promote the fortunes of Airbus by preventing Boeing and MD from reducing their costs via merger. According to the NEC's memo, the question before the Principals is what if any actions the Administration should take toward the EU.

Taking a moderate line

There's no proposed list of such actions, so I'm not sure what's on the table. Short of that, I have a few points to keep in mind that suggest not taking much action.

1) Commissioner Ascuenaga's dissent suggests to me that reasonable people can differ on the evaluation of the competitive effects of this merger, so I don't think it would be all that easy to argue that the EU was completely out of line on this. Among the issues reasonable people might differ are:

a) An underlying argument is that R&D expenses in aircraft are so high to as make the business a natural monopoly. As I mentioned the other day, although this contention sounds like every other contention made by firms explaining why their monopolistic merger should be excused, it may well be true here. But the merging parties ought to bear a fairly substantial burden of proof on this, and the EU could have decided fairly that it was not met.

b) While MD may not be developing future aircraft, their older aircraft could continue to compete with (and restrain the price of) newer aircraft from Boeing or Airbus. The FTC majority cited "the virtually unanimous testimony of forty airlines" that MD "can no longer exert a competitive influence" in this market. However, the dissenter claimed that "the evidence shows that Douglas has added an element of competition" in this market.

2) There's some question about the EU's rights regarding firms that "do not do business in the EU." But if EU airline companies purchase planes from Boeing or MD, or if EU residents fly airlines that use those planes, they have an economic interest in competition in the aircraft market. As Dorothy's memo notes, US antitrust authorities would reserve the right to act against a merger of non-US firms with similarly predictable anticompetitive effects.

3) The US would clearly reserve the right to block or condition mergers that the EU would approve. Just today, DOJ announced its approval of British Telephone's acquisition of MCI, but with conditions placed upon in that the EU apparently did not place.

Looking at the EU's conditions

Speaking of conditions -- the various conditions the EU is seeking are:

1) Reducing or eliminating exclusive agreements Boeing has to sell planes to American, Delta, and Continental. Exclusive dealing arrangements in general may enhance efficiency by giving Boeing added incentives to provide operational and maintenance expertise to those airlines without concern that such expertise would be used on behalf of aircraft supplied by others. These arrangements may become problematic when a firm gets exclusive contracts with a monopoly share of the "other" market (here, airlines). In this case, the purchasers buy only 11% of airplanes, although there is an argument that these three airlines constitute a larger share of some "key" market in airlines that essentially certify to the rest of the industry that a particular airplane is a good value. The EU's concerns in this area, however, appear at best exaggerated, and at worst a bald attempt to secure more sales for Airbus.

2) Divestiture of Douglas Aircraft (MD's commercial aircraft division). A common remedy in problematic mergers is to spin off divisions that create anticompetitive overlaps. Of course, if Douglas is on its way out, this may not be a viable option. I suspect that the FTC majority would have preferred that Douglas Aircraft not go to Boeing, but they did not explicitly say in their statement why this option was rejected.

3) Permission to raise the 33% cap on direct government support of Airbus. The NEC memo suggests that EU wants to renegotiate this limit, reached in a 1992 bilateral agreement with the U.S. If it is the case that the industry is a natural monopoly because of the cost of R&D, then it appears

possible that competition could be improved by subsidizing a second firm (assuming we aren't going to impose price regulation on Boeing). If Europeans are going to pay that subsidy, so much the better for U.S. airline companies and consumers.

4) Disclose government funded R&D. The EU has also argued that Boeing gets an unfair advantage from what it learns as a U.S. defense contractor. Certainly, airlines and consumers should benefit from any economies of scope Boeing obtains from being in both the defense and commercial aircraft business. Were the aircraft industry competitive, one could also argue that any profits from these scope economies would be competed away by defense contractors and captured by the taxpayers. However, if the industry is not competitive, as the US seems to be claiming, then this may not be true. At what point does this become a "subsidy" for trade purposes? Hmm.

Reasonable people could differ about these conditions, suggesting that we probably would not have enough certainty to start a trade dispute over them. My strongest objection would be to the EU's efforts to amend the exclusive dealing contracts.

Checking the process

Unfortunately, the EU's objections are also consistent with a policy to favor Airbus in a setting it would be efficient for Boeing to purchase MD. So, it will probably be important to pay attention to the fairness of the EU's process. My reading of the NEC's memo is that it would be hard to make a case that the EU's process was unfair. So, even if we think the EU is unreasonable, it is probably hard to justify strong actions in that regard, particularly when it could open the door to reciprocal threats a gainst the US when it wants to impose conditions for competition policy reasons. Unfortunately, unlike evaluating the health effects of hormone-fed beef, economics is not enough of a science to force these EU statements outside the bounds of reasonableness.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Steven N. Braun (CN=Steven N. Braun/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 9-JUL-1997 13:59:12.00

SUBJECT: DRI visit

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Alicia H. Munnell (CN=Alicia H. Munnell/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Christopher D. Carroll (CN=Christopher D. Carroll/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Charles F. Stone (CN=Charles F. Stone/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Ha Y. Lee (CN=Ha Y. Lee/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: William B. English (CN=William B. English/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:

Please let me know as soon as possible if you wish to attend a DRI presentation on the economy by David Wyss tomorrow at 3 pm. in the NEOB. Mark Wasserman needs a headcount. (I just found out about this.)

---------------------- Forwarded by Steven N. Braun/CEA/EOP on 07/09/97 01:55 PM ---------------------------

Mark A. Wasserman
07/09/97 12:37:20 PM
Record Type: Record

To: Steven N. Braun/CEA/EOP
cc:
Subject: DRI visit

I just got a call from DRI that David Wyss would like to see us when he is in town on tomorrow, Thursday afternoon to discuss the economic outlook.

I've arranged for 3 pm in Justine's office, 9025 NEOB.

Can you or any of your colleagues join us?

Let me know who will be coming. I may need to get a bigger room.

Withdrawal/Redaction Marker
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
005. email	hermalin@haas.berkeley.edu to Janet L. Yellen at 12:20:42.00. Subject: Admission of Paul Gertler to EAP + more teaching glory. (2 pages)	07/09/1997	Personal Misfile

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
CEA ([Yellen])
OA/Box Number: 950000

FOLDER TITLE:

[06/12/1997 - 07/13/1997]

2013-0723-F
ab1270

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

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RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

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b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Daniel L. Goroff (CN=Daniel L. Goroff/OU=OSTP/O=EOP [OSTP])

CREATION DATE/TIME:10-JUL-1997 08:50:16.00

SUBJECT: tuition wavers

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Hi Janet. Its Daniel Goroff here (your student years ago at Harvard -- we met again recently at the Academy for the Human Capital Conference). OSTP would like to weigh in about the proposed legislation to tax tuition waivers for graduate students and would like to coordinate with your office about the best ways to go about that. I would therefore be grateful for your advice on who to contact about our stand on this issue.
Many thanks and best regards, Danny

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:10-JUL-1997 19:33:16.00

SUBJECT: Re: tuition wavers

TO: Daniel L. Goroff (CN=Daniel L. Goroff/OU=OSTP/O=EOP @ EOP [OSTP])
READ:UNKNOWN

TEXT:
I noticed a few weeks ago that the House tax bill treats tuition wavers as taxable income for graduate students and spoke to Don Lubick (Treasury's Assistant Secretary for Tax Policy) about it during a meeting we were both attending. He assured me that Treasury had noticed this provision, is opposed to it, and would see to it that it is eliminated from the final bill. I felt quite reassured and haven't pursued it since, but certainly it is very worrisome provision and would be disastrous for graduate edu cation. You could call Don to weigh in on this and check on the current status of this matter. You could say that we have conferred and that I am also concerned. If you think there is a real problem that needs our joint attention just let me know.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Daniel L. Goroff (CN=Daniel L. Goroff/OU=OSTP/O=EOP [OSTP])

CREATION DATE/TIME:10-JUL-1997 20:21:48.00

SUBJECT: Re: tuition wavers

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

Clifford J. Gabriel (CN=Clifford J. Gabriel/OU=OSTP/O=EOP [OSTP])
READ:UNKNOWN

Sybil Francis (CN=Sybil Francis/OU=OSTP/O=EOP [OSTP])
READ:UNKNOWN

Daryl E. Chubin (CN=Daryl E. Chubin/OU=OSTP/O=EOP [OSTP])
READ:UNKNOWN

Beverly K. Hartline (CN=Beverly K. Hartline/OU=OSTP/O=EOP [OSTP])
READ:UNKNOWN

TEXT:
Janet--

Many thanks for the information. I also had a helpful conversation about the graduate student issue with Mark Mazur.
Other provisions in the bills that worry higher education include: taxing free tuition for faculty, staff, and their families;
taxing employer-paid tuition in general; taxing the TIAA-CREF reserve fund; and the $150 million bond cap for capital expenditures by private colleges and universities. These are on our minds because OSTP is leading work on a Presidential Review Directive to examine stresses in the the federal government's relationships with research universities. Let's keep in touch about this and other matters of mutual concern.

Best regards,

Danny
456-6003

Janet L. Yellen
07/10/97 07:34:33 PM
Record Type: Record

To: Daniel L. Goroff/OSTP/EOP

cc:
Subject: Re: tuition wavers

I noticed a few weeks ago that the House tax bill treats tuition wavers as taxable income for graduate students and spoke to Don Lubick (Treasury's Assistant Secretary for Tax Policy) about it during a meeting we were both attending. He assured me that Treasury had noticed this provision, is opposed to it, and would see to it that it is eliminated from the final bill. I felt quite reassured and haven't pursued it since, but certainly it is very worrisome provision and would be disastrous for graduate edu cation. You could call Don to weigh in on this and check on the current status of this matter. You could say that we have conferred and that I am also concerned. If you think there is a real problem that needs our joint attention just let me know.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Cristian J. Santesteban (CN=Cristian J. Santesteban/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:10-JUL-1997 20:21:41.00

SUBJECT: Tim's last full day is Friday ...

TO: William B. English (CN=William B. English/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Thomas A. Rhoads (CN=Thomas A. Rhoads/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Susan P. Clements (CN=Susan P. Clements/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Steven N. Braun (CN=Steven N. Braun/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Sarah J. Reber (CN=Sarah J. Reber/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Sandra F. Daigle (CN=Sandra F. Daigle/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Sanders D. Korenman (CN=Sanders D. Korenman/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Rosalind V. Rasin (CN=Rosalind V. Rasin/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Ravi K. Sandill (CN=Ravi K. Sandill/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Quindi C. Franco (CN=Quindi C. Franco/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Mary Fibich (CN=Mary Fibich/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Mary E. Jones (CN=Mary E. Jones/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Mary A. Thomas (CN=Mary A. Thomas/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Mark J. Mazur (CN=Mark J. Mazur/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Lisa D. Branch (CN=Lisa D. Branch/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Linda A. Reilly (CN=Linda A. Reilly/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Lael Brainard (CN=Lael Brainard/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Joseph E. Aldy (CN=Joseph E. Aldy/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: John D. Montgomery (CN=John D. Montgomery/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Jeremy B. Rudd (CN=Jeremy B. Rudd/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Jason Shogren (CN=Jason Shogren/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Jason Furman (CN=Jason Furman/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Harsh N. Trivedi (CN=Harsh N. Trivedi/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Ha Y. Lee (CN=Ha Y. Lee/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Francine P. Obermiller (CN=Francine P. Obermiller/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: David L. Sunding (CN=David L. Sunding/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Daniel K. Chang (CN=Daniel K. Chang/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Cynthia K. Gustafson (CN=Cynthia K. Gustafson/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Cristian J. Santesteban (CN=Cristian J. Santesteban/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Christopher D. Carroll (CN=Christopher D. Carroll/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Christel M. Sice (CN=Christel M. Sice/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Charles F. Stone (CN=Charles F. Stone/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Catherine H. Furlong (CN=Catherine H. Furlong/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Caroline Thompson (CN=Caroline Thompson/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Brian A. Amorosi (CN=Brian A. Amorosi/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Aryeh J. Aslan (CN=Aryeh J. Aslan/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Alicia H. Munnell (CN=Alicia H. Munnell/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
... oh, no! Who's going to handle electricity, Intelsat, product liability, tobacco, telecom, auctions, aircraft manufacturing, ... (had I continued with the full portfolio of his activities, I would have overflowed the network).

We're going to lunch at 12:30 Friday, July 11. Destination TBA tomorrow morning.

Please RSVP to me. Thanks.

- Cristian

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Steven N. Braun (CN=Steven N. Braun/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:11-JUL-1997 15:16:09.00

SUBJECT: MSR & my vacation

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Alicia H. Munnell (CN=Alicia H. Munnell/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Dear Janet,

I have been assured that there is no chance that the MSR will come out next week. However, there is a tiny chance it could come out on Monday 21 July. If it does, I will hear about it and will be back by then. Else, I will take off Monday as well.

In case the MSR does come out early, I have given Michele a draft press statement. You can also try calling me if I can be of assistance (518-523-1319). However, I will not have voice mail.

Steven

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:11-JUL-1997 14:44:00.00

SUBJECT: Electricity #6 -- Federal involvement in retail electricity competition

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Kathleen M. Wallman (CN=Kathleen M. Wallman/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: William.Dinkelacker (William.Dinkelacker @ MS01.DO.treas.sprint.com @ INET @ LNGTWY [UNKNOWN])
READ:UNKNOWN

CC: Daren K. Wong (CN=Daren K. Wong/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: Thomas A. Rhoads (CN=Thomas A. Rhoads/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Douglas.w.smith (Douglas.w.smith @ hq.doe.gov @ inet [UNKNOWN])
READ:UNKNOWN

CC: James Mietus (CN=James Mietus/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

CC: Cristian J. Santesteban (CN=Cristian J. Santesteban/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Retail competition -- encourage or mandate with "opt out"?

The July 11th meeting of the interagency group focused on the central question--what should the federal government do about directly encouraging states to adopt retail competition. The original and revised DOE options on this question were presented and discussed. In a nutshell, these were:

Original -- Encourage but not mandate: States should be encouraged to adopt retail competition by removing federal laws that impede such competition, but the option should remain entirely with the states.

Revised -- Mandate, with opt out: States would be required to adopt retail competition by some date, e.g., 2003, but could "opt out" if the state legislature or regulatory commission made certain specified findings.

A third option, mandate but with no "opt out," is not on the interagency table, although some of the bills introduced in Congress by the Republican majority have that flavor.

I have a slight preference for the original proposal. As originally presented, our choice was between "encourage" or "mandate," without the "opt out" idea. The arguments in favor of "encourage", DOE's originally preferred option, over a mandate were several:

1. There are many ways to implement competition, and we don't know which one is best, so a federal "one-size-fits-all" mandate would be substantively risky.

2. If the Federal government were to mandate retail competition, it would have to take the responsibility for implementation, including the very thorny issue of determining which "stranded costs" should be borne by electricity customers, and which should be borne by utility stockholders. [Reminder: "Stranded costs" are undepreciated utility expenses that would not be recovered if competition holds prices down.]

3. Many states have already adopted competition plans, which often have involved delicate local political balancing (including stranded cost recovery). A Federal mandate could upset those agreements, while merely encouraging competition would leave them alone.

4. As a matter of efficient decision making state governments should generally have authority over policies that affect only their constituents.

To the extent these arguments are valid, they tend to support DOE's original option over their revised option. The impetus for the revised option is that it was proposed by then FERC chief, now Deputy Energy Secretary Betsy Moler. The arguments in its favor are:

1. It would only affect states that would fail to adopt retail competition because of inertia. Requiring them to make an affirmative "opt out" would at least air the pro and con arguments, with hopefully more fact than myth, leading to a reasoned decision.

[Note 1: Leon Lowery (I believe) from FERC pointed out that already implemented policies providing for wholesale competition in sales from generators to distribution companies already will tend to equalize power prices across states. Therefore, a state with low cost power, e.g., in the Pacific Northwest, ought not delay retail competition believing that doing so would prevent power equalization.]

2. Most states will do retail competition anyhow, making it unlikely that FERC would actually have to implement competition.

3. No state that "really" doesn't want competition will have to take it.

4. If political decision makers do not look too hard, the proposal appears to satisfy both those supporting Federal mandates and those supporting states rights, making passage of a bill more likely.

The first two points are empirical speculations, and the third political. On neither do I have a firm opinion one way or the other. I only think it ought to be pointed out that the "mandate with opt out" proposal could be quite costly if the factual speculations do not hold, and FERC ends up having to manage transitions to local competition in a variety of states. There also appears to be some question as to whether a mandate, even with an opt out, is constitutional, but that issue was deferred.

Stranded costs

One advantage of the original "encourage, not mandate" idea was that it would keep the Federal government from having the responsibility for picking up the pieces when retail competition is implemented. A big piece, reported in the 1996 ERP to be $135 billion, is the estimated amount of "stranded costs" in older power plants, nuclear plants, high-cost power purchase contracts, and other expenses on the books of utilities that they will not be able to recoup in charging low, competitive prices for electricity. Because DOE is now supporting "mandate, with opt out," it perceives a need to stake out a stranded cost policy.

DOE's proposal is to have legislation "endorse a principle of recovery of prudently-incurred, legitimate and verifiable retail stranded costs that cannot reasonably be mitigated." According to DOE, this is the principal FERC applied in granting wholesale stranded costs recovery in its open access Order 888 last year. (The 1996 ERP also proposed a similar standard.) Two problems with this come to mind:

1. Depending on what the adjectives mean, particularly "legitimate," this could be a tautology with which no one could disagree (which is partly why it was in the 1996 ERP.)

2. DOE is not seeking to make this a legally binding principle. In fact, it opposes allowing dissatisfied utilities or consumers to appeal a state's stranded costs decision to FERC.

Kathy Wallman suggested that a non-binding principle could be used by the states as a policy guidepost, in much the way some of them have used the FCC's pricing principles in their interconnection regulations--despite the Court of Appeals' refusal to let the FCC establish those pricing principles as legally binding "backstops" to state regulatory decisions.

Bottom lines on these issues

Still, the effect and force of DOE's proposal remains a bit mysterious to me, furthering my doubts regarding a proposal that would leave at least some risk that FERC would, in fact, have to get into the retail competition management business. In fact, that risk is heightened to that extent that politically powerful forces within states might try to impede state retail competition proposals, or "opt out" proceedings, if they thought they could do better under FERC regulation, and with FERC's stranded cost approach.

Accordingly, I'd recommend that CEA should continue to support DOE's original proposal. However, I would probably not spend a lot of institutional capital to make that case. Deputy Secretary Moler seems strongly in favor of it, the arguments against it as well as for it are, while stronger to me, also speculative, and the political appearance of being a "compromise" may be too attractive to resist.

A second issue is whether something should be added to the stranded cost recovery argument. DOE, DOJ, and EPA all expressed in one way or another a preference that stranded costs be neutral regarding the competitive standing of incumbents vis a vis entrants, and the incentives to keep uneconomical plants running. There seemed to be little disagreement about that. A potentially more thorny issue is whether stranded cost recover should be a neutral "wires tax" on power, or whether it should be implemented on a lump-sum basis. This introduces the familiar tradeoffs between the efficiency of keeping marginal prices close to cost, and the equity of raising revenue on the basis of use. I would not expect to approach an issue of this sort with the view that "lump sum" recover of stranded costs could be successfully implemented, but CEA could keep its eyes open for the possibility if it becomes feasible here.

Public benefits, again

USDA proposed that state retail competition plans be required to meet a "public policy check," to see that rates did not go up to rural or low-income users. This seemed to elicit some support. There was not much time for discussion. I've stated elsewhere (including in the 1997 ERP) that regulatory price setting is at best an ineffective remedy for wealth inequality, and is at most a tragic distraction of attention away from policies that might really do something about inequality. Treasury has pointed out here that we have a variety of tax programs to help low-income persons. We probably ought to have more, but I'm not sure holding electricity prices below costs to some people by a couple of cents per kWh is the way to go. To make another trite argument, it is also less than obvious to me why urban working class people should be taxed, or deprived of the benefits of competition, to keep prices low in rural areas.

Finally, even if these arguments are not persausive--and I'm under no illusion that they would be--one could respond to USDA's proposal that the legislation already will likely include recommendations for funding a variety of public benefit programs, and would be designed to share costs with the states in such a way to encourage them to provide these benefits. With one set of programs in place, we likely do not need to impose additional requirements on the states, especially if we are putting the burden on them either to adopt retail competition or to "opt out."

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Christopher D. Carroll (CN=Christopher D. Carroll/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:11-JUL-1997 18:35:33.00

SUBJECT: Conference.

TO: Mary Fibich (CN=Mary Fibich/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Alicia H. Munnell (CN=Alicia H. Munnell/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Hello all:

A couple of months ago I was invited to a conference at the Santa Fe Institute from Friday, July 31-Sunday August 1 (SFI will pay my way). I would like to attend at least on Saturday and Sunday, but to do so will require leaving on Friday, July 31. I have been delaying giving a definite reply because I wanted to be sure that my being gone that day would not cause headaches here. Now I need to give SFI a final answer. Is it OK to make plans to be gone July 31?

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Timothy J. Brennan (CN=Timothy J. Brennan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:12-JUL-1997 15:08:21.00

SUBJECT: FTC "Results Act" Report

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
The FTC sent to you a draft of the "Strategic Plan" it has to prepare to satisfy the Government Performance and Results Act. Through no fault of the FTC, this document is what you'd expect--about as scintillating and useful as a university department self-study. Despite that, I suppose we could make a few comments to Jon Baker informally on it.

1) The only really interesting issue, and one the FTC addresses indirectly at best, is why have an FTC when we have an Antitrust Division, CPSC, FDA, etc.

2) P. 5, bottom: In congratulating themselves for preserving competition in gene therapy R&D, the FTC cites health benefits "that cannot be measured in dollars." Without wanting to get too philosophical here, might it be safer, in light of the cost-benefit problems we are finding ourselves in, to encourage the FTC to say that these benefits "cannot be measured simply by reduced prices in the market place." This allows one to distinguish consumer surplus from reduced expenditures, without having to concede that measurement by dollars is necessarily inappropriate.

3) P. 7, line 6: The FTC refers to its "resource levels" when I think it means "budget."

4) P. 12, point 1.B -- "Assure" should be "Ensure."

5) Perhaps GPRA requires commitment-like phrasing, but it is disconcerting to read here and elsewhere that the FTC "will" achieve the various goals set out on the page. Moreover, in some cases it seems impossible to predict or almost inherently inefficient. For example, when on p. 25 the FTC commits "to open about the same number of nonmerger investigations" per year for the next five years, are these plans independent of how many such investigations are actually necessary over that time period?

6) In the competition area, the FTC lists three objectives:

1) Identify anticompetitive mergers and practices that cause the greatest consumer injury.

2) Stop anticompetitive mergers and practices through law enforcement.

Isn't the only point of doing #1 to do #2 better?

When I come in on Tuesday, I could fax these comments to Jon Baker, if you think they are appropriate. See you then.

Tim

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Jason Shogren (CN=Jason Shogren/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:12-JUL-1997 14:38:44.00

SUBJECT: Re: analysis question

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
the climate tsar finally asks the right question.

we have not done enough of this to answer todd's question--we do not have a benefit side in any of the three IAT models, so the benefits have not really been debated. OSTP is drafting "impact" papers separately. we need, if we are going to do more analysis, an Integrated Assessment style model to answer todd's question. otherwise, the enviro-side will always claim dooms day is just around the bend.

below are two potential responses to Jorgenson's "worse than nothing"

Is the Administration,s approach worse than doing nothing at all?

First, the Administration,s final policy has yet to be decided on by the President. Projecting the Berlin statement of target and timetables as final Administration policy is premature. The Administration recognizes the importance of global climate change policy and the US economy. And that is why the President has called for a national dialog over the next few months to layout the pros and cons of alternative climate change policies.

We know good climate policy depends on a good understanding of the relative magnitudes of benefits and costs. While costs of abatement are relatively straightforward to evaluate, the benefits of climate protection are more difficult to quantify. Reasonable people can disagree over the potential short-term and long-term benefits of climate protection. This is a complex question. Again the national debate asks for the people to reveal what they perceive as the potential benefits from climate protection.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:12-JUL-1997 14:25:39.00

SUBJECT: analysis question

TO: Jason Shogren (CN=Jason Shogren/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
---------------------- Forwarded by Janet L. Yellen/CEA/EOP on 07/12/97
02:25 PM ---------------------------

Todd Stern
07/11/97 10:56:22 AM
Record Type: Record

To: David B Sandalow/CEQ/EOP
cc: Janet L. Yellen/CEA/EOP, Daniel K. Tarullo/OPD/EOP, Gene B. Sperling/OPD/EOP, Kathleen A. McGinty/CEQ/EOP
Subject: analysis question

David -- has the Administration done analytic work in comparing the different environmental impacts on different emission targets and time frames? I.e., what would the comparative environmental effects be in 2050 or 2100 of a requirement to meet

1990 levels in 2010, or
1990 levels in 2020, or
1990 + 10% in 2010 or 2020
or stabilizing at current levels by 2020, etc. etc.

The above are just some possible targets/timeframes. My question is whether we have done the best analysis we can to estimate how the different targets/timeframes would impact GHG concentrations at relevant future points.

If, for example, we knew that the cost to reach a 1990 level by 2010 rather than by 2020 was quite high while the added environmental benefit of doing so in terms of reduced GHG concentrations in, say, 2050, was quite low -- that might well influence our policy.

Has that analytic work been done, or is it being done? tds

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:12-JUL-1997 14:29:35.00

SUBJECT: Re: tuition wavers

TO: Daniel L. Goroff (CN=Daniel L. Goroff/OU=OSTP/O=EOP @ EOP [OSTP])
READ:UNKNOWN

TEXT:
Don Lubick also mentioned to me that Treasury opposes the taxation of free tuition for families of faculty, but I haven't discussed the other issues on your list with him or anyone else from Treasury. It would be useful to review the entire agenda with Treasury.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Alicia H. Munnell (CN=Alicia H. Munnell/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:13-JUL-1997 18:21:12.00

SUBJECT:

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D95]MAIL42716639U.116 to ASCII,
The following is a HEX DUMP:

Statement before the House Commerce Subcommittee on Energy and Power
Dr. Janet Yellen
Chair, President's Council of Economic Advisers
Tuesday, July 15, 1997

Good afternoon. Mr. Chairman and distinguished members of the Committee. I appreciate the opportunity to discuss with you today what economists both inside and outside the Administration know about the economics of global climate change.

Introduction

President Clinton has said that he believes that global climate change is a serious issue. The President indicated in his speech to the United Nations General Assembly in late June that he wants to open a dialogue with the American people to discuss the problems posed by greenhouse gas accumulations and to search for policy solutions. To this end, the President will hold a White House conference on climate change later this year, and Members of his Cabinet and other senior Administration officials will meet with scientific and economic experts, environmentalists, local government officials, and business and labor leaders on a regular basis over the next several months to discuss issues related to climate change. This process is intended to inform the Administration's decision-making process, which will culminate in a U.S. policy position in the international negotiations in Kyoto in December of this year. At this time, however, the Administration has not settled on a particular set of policies on how to reduce greenhouse gas emissions.

Most economists also believe that the risks posed by global climate change are a legitimate problem and that preventive steps are justified. More than 2000 economists, including 8 Nobel laureates, have signed a statement supporting measures to reduce the threat of climate change. The statement endorses conclusions from last year's report by the Intergovernmental Panel on Climate Change (IPCC), which said that governments should take steps to reduce the threat of damage from global warming and that market-based policies can significantly reduce greenhouse gas emissions without harming the American economy.

In my testimony today, I intend to describe for you what we have learned so far from the tremendous amount of economic analysis that has been done so far on the impact of global climate change.

Underlying Uncertainties

But, before I begin my discussion of the economics literature, I would like to first emphasize the great uncertainties associated with estimating the costs and benefits of reducing greenhouse gas emissions. Let me give you some perspective: as you all know, it is difficult to gage exactly what the impact of the balanced budget agreement will be on the U.S. economy's growth rate, levels of employment, interest rates and consumption over the next five years.

With global climate change, we are not talking about just the next five years and we are not talking only about the US economy. Instead, we are talking about economic and physical processes that operate globally and over decades, if not centuries. The potential damages of greenhouse gas emissions are not predicted to happen for many decades, and it is difficult to know which regions will get warmer, which will get cooler; which will get wetter, which will get drier; which will get stormier; and which will get calmer. This means that the benefits of climate protection are very difficult to quantify. And, while the costs of reducing greenhouse gas emissions may be more immediate, they too, as I will discuss below, are difficult to predict with any certainty. Many unanswered questions exist about the biophysical systems, potential thresholds, and economic impacts. In short, if anybody tells you he or she has the definitive answer as to the costs and benefits of particular climate change policies, I would suggest that you raise your collective eyebrows.

Lessons from the Economic Literature

Let me now turn to the economics literature and try to summarize for you what we think we know so far about this difficult topic. With a few notable exceptions, economists have generally not addressed the benefits of climate protection, but rather have focused on the costs of alternative paths of reducing greenhouse gas emissions. The economics literature includes estimates using many different models to evaluate alternative emission reduction strategies; describing each alternative to you would not be useful. In fact, economists initially had a tough time talking with each other because they could not sort out the extent to which the differences in their results depended on differences in models versus differences in baseline emission paths and policies. To solve this problem, economists have adopted the convention of calibrating their models by performing a common exercise; this exercise has generally involved stabilizing greenhouse gas emissions at 1990 levels by 2010 or 2020.

The Administration's Interagency Analysis Team (IAT) has adopted this same exercise in their attempt to understand the economics of this issue. The staff IAT report summarizing this work was released yesterday [OR will be released by the end of July], along with the reviewers comments. As we go forward in this process, I would be happy to answer any questions that this preliminary staff analysis raises.

The Lessons. The modeling efforts both inside and outside the Administration clearly indicate theat we cannot hope for more than range of possible impacts, but they do provide several important lessons that I would like to share with you today.

How the economy works. First, the magnitude of the costs of reducing greenhouse gas emissions depends crucially on assumptions incorporated in the models about on the how the economy enveloping countries face incentives to move away from carbon intensive energy sources works. For instance:

- If firms in the economy can shift from high carbon to low carbon energy sources quickly, the costs of climate protection will be lower.
- If the economy has a lot of currently unused energy-saving technology that can be

brought into play, the costs of climate protection will decrease.

- If technological change occurs at a rapid rate, the costs will fall.
- If the Federal Reserve keeps the economy at full employment, transitional output costs will be less.

In short, the more substitution possibilities and the faster the economy can adapt, the lower the costs.

How the plan is implemented. Second, costs depend crucially on how emission reduction policies are implemented. It boils down to--if we do it dumb, it will cost a lot; if we do it smart, it will cost less. This conclusion was reflected in the statement signed by the over 2000 economists. They argued that any global climate change policy should be based on market-based mechanisms to minimize the costs to the US economy. These mechanisms allow for flexibility in both the timing and location of emission reduction.

- The speed at which emissions reductions occur has large effects on the estimated costs. If emissions reductions happen over a longer period of time, the natural turnover of the capital stock will incorporate newer, energy-efficient technology, lowering the ultimate economic costs of meeting the specified emissions target. Similarly, longer lead times until the emissions constraints are binding would permit a more orderly fuel-switching process, preventing bottlenecks that can drive up the estimated costs.
- Issuing emission permits and allowing firms to trade among themselves will insure that emission reduction will occur at the lowest possible cost within the United States.
- International emission permits and trading applies the same cost-minimizing principle globally.
- So-called "banking" and "borrowing" allows firms to change to timing of their emission reductions so as to minimize costs.
- Joint implementation, where US firms get credit for undertaking emission reduction in countries with low abatement costs, would also lower the domestic burden.

An additional aspect of implementation that has a profound effect on the costs of reducing emissions concerns "revenue recycling." In many of the model simulations, emissions are reduced either by selling permits to emit carbon, or by imposing a tax on carbon. In either case, the federal government ends up with significant revenues. How these revenues are used determines the costs of climate protection. For example, if the revenues are used to reduce distortionary taxes that diminish incentives to invest, save or work, the tax reduction can spur investment and growth. In other words, how the revenues are recycled has a big impact on costs.

What countries participate. The third lesson that emerges from a study of the economics of climate protection is that developing, as well as developed, countries must be part of the process. While developed countries are responsible for most of the greenhouse gas currently in the atmosphere, developing countries are starting to catch up. By 2020, the largest fraction of emissions will come from developing countries. Any comprehensive plan to deal with this global problem must have a mechanism and a timetable; to bring developing countries into the process.

The timing of the inclusion of developing countries is also important. First, the sooner that developing countries face incentives to move away from carbon intensive energy sources the less likely they will become dependent on those types of fuels to spur their economic growth. Second, if left outside the process, developing countries could serve as a haven for carbon-intestive industries from developed countries. In short global problems require global solutions.

Conclusion

Thank you. I would be happy to answer any questions you may have.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Mark J. Mazur (CN=Mark J. Mazur/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:13-JUL-1997 11:34:04.00

SUBJECT: draft testimony on climate change

TO: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Jason Shogren (CN=Jason Shogren/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Alicia H. Munnell (CN=Alicia H. Munnell/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Folks,
Here is a set of draft testimony. It may be a bit too long, but I tried
to be comprehensive.

I will be at the Orioles game this afternoon, but I should be home by 7
pm. Feel free to call me in the evening, if you have any issues you wish
to discuss. Otherwise, I will see you Monday morning.
Mark

=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D95]MAIL436224396.116 to ASCII,
The following is a HEX DUMP:

Statement before the Senate Committee on Important Stuff

Dr. Janet Yellen

Chair, President's Council of Economic Advisers

Tuesday, July 15, 1997

Good morning. I would like to thank the Committee for inviting me here today to discuss the economic aspects of policies to address global climate change. This is an incredibly important issue, with vast implications and a time-scale that policymakers are unaccustomed to dealing with.

I am the Chair of the President's Council of Economic Advisers and I want to make clear that I am not an expert on the subject of climate change. Until the end of May, Dr. Everett Ehrlich, Undersecretary of Commerce served as spokesperson in this area. With Dr. Ehrlich's departure for the private sector, I have stepped in as his replacement. But I am still learning the subtleties of the issue, and, while I am a fast learner, I may not be able to address every aspect of the analysis at this time.

The Science. Accumulations of greenhouse gases in the atmosphere have the potential to disrupt climate on a global scale. While climate scientists cannot predict regional effects with much precision, they can forecast some of the likely global effects if the world's population continues on the current path of greenhouse gas emissions. My understanding of these predictions for the end of the next century is that they include: average temperature increases of 2.0 to 6.5 degrees Fahrenheit, with larger increases likely in the higher latitudes; increased sea levels of perhaps 20 inches, inundating many low-lying coastal areas; greater variability in weather patterns as the hydrological cycle is stressed, leading to more severe droughts and downpours; and the potential for greater spreads of vector-borne diseases, such as malaria.

The International Panel on Climate Change (IPCC), a group of over 1,500 internationally-known scientists, has reported that "the balance of evidence suggests a discernible human influence on global climate." I understand that there may be some dispute among scientists about the ability to detect climate effects of greenhouse gas accumulations over the last 20 or 30 years. However, there is virtually no disputing the projections that rapidly increasing greenhouse gas concentrations in our atmosphere will lead to undesirable climatic effects on a global scale.

Since the possible negative effects of greenhouse gas accumulations on the global climate are huge and since the science indicates a strong likelihood of experiencing these effects if these accumulations are allowed to increase substantially, it seems prudent for policymakers to consider ways of reducing greenhouse gas emissions as a form of "insurance policy" against these adverse consequences. Science and prudence indicate that we should take out such an insurance policy. The only remaining question is how large that policy should be.

Current Administration Stance. In his speech to the United Nations General Assembly in late June, President Clinton announced his intention to open up a dialogue with the American public to discuss the seriousness of the problems posed by greenhouse gas accumulations and to cooperate in a search for policy solutions. As part of this dialogue, the President announced a White House conference on climate change to be held later this year. Also, a major part of the dialogue will involve Cabinet Members and senior Administration officials speaking with the public, elected officials, and business and labor leaders on a regular basis. The entire process is intended to inform the Administration's decision-making process.

As you know, the Administration is engaged in a set of international negotiations meant to address the issue of climate change. This round of negotiations grew out of a realization that the previous treaty signed in Rio de Janeiro in 1992, and based on voluntary measures to reduce greenhouse gas emissions, was not sufficient to address the problem. The hope for this round of negotiations is that it will lead to an international agreement on an effective treaty that can be signed in Kyoto in December.

The Administration has set forth a series of proposals for the negotiations, including:

(1) legally binding targets and timetables for reducing emissions in the medium term (generally thought of as 2005 to 2020);
(2) maximum domestic flexibility for individual countries in meeting treaty obligations by using the means most appropriate to their circumstances;
(3) maximum international flexibility by establishing an international emissions trading regime among nations with established targets and a joint implementation regime among nations with established targets and those without; and
(4) developing countries' participation in the treaty, with their participation increasing over time.

These proposals recognize the importance of relying on flexible and market-based mechanisms to reduce the overall worldwide cost of meeting any given emissions target. They also recognize that, in the long-term, all nations of the world must participate in order for the agreement to be effective in limiting greenhouse gas concentrations. So far, however, the United States has not articulated a settled on a specific target and timetable for emissions reduction, despite many calls from those in the international community for this particular item. The Administration intends to develop a position on a target and timetable over the next few months, in conjunction with the ongoing dialogue with the American public.

At this point, the Administration has not settled on a particular set of policies to address the issue of climate change. But some things are clear. The President believes that the issue is important and that some steps need to be taken to reduce emissions. This is certain to disappoint those on the right who believe that no changes to current policies are warranted. The President also does not believe that the U.S. should harm its economy to meet arbitrarily chosen targets for emissions reductions. After all, President Clinton has made it a top priority to ensure that the economy continues on track and creates the jobs necessary to maintain and increase the standard of living for all Americans. This is certain to disappoint those on the left who believe that the United States should rapidly and substantially reduce greenhouse gas emissions. The President will listen to the American public, experts, and elected officials, and then make an informed judgment about the policies that are best for America.

The task of getting greenhouse gas emissions under control is not going to be solved in this round of negotiations. The Administration realizes that the current round of talks is just one step in a process that will span decades. Accordingly, the most important objective is to create a flexible and durable framework for emissions reductions that can accommodate unfolding events for years to come. Such a framework would permit targets and timetables to be adjusted as we learn more about the science and the efficacy of various policies. The framework should also accommodate new participants (e.g., developing countries) on a reasonable schedule that is acceptable to all parties.

The Economic Literature. There is a voluminous literature on the economic effects of climate change policies. Much of this literature has been generated in the past decade, with the newer work generally building on the earlier research. One particular area of extensive research activity involves modeling the economic effects of specific emissions constraints. There are probably a couple dozen of these models referenced in the academic literature and literally hundreds of cost estimates. The results of sixteen of these models (and over 160 cost estimates) are summarized in a recent paper by Robert Repetto and Duncan Austin of the World Resources Institute. What I want to do today is provide a brief overview of this literature to provide a context for the work done by the Administration's Interagency Analytic Team (IAT), a collection of the best economic and energy modelers working for the Federal government.

Economic models are simply collections of assumptions and posited relationships that are used to sharpen our insight into difficult issues. Many of these models base their projections of future relationships between key economic variables (energy use is a key variable in modeling the effects of climate change policies) on econometric estimates using 2 or 3 decades of data, or the modeler's judgment. One of the main values of economic models is the imposition of consistency on complex inter-relationships between variables that may not be immediately apparent in simpler analysis. For example, economic models can make sure that price increases in one market are accompanied by behavioral changes in other, related, markets. And, economic models can help make sure that simple definitional relationships, such as the composition of GDP, are respected in the model output.

Two main types of economic models are used to evaluate the effects of climate change policies on the economy: macroeconomic models and computable general equilibrium models. Macroeconomic models have grown out of a desire to forecast and understand the response of the economy to the business cycle. The focus of these models is on the adjustment the economy makes in response to a stimulus or "shock". These models allow for temporary and persistent unemployment and accommodate markets that do not clear due to an imperfect matching of supply and demand. Often, these models permit a "vintaging" of capital stock, whereby machinery and equipment retain the efficiency characteristics they possessed when placed in service (some models permit performance of capital to deteriorate over time as the capital depreciates). Some of the more complex macroeconomic models provide detailed representations of various industries, regions, and household types, allowing a rather detailed look at the specific parties affected by a policy change. Modern versions of these models incorporate many relatively sophisticated relationships between labor, capital, energy, and other factors of production and posit fairly wide ranges of behavioral reactions in response to economic changes introduced into the model. The main value of macroeconomic models is the portrayal of how the economy adjusts when a new policy is introduced. These models are likely most effective when used as part of a short or medium term forecast; longer term projections may not be as reliable as those made for shorter periods.

Computable general equilibrium models are intended to capture the long-run economic responses to policy changes and generally do not consider the transition costs to the new state of the economy as very important. These models represent the economy as a set of perfectly inter-related markets, where prices and quantities adjust to ensure that supply equals demand in each market in each period. This ideal economic portrayal of the world ensures that there is no involuntary unemployment and that all factors of production (e.g., labor and capital) are paid in accordance with their productivity. The main value of computable general equilibrium models is their focus on the long run, and the ability to let researchers know about the likely lingering effects of the policy changes under consideration. Because these models are computationally very intensive, they often have very sketchy portrayals of individual industries (sometimes they model only a single composite consumption good) and household types, and generally provide no detail on regional effects.

Useful summary statistics for how climate change policies affect the economy are the effect on GDP and the effect on energy prices. GDP measures the total output of goods and services in the economy in any one year and often is used as a measure of economic well-being, even though GDP does not measure non-market values (such as changes in environmental quality of life) nor tell us anything about distributional concerns. As such, GDP should be regarded as a crude indicator of the effect of the specific policy on the overall economy. Often, economists favor market-based policies to implement any constraints on greenhouse gas emissions. Such policies generally show up as changes in prices for fossil fuels, the largest source of greenhouse gas emissions. Changes in energy prices can give us some notion about the impact a policy may have on individuals' well-being and their economic behavior. Other indicators that can be used to demonstrate the effect of policies on the overall economy include: consumption, unemployment, trade balances, and personal income. These indicators often are not presented in the output of all the economic models used, but they can be helpful in elaborating on the GDP results which are presented.

Table 1 presents estimates for GDP changes associated with various emissions reduction targets. [try to create a table with 1990 emissions levels for 2010 and 2020 and for 90 percent of 1990 emissions levels for 2010 and 2020 -- or whatever is available and similar]
These results show that there is a wide range of estimated GDP effects, with some studies predicting large losses in economic output and other predicting either small losses or even small gains. Two points are important to keep in mind when considering these results. First, the range of possible error associated with any one of these estimates is large. As mentioned earlier, these models are complicated systems of equations, each based on econometric estimates or modeler

judgment. Each of these equations, therefore, has embedded in it some amount of possible error, since the equation will never exactly forecast the outcome the future will bring. Combining many of these equations increases the potential for significant forecast errors, especially when projections are made for decades into the future. Second, each economic model incorporates some of the biases and interests of the modeler. For instance, a modeler who believes that capital can quickly shift from one use to another will bring that feature into the model, and the results will reflect the low costs of moving capital around in the economy. A modeler who believes that capital remains fixed in place until it is retired will make a different set of assumptions that will lead to higher costs of redeploying capital in other uses.

Another key element that goes into the models, but is sometimes overlooked, is the baseline forecast for the economy in the absence of policy changes. These baseline forecasts must incorporate the changing size and composition of the economy, as well as forecasting energy prices and corresponding energy use and emissions. Models from only a few years ago generally had fairly steeply rising energy prices over the forecast period. These energy price forecasts implied that future growth in energy use would be muted, making it less difficult to reach any specific greenhouse gas reduction target. Similarly, forecasts for future economic growth have profound implications for the ease of meeting specific emission targets, because historically energy use has been positively correlated with economic output.

Several observers of the economic modeling activity in the climate change area have noted a small number of key items that really drive the results of this modeling. These include:

Type of model used (engineering vs. economic, macroeconomic, computable general equilibrium);

Ease of substitution between factors of production;

Rate of technology change and energy efficiency improvement;

Existence and type of "backstop" technology;

Whether an international emissions trading regime exists;

How fast emissions are reduced;

Whether changes to the tax system are made; and

Whether environmental benefits are counted in the analysis.

Let me briefly discuss each of these.

Type of Model. A key distinction should be noted right away between modeling done by economists and that done by engineers, the so-called "bottom's up" approach. In "bottom's up" modeling, the focus is on the types of technology that are available (or that could be made available). These models usually posit that there are many opportunities to increase energy efficiency or to decrease greenhouse gas emissions at zero or low cost. The "bottom's up" modelers assume, that with the right policy push, these technologies would be adopted. Once in place, these greenhouse gas friendly technologies would form the base for meeting the specified emissions reduction target, lowering the overall cost of doing so.

Economists generally take a different, and more conservative, approach. They note that companies cannot be expected to long overlook profitable energy-efficiency opportunities and that there must be barriers to adoption not incorporated in the "bottom's up" analysis if valuable technologies remain unexploited. Economic analysis generally examines the effects of emissions constraints on the overall economy, looking at such variables as changes in GDP, consumption, investment, aggregate employment, interest rates, and energy prices. As noted above, two types of models are used in this analysis -- macroeconomic and computable general equilibrium (CGE) models. In general, the results from macroeconomic models indicate greater economic costs for a given emissions constraint than do CGE models.

Ease of Substitution. Models differ in the amount of rigidity assumed in the economy. Some models assume that it is relatively easy to shift capital and labor between industries, to change consumer behavior, and to switch from one fuel to another. These models tend to show lower economic costs from implementing greenhouse gas emissions constraints than do models that assume these changes are more difficult and occur more slowly.

Rate of Technological Change and Diffusion. Assumptions about the rate of technological change and diffusion are among the most contentious in the climate change modeling arena. Economists do not have a compelling explanation of how technological change occurs. Therefore the models generally make ad hoc assumptions about, for example, the pace of energy efficiency improvements adopted in response to the imposition of greenhouse gas constraints. As you might imagine, the more optimistic the assumptions about technological change, the lower the economic cost of meeting a specified emissions target.

Backstop Technologies. Most models assume that some sort of non-fossil-fuel-based technology will be available in the future to cap potential energy price increases. These technologies could include solar power, nuclear power, biomass, and fuel cells, and the modeler generally specifies a fixed price at which this backstop technology is available in the future. Again, more optimistic assumptions about the existence of a backstop technology lower the estimated economic cost of meeting a specified emissions target.

International Emissions Trading. The existence of a regime where emissions permits can be traded among countries would allow emissions reductions to occur in the cheapest location. Since greenhouse gases are a global concern, reductions in any country are equally valuable. Therefore, if some countries have relatively cheap emissions abatement opportunities available, worldwide costs would be minimized if these countries can arrange to trade emissions permits with countries that have higher abatement costs. Models that incorporate international emissions trading have to specify the costs of emissions reduction opportunities in all the countries involved in the trading, adding to the model's complexity. However, those models that do incorporate international emissions trading find that the costs of meeting specified emissions targets are lower than in those models that examine the U.S. economy in isolation.

Time Path. The speed at which emissions reductions are specified to occur can have large effects on the estimated costs. In general, faster reductions impose greater costs because there is a lot of inertia in the economy and rapid change is costly. If emissions reductions occur over a longer period of time, many models assume that the natural turnover of the capital stock will incorporate newer, energy-efficient technology, lowering the ultimate economic costs of meeting the specified emissions target. Similarly, longer lead times until the emissions constraints are binding would permit a more orderly fuel-switching process, preventing bottlenecks that can drive up the estimated costs in the models.

Changes to the Tax System. Many models examine emissions reduction policies that are specified as either taxes or as domestic emissions trading. In both instances, there are potentially large amounts of revenues generated for the Federal government (for instance, if emissions permits are auctioned to fuel producers and importers). In principle, these revenues could be used to reduce the Federal budget deficit (or retire debt if a budget surplus is achieved) or to reduce taxes elsewhere in the economy. In practice, many models assume that climate change policies are enacted on a "revenue neutral" basis, so that any revenues raised are returned to the private sector, or "recycled". This is often assumed to be done through reducing payroll taxes, individual income taxes, corporate income taxes, or even creating an investment tax credit. In many models, GDP growth is fairly sensitive to certain tax parameters; in some models, an investment tax credit can lead to a rapidly expanding capital stock and greater overall output. In some models, then, changing the balance of revenues in the overall tax system can substantially reduce the estimated costs of meeting an emissions target. Of course, the models would operate the same way (generating an expanding GDP, for example) if the shift in tax burdens was done by itself, and not as part of an emissions reduction strategy.

Counting Environmental Benefits. In many economic models, GDP is viewed as the main measure of economic well-being. But policies to reduce greenhouse gas emissions can have other, non-GDP benefits, such as reducing the risk of disruptive weather patterns and reducing conventional pollution and congestion. Placing a value on these benefits and incorporating them into the analysis reduces the net cost of meeting a specified emissions target.

These key assumptions explain a large portion of the variation in cost estimates of emissions reduction policies. By combining the most pessimistic sets of assumptions -- a macroeconomic model with little substitution among factors of production, slow diffusion of new technology with an expensive backstop technology, no international trading, a rapid reduction in emissions in the short term, returning any revenues to households in the form of a flat per capita payment, and ignoring environmental benefits -- can easily lead to a 3 percent reduction in GDP in the model (for, say, a 25-30 percent reduction in emissions).

But, if the most optimistic set of assumptions is used -- CGE model with flexible factor substitution, rapid deployment of new and inexpensive energy-efficiency technology, full-blown international trading and joint implementation, a modest reduction of emissions over decades, a pro-investment "recycling" of any revenue raised, and large environmental benefits incorporated into the analysis -- the costs of implementing the emissions constraint would be estimated as very small (or perhaps the estimate might show a net benefit to the economy).

The main point here is that the modeling results are very much dependent on the sorts of assumptions built into the models used, as well as the policies being modeled. The range of results in the literature is large and so results from any one model should not be viewed as definitive.

The Interagency Analytic Team. The various agencies interested in climate change policies contributed some of their best analysts to an Interagency Analytic Team (IAT). This group selected three models in an effort to evaluate the effects of emissions reduction policies. These models included one macroeconomic model, one general equilibrium model, and one model that possessed a large amount of detail on available technology choices. After months of establishing a baseline, calibrating the models, and putting them through a rigorous set of checks for internal consistency, some results were produced. Not surprisingly, the IAT results for a set of policies modeled elsewhere in the literature were right in the middle of the range of published results. I say "not surprisingly" because the assumptions made by the IAT modelers tended to be in the middle of the ranges used by modelers in this area.

One thing we took away from the IAT process was a sense that it is futile to expect a definitive answer to the question of "what are the economic effects of a specific emissions reduction policy?". The best the IAT could do was come up with a rather wide range of effects, depending on a host of assumptions. Moreover, the IAT found that it is difficult, if not impossible, to model specific detailed policies because the models are constructed at a very high level of generality.

The IAT modeling was not a full-blown cost-benefit analysis, but rather an exercise that focused on the economic costs of implementing the specified policies. Little effort was made to quantify the benefits of reducing greenhouse gas emissions and eventually limiting greenhouse gas concentrations in the atmosphere. These benefits are real, but are very difficult to quantify, because they manifest themselves only in the distant future and because they are dependent on worldwide cooperation in meeting the specified targets.

I understand that a staff draft of an IAT report was leaked a few weeks ago. This particular draft had a number of shortcomings, some of which have been addressed in the last few weeks, as part of the peer review process. A revised version of this paper will be released by the end of July, as soon as some final minor edits are made. I want to emphasize, however, that this report is a staff-level draft that examines several possible emissions reduction targets, centered on ones most often seen in the academic literature. It is not an official Administration document, nor is it intended to indicate preferred Administration policies.

(If the IAT report is released Monday, use the following bracketed material instead)

[The IAT released a staff draft report on its modeling activities on Monday. This report examines several possible emissions reduciton targets, centered on ones most often seen in the academic literature. This is not an official Administration report, not is it intended to indicate preferred policy choices. Rather, the report gives the state of the IAT modeling at the beginning of June.

Since that time, we have become convinced that further refinement of the models for purposes of obtaining "better" estimates is not desirable.]

Lessons Learned. Despite being unable to calculate precisely the economic effects of choosing particular emissions targets, the IAT modeling exercise did yield a few important lessons for developing policy. These include:

1. The macroeconomic costs of imposing constraints on emissions are significant, but do not derail the economy. This recognizes that the U.S. economy is robust and dynamic and eventually can adapt to the shock imposed by binding emissions constraints.

2. Higher domestic energy prices can have substantial effects on certain sectors of the economy, even if the aggregate economy performs well. Generally, fuel producers and energy-intensive industries have the most difficult adjustments to make.

3. In almost all model runs, coal bears the brunt of the emissions constraints. This is because coal is the most carbon-intensive fuel and because fuel switching (e.g., substituting natural gas for coal in electricity generation) is a fairly low-cost and feasible alternative.

4. The existence of a well-functioning international emissions trading market can cut the economic cost of U.S. compliance with emissions constraints substantially (perhaps as much as in half). Such a market allows high cost abaters (e.g., the U.S.) to trade with lower cost abaters (e.g., Russia), reducing worldwide compliance costs.

5. In the very long run (say over 100 years) technology must be developed to allow economies to function in less greenhouse gas intensive ways. Faster technological progress can reduce the economic costs of meeting a specified constraint substantially, especially after 20 years or so.

6. Promoting additional investment is a key way to reduce overall economic costs, because newer

investment likely will embody the latest in energy-efficient technology.

7. Phasing in emissions constraints generally reduces the economic costs by spreading out the shock of higher energy prices. The economy can better adjust to the imposition of emissions constraints if a credible price path is apparent early on (this allows firms to make better choices for long-lived investments).

8. The effects on U.S. industries due to trade flows need not be large. If the OECD adopts tight emissions controls and developing countries do not, some fear that U.S. industries will be placed at an incredible disadvantage. However, this ignores the fact that U.S. companies already face incredible differences in energy prices, wages, taxes, productivity, and so on, without suffering much from worldwide competition. Very preliminary analysis suggests that moderate increases in energy prices should not be expected to have huge across-the-board effects, though some industries could certainly be affected.

If I only leave you with one thing today, I would like it to be the following: Models are only as good as the assumptions that they are built upon. Models of climate change are more complicated than most, and the results generated span a very wide range. At this point, economic models can give us some lessons in how to think about emissions reduction policies, but it is fruitless to think that these models will be able to precisely tell us how the U.S. economy would react to emissions constraints over the next few decades.

This concludes my prepared testimony. I would be happy to answer any questions that you may have.

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Statement before the House Commerce Subcommittee on Energy and Power
Dr. Janet Yellen
Chair, President's Council of Economic Advisers
Tuesday, July 15, 1997

Good afternoon. Mr. Chairman and distinguished members of the Committee. I appreciate the opportunity to discuss with you today the economics of global climate change today, based on the analyses of economists both inside and outside the Administration.

Introduction

In his speech to the United Nations General Assembly in June, President Clinton emphasized that the risks posed by global climate change are real and that sensible preventive steps are justified. This assessment accords with the views of the more than 2000 economists, including 8 Nobel laureates, who signed a statement supporting measures to reduce the threat of climate change. That statement endorses conclusions from last year's report by the Intergovernmental Panel on Climate Change (IPCC), which said that governments should take steps to reduce the threat of damage from global warming and that market-based policies can significantly reduce greenhouse gas emissions without harming the American economy.

At this time the Administration has not settled on a particular set of policies to reduce greenhouse gas emissions. Instead, the President indicated in his U.N. speech that he intends to open a dialogue with the American people to discuss the problems posed by greenhouse gas accumulations and to search for policy solutions. To this end, the President will hold a White House conference on climate change later this year, and Members of his Cabinet and other senior Administration officials will meet with scientific and economic experts, environmentalists, local government officials, and business and labor leaders on a regular basis over the next several months to discuss issues related to climate change. This process is intended to inform the Administration's decision-making process, which will culminate in a U.S. policy position in the international negotiations in Kyoto in December of this year.

In my testimony today, I would like to describe some of the principal lessons that emerge from the voluminous literature, much of it relatively recent, on the economic impacts of policies to address global climate change.

Underlying Uncertainties

Before I begin my discussion of the economics literature, I would like to first emphasize the great uncertainties associated with estimating both the costs and benefits of reducing greenhouse gas emissions. To provide some perspective: as you all know, it is difficult to gauge exactly what impact the balanced budget agreement will have on the U.S. economy's growth rate, levels of employment, interest rates and consumption over the next five years. But with global climate change, we are concerned with not just the next five years and not just the American economy. Rather, we are dealing with economic and physical processes that operate globally and over decades, if not centuries. The potential damages associated with increasing concentrations of greenhouse gases are not predicted to occur for many decades, and it is difficult to know which regions will get warmer and which will get cooler; which will get wetter and which will get drier; which will get stormier and which will get calmer. This means that the benefits of climate protection are very difficult to quantify. And, while the potential costs of reducing greenhouse gas emissions may be more immediate, they too, as I will discuss below, are difficult to predict with any certainty. Many unanswered questions exist about the biophysical systems, potential thresholds, and economic impacts. In short, if anybody tells you that he or she has the definitive answer as to the costs and benefits of particular climate change policies, I would suggest that you raise your collective eyebrows.

Lessons from the Economic Literature

Let me now turn to the economics literature and try to summarize what I think we know so far about this difficult topic. With a few notable exceptions, economists have generally not addressed the benefits of climate protection, but rather have focused on the costs associated with alternative paths for reducing greenhouse gas emissions. The economics literature includes estimates using many different models to evaluate numerous alternative emission reduction strategies. In fact, for this reason, economists initially faced difficulties in comparing results: they could not sort out the extent to which differences in results stemmed from differences in models and assumptions versus differences in baseline emission paths and policies. To solve this problem, thereby enabling meaningful comparisons, it is necessary to calibrate the models by performing a standardized simulation: such model comparisons commonly assess the consequences of stabilizing greenhouse gas emissions at 1990 levels by 2010 or 2020.

To facilitate comparison with the broader literature, the Administration's Interagency Analysis Team (IAT)--a staff level group working to understand the economic implications of climate change policies--took the identical emissions scenario--stabilizing emissions at 1990 by 2010--as the starting point for their own analysis. The staff IAT report summarizing this work was released yesterday [OR will be released by the end of July], along with the reviewers comments.

The Lessons. Modeling efforts both inside and outside the Administration clearly indicate that economic analysis can do no more than estimate a range of potential impacts from particular policies and highlight how outcomes depend on underlying assumptions about how the economy works and the ways in which policy is implemented. However, the economics literature on climate change does point to several important lessons:

How the economy works. First, the magnitude of the costs of reducing greenhouse gas emissions in the various models depends crucially on a number of key assumptions about how the economy works. For instance:

- If firms in the economy can shift from high carbon to low carbon energy sources quickly, the costs of climate protection will be lower.

- If there are significant opportunities, even now, to employ energy-saving technology at low or even negative costs, the costs of climate protection will be lower.

- If technological change occurs at a rapid rate, or is highly responsive to increases in the price of carbon emissions, the costs will be reduced.

- If the Federal Reserve pursues a monetary policy oriented toward keeping the economy at full employment, transitional output costs will be lower.

In short, the greater the substitution possibilities and the faster the economy can adapt, the lower the costs.

How the plan is implemented. Second, costs depend crucially on how emission reduction policies are implemented. It boils down to this: if we do it dumb, it could cost a lot, but if we do it smart, it will cost much less and indeed could produce net benefits. The over 2000 signatories of the economists' statement argued that any global climate change policy should be based on market-based mechanisms because such mechanisms allow for flexibility in both the timing and location of emission reductions, thereby minimizing the costs to the U.S. economy. The economists concluded that "there are policy options that would slow climate change without lowering American living standards and these measures may in fact improve productivity in the longer run."

- The speed at which emissions reductions occur has large effects on the estimated costs. If emissions reductions are phased in over a longer period of time, the natural turnover of the capital stock will incorporate newer, energy-efficient technology, lowering the ultimate economic cost of meeting any specified emissions target. Similarly, longer lead times until emissions constraints are binding permits the development of new technologies and allows a more orderly fuel-switching process, preventing bottlenecks that can drive up the estimated costs.

- A "cap and trade" system in which emission permits are issued and then traded among firms can substantially reduce the cost of meeting an emissions target by creating incentives for emissions to be reduced by those firms and in those activities where costs are lowest.

- International emission permits trading substantially lowers costs by applying the same cost-minimizing principle globally.

- So-called "banking" and "borrowing" of permits increases flexibility and lowers costs by allowing firms to change the timing of their emission reductions.

- Joint implementation, whereby US firms would receive credit for undertaking emission reductions in countries with low abatement costs, would also lower the domestic burden.

An additional aspect of implementation that profoundly affects the costs of reducing emissions concerns "revenue recycling." In many model simulations, emissions are reduced either by selling permits to emit carbon, or by imposing a carbon tax. In either case, the Federal government realizes an increase in revenues. Economic growth can receive a long-term boost if these revenues are used to reduce distortionary taxes that diminish the incentive to invest, save or work, or if the revenues are channeled into deficit reduction, thereby boosting investment. In fact, in some models and scenarios, emissions reduction generates a net economic benefit when the revenues are recycled in a growth-promoting fashion.

What countries participate. The third lesson that emerges from a study of the economics of climate protection is that developing, as well as developed, countries must be part of the process. While developed countries are responsible for most of the greenhouse gas currently in the atmosphere, developing countries are starting to catch up. By 2020, the largest fraction of emissions will come from developing countries. Thus, any comprehensive plan to deal with this global problem must include a mechanism to bring developing countries into the process.

The timetable for the inclusion of developing countries is also important. First, the sooner that developing countries face incentives to move away from carbon intensive energy sources, the less likely it is that they will become dependent on those types of fuels to spur their economic growth. Second, if left outside the process, developing countries could serve as a haven for carbon-intestive industries from developed countries. In short global problems require global solutions.

Conclusion

Policies to promote economic growth, create jobs, and improve the living standards and opportunities of all Americans have been and always will remain the top priority of the President and his Administration. In his remarks to Business Roundtable on global climate change, the President said "[l]et's find a way to preserve the environment, to meet our international responsibilities, to meet our responsibilities to our children, and grow the economy at the same time."

Let me conclude by highlighting the key economic lessons we have learned that will help us achieve the President's goal:

- Inherent uncertainty dictates that models should only be expected to generate a range of economic impacts, not definitive answers.

- Key assumptions about how the economy works directly influence the estimated costs of climate protection.
- Implementation of any policy needs to be market-based and maximally flexible over time and space.
- All nations, both developed and developing, need to participate.

Thank you. I would be happy to answer any questions you may have.