Withdrawal/Redaction Sheet
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	meese@haas.berkeley,edu to Janet L. Yellen at 12:49:44.00. Subject: Re: A question (2 pages)	10/21/1997	Personal Misfile
002. email	brennan@rff.org to janet l. yellen at 14:11:25.00. Subject: shotgun marriages. (2 pages)	10/29/1997	Personal Misfile

COLLECTION:

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

FOLDER TITLE:

[10/21/1997 - 11/14/1997]

2013-0723-F
ab1273

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]
- 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: Joseph E. Aldy (CN=Joseph E. Aldy/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:21-OCT-1997 16:02:10.00

SUBJECT: Re: climate change draft #1 -- CLOSE HOLD

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

TEXT:
---------------------- Forwarded by Joseph E. Aldy/CEA/EOP on 10/21/97
04:02 PM ---------------------------

Joseph E. Aldy
10/21/97 03:05:03 PM
Record Type: Record

To: Michele Jolin/CEA/EOP
cc:
Subject: Re: climate change draft #1 -- CLOSE HOLD

Michele,

There are 3 paragraphs of the speech in which we have some serious concerns (I spoke with Randy to clarify a couple of things). On page 4, the paragraph beginning "In 1970", appears to be factually wrong, and is off-point. Today's emissions standards are not $400/car, as implied by this, but much more. The auto emissions standards were not flexible, market based incentives as implied either. The paragraph should be removed.

In the following paragraph, vinyl chloride was not banned in the 1970s, it was regulated. The ban of DDT did not involve any ex ante (or for that matter, any ex post) analysis of the economic costs, as implied. The paragraph should play up the phase-out of lead (a real success story) and our early success with sulfur dioxide.

In the last paragraph on that page, The sentence beginning "Economists once believed that a nation could be either clean or rich" is unnecessarily pejorative and should be removed.

Stop by when you have a chance and we'll talk.

Joe

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:21-OCT-1997 09:58:49.00

SUBJECT: Re: Frankel's trip to Bonn

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:
---------------------- Forwarded by Michele Jolin/CEA/EOP on 10/21/97
09:58 AM ---------------------------

David B Sandalow
10/21/97 09:58:15 AM
Record Type: Record

To: Michele Jolin/CEA/EOP, Jeffrey A. Frankel/CEA/EOP
cc: Peter R. Orszag/OPD/EOP, William J. Antholis/OPD/EOP
Subject: Re: Frankel's trip to Bonn

Who will answer economic questions about the President's plan? There will
dozens of business groups, Congressional staff and others. I absolutely
think Jeff needs to be there, Thursday and Friday.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:21-OCT-1997 10:09:59.00

SUBJECT: Re: Frankel's trip to Bonn

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:
If the argument for my going to Bonn is so that they have an economist to defend the President's program to the press, then we are not enthusiastic about the idea. Right?
JF
---------------------- Forwarded by Jeffrey A. Frankel/CEA/EOP on 10/21/97 10:07 AM ---------------------------

David B Sandalow
10/21/97 09:58:15 AM
Record Type: Record

To: Michele Jolin/CEA/EOP, Jeffrey A. Frankel/CEA/EOP
cc: Peter R. Orszag/OPD/EOP, William J. Antholis/OPD/EOP
Subject: Re: Frankel's trip to Bonn

Who will answer economic questions about the President's plan? There will dozens of business groups, Congressional staff and others. I absolutely think Jeff needs to be there, Thursday and Friday.

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	meese@haas.berkeley,edu to Janet L. Yellen at 12:49:44.00. Subject: Re: A question (2 pages)	10/21/1997	Personal Misfile

COLLECTION:

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

FOLDER TITLE:

[10/21/1997 - 11/14/1997]

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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:23-OCT-1997 20:26:39.00

SUBJECT: EPC Letter Draft

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

TEXT:
I thought it might be better to just include a letter without an
attachment. Suggestions are welcome. =================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D9]MAIL450057591.216 to ASCII,
The following is a HEX DUMP:

Most OECD countries will soon participate in an international conference on global climate change in Kyoto, at which commitments may be made to achieve specific goals for reducing emissions of greenhouse gases. As you know, from 1992 to 1995 the OECD devoted considerable resources to studying the economics of global climate change. At U.S. request (ratified by other OECD members), at the next WP1 meeting the Secretariat will present a brief summary of past OECD work on climate change. Given the importance of the issue, however, and given the OECD's accumulated expertise in the area, the U.S. believes that a major new research effort on the economics of global climate change could provide valuable advice to policymakers. The United States would therefore like to request that the OECD undertake such a research program. Given the range of issues involved, such a study would necessarily involve multiple directorates and considerable resources. But the importance of the issue warrants such an effort.

The U.S. proposes to have the OECD particularly focus on two questions relating to the economics of global climate change. The first question concerns how future commitments, beyond those agreed to in Kyoto, should be structured to attain in a cost-effective way the U.N. Framework Convention's ultimate objective, namely "stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system." The OECD could examine how the timing of further emissions reductions would affect the overall economic cost of attaining this environmental goal.

The second question relates to the design, implementation and effectiveness of alternative policy instruments to achieve emissions reductions goals. This analysis could center on a detailed comparison of the experience of OECD member countries with tradeable permits, pollution taxes, programs to foster research and development of carbon lean technologies, and with regulatory and other approaches. In addition the research could analyze the scope for and design of institutions to facilitate international emissions trading and joint implementation.

We would welcome any input that other OECD member countries or the OECD Secretariat might have on our proposal.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:23-OCT-1997 23:24:50.00

SUBJECT: Re: EPC Letter Draft

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

TEXT:
It looks good. My only possible suggestion is that you might want to add before the last sentence of the first paragraph something like: "It would also likely take several years to complete such a project."

Or not. (The intent would be mainly to make clear that we don't expect anything before Kyoto, or even close to it.)

JF

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:23-OCT-1997 18:24:56.00

SUBJECT: Confirmation of Fed Nominees

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

TEXT:
I spoke with someone on John Hilley's staff about the Fed nominees. She said that Hilley is aware of the hold and "trying to work on it." She said that they are talking to Lott's staff and Harkin's staff and trying to get a sense of what the WH can do to get the hold lifted. She said that they had hoped that the nomination would go through tonight with several of the other nominations but that something held it up and it did not happen. She said she will let us know as soon as she hear's any progress.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Rebecca M. Blank (CN=Rebecca M. Blank/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:24-OCT-1997 11:33:57.00

SUBJECT:

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

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

TO: Aaron S. Edlin (CN=Aaron S. Edlin/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:
Janet, Michele, Aaron and Jeff --

As part of my "meet and greet" efforts, I just had a conversation with Don Gips in the VP office. He's obviously very involved in some of the science and technology issues. Two points that he raised:

(1) He thought the range of issues relating to internet regulation would be very important over this next year. At present, he doesn't think CEA is on this working group (he co-chairs this group with Ira Magaziner, if I understood correctly.) He noted that Aaron had been part of the telcom working group, and that issues between that group and the internet group often overlap. This internet group sounds like something we want to participate in...what do you think?

(2) Clearly lobbying me a little, he also mentioned that he thinks a big new issue coming down the line is going to be mergers within the broadcast industry. his concern is less traditional anti-trust concerns than "diversity of voice" concerns. He clearly wants to get some discussion of this started within the administration...this is just a heads up to you about this possibility.

Becky

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:24-OCT-1997 09:06:01.00

SUBJECT: Letter to OECD Secretary General

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

TEXT:
The attached letter should be formatted and sent to the Secretary General
of the OECD. Jeremy has the details concerning this.==================== ATTACHMENT 1
====================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D47]MAIL498733691.216 to ASCII,
The following is a HEX DUMP:

The Honorable Donald Johnson
Secretary General
OECD
2, rue Andre Pascal
75775 Paris
FRANCE

Dear ??

Most OECD countries will soon participate in an international conference on global climate change in Kyoto, at which commitments may be made to achieve specific goals for reducing emissions of greenhouse gases. As you know, from 1992 to 1995 the OECD devoted considerable resources to studying the economics of global climate change. At U.S. request (ratified by other OECD members), at the next WP1 meeting the Secretariat will present a brief summary of past OECD work on climate change. Given the importance of the issue, however, and given the OECD's accumulated expertise in the area, the U.S. believes that a major new research effort on the economics of global climate change could provide valuable advice to policymakers. The United States would therefore like to request that the OECD undertake such a research program. Given the range of issues involved, such a study would necessarily involve multiple directorates and considerable resources. It would also likely take several years to complete such a project. But the importance of the issue warrants such an effort.

The U.S. proposes to have the OECD particularly focus on two questions relating to the economics of global climate change. The first question concerns how future commitments, beyond those agreed to in Kyoto, should be structured to attain in a cost-effective way the U.N. Framework Convention's ultimate objective, namely "stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system." The OECD could examine how the timing of further emissions reductions would affect the overall economic cost of attaining this environmental goal.

The second question relates to the design, implementation, and effectiveness of alternative policy instruments to achieve emissions reductions goals. This analysis could center on a detailed comparison of the experience of OECD member countries with tradeable permits, pollution taxes, programs to foster research and development of carbon lean technologies, and with regulatory and other approaches. In addition the research could analyze the scope for and design of institutions to facilitate international emissions trading and joint implementation.

We would welcome any input that other OECD member countries or the OECD Secretariat might have on our proposal.

cc: Dr. Ignazio Visco

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:27-OCT-1997 12:17:42.00

SUBJECT: Award remarks

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

TEXT:
Attached is a rough draft of some remarks. Comments would be
appreciated. =================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D27]MAIL42442599U.216 to ASCII,
The following is a HEX DUMP:

Remarks at Women's Economic Roundtable Award Dinner

It is an enormous honor to receive the Maria and Sidney Rolfe Award for national economic policy. I would like to thank the Women's Economic Roundtable for selecting me for this distinguished award and I particularly want to thank Paul Volcker for his very generous remarks. I consider it a special tribute to receive this award from an individual whose own contributions to public service and economic policy are legendary. Paul's distinguished career epitomizes the ideals to which economists aspire when we are given the chance to help formulate public policy. Most students of economics recognize that the core insights of our discipline have enormous relevance to the design of public policy, so that there is the potential for economics to contribute enormously to societal welfare. But relatively few economists are offered the opportunity to serve. I thus owe President Clinton a huge debt of gratitude for affording me two extraordinary opportunities to do my best to put economics to work in the public interest--first, in our nation's Central Bank and now, at the Council of Economic Advisers.

I will confess that serving as a Governor of the Federal Reserve was a dream that I had harbored ever since I took my first course in macroeconomics as an undergraduate at Brown in 1965. When the phone rang, in April of 1994, and I was asked "Would I be interested in being considered for the position of Governor of the Federal Reserve System?" it therefore took me all of 2 seconds to say yes. It was apparent to me that monetary policy, properly conducted, has the potential to mitigate economic fluctuations and to create the backdrop of price stability which is a necessary prerequisite for sustainable growth at a maximum pace. Even more fundamental, the Federal Reserve's task is to insure the safe and sound operation of our national and global financial system. Having a seat at the coveted FOMC table I knew would provide an extraordinary opportunity for public service. Because Paul did the hard work of moving this country toward price stability, it was my good fortune to serve on the FOMC during a period when everything has been coming up roses. During my watch, the major intellectual challenge for monetary policy to address was "why is inflation so well behaved with unemployment below what most of us conceived of as NAIRU." Even so, I considered it fascinating to have the chance to debate, to research and to weigh alternative explanations of what is responsible for America's good fortune and to tackle challenging strategic questions relating to the conduct of monetary policy--what its long run run goals should be, whether and how to enunciate them, and what tactics to follow in attaining those goals.

Although I had been extremely surprised to receive a call inquiring about my interest in a Governorship at Federal Reserve, I confess that I was literally stunned when, two years later, I received a call from Erskine Bowles asking if I would consider serving as Chair of the Council of Economic Advisers?

This time I hesitated. I was extremely happy at the Federal Reserve, which is a truly extraordinary institution, and I thought that I had finally learned enough to be productive. And I had never had the audacity to even dream of being the Chair of the Council of Economic Advisers. The task seemed daunting. Nevertheless, when the President asks, it is one's duty to accept.

The CEA is one of the great creations of the American government--an economic consulting group within the White House. It is one of the smallest agencies in Washington. While others have budgets of billions, the CEA subsists, with its 3 members 10 senior economists, mainly one year rotators from academia, and support staff on a budget that is considerably smaller than that of a medium-sized department of economics, about one thousandth of the budget of the still fairly small Federal Reserve. Nevertheless, the CEA is the mouse that roars.

Beyond keeping the President informed about the key economic developments in the American and global economies, the CEA's duty is to assess the economic impacts on national welfare of the various policy options under consideration by the President relating to any Administration decision with a significant economic component--almost everything these days. To make such assessments, the CEA relies on the full body of available economic theory and data, including the most timely and relevant economic analyses available on whatever topic is under consideration. We reach out to the economics profession broadly to assimilate the best thinking on the topics under consideration. In this sense I consider myself the representative of the economics profession in Presidential decisionmaking.

Before I took this job I considered it all but impossible, requiring simply too broad a range of knowledge concerning too many topics. Indeed, at any time, a dozen or more different issues may be under active consideration and debate: To provide a few examples, over the last six months I have been involved in policy processes in the areas of: global warming, affirmative action, entitlements, tax reform, the budget, the tobacco agreement, financial sector modernization, implementation of the Clean Air Act, electricity restructuring, privatization of USEC, implementation of new programs on children's health and fast track. In spite of this extraordinary range, I am discovering what other CEA chairs before me have observed--that the theoretical principles which most often require emphasis are not those at the frontiers of current research but rather the tried and true principles of supply and demand, opportunity costs, incidence, and comparative advantage that are the bread and butter of mainstream economics--all of the principles familiar to students of Economics One.

By applying core economic principles and focusing on the national interest, broadly defined, rather than any special interest, the CEA has always--in Democratic and Republican Administrations--served as a practical and moderate voice in Washington. It has stood against the controlled economy in all of its forms. But it has also opposed completely unrestrained laissez faire. It has espoused the importance of capitalism and the market, but recognized that the government has a complementary role to play to make markets work and to address market failures. The CEA has alwys supported free, and also free-er, trade. We have usually been in favor of deregulation, and where regulation is necessary and desirable, as in the pursuit of environmental objectives, we have favored the use of prices and markets as the preferred means of achieving the object of regulation. And the CEA's job has always been to stop bad ideas from becoming policy and to focus on factors influening the long run performance of the economy-- particularly its potential to grow.

One of the CEA's most useful roles is examining incentives and looking for loopholes. Faced with a constant stream of well-intentioned proposals, we typically ask if the policy will actually work as planned? For example, will money given to the states for education or for welfare really be used for these purposes, or will it just add to the general state coffers with the money redistributed as the Governors and the state legislatures wish? Will programs for affirmative action really end up in aiding minorities? Will seemingly small changes in financial regulations dismantle important safety provisions because opening the window a crack is the precursor to unforeseen inventions which will open the window wide? The fundamental work of Miller and Modigliani which says that the private market will undo any attempts by the firm to control its valuation by setting the debt equity ratio is an always pertinent insight for government. As economists we scrutinize carefully each and every proposal with the question: will the private market undo what the government seeks by legislation or by regulation?

~~The CEA has always been a voice of reason in Washington by using elementary economic logic, but increasingly over time we have been able to do even better by by bringing empirical evidence to bear on policy decisions. Economics has advanced as a science and we now have better estimates of parameters that turn out to be crucial to policy design, like the rate of return to an additional year of schooling, or the demand elasticities and supply elasticities that are critical to estimating the costs and the benefits of most programs.~~

People often make fun of economists. They see them as too concerned with greed and never willing to make a commitment. But economists have been successful in Washington and elsewhere because they can see both sides of an issue. They understand tradeoffs, can weigh costs and benefits and appreciate differences in points of view. Economists are accused of being two-handed. They joke that they tend to say:, "On the one hand this, and on the other hand that" or "It all depends." But the body politic errs when it insists that the right answer can fit on a T-shirt. Economists are good at insisting on asking hard questions and demanding solid evidence.

Let me conclude by emphasizing that, as the President's Chief Economist in the White House, I have the great privilege of serving as an intermediary between the economics profession and the Administration, bringing the best economic research to bear in the process of public policy formation. It was a tremendous honor to have been appointed to the job and and a particular honor to be named the recipient of the Rolfe Award this evening. I accept it not just on behalf of myself but on behalf of the Council of Economic Advisers, which for the past 50 years has served the President and the nation and and has represented the cumulative wisdom of the economics profession.

Thank you very much.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Adele C. Morris (CN=Adele C. Morris/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:27-OCT-1997 17:22:10.00

SUBJECT: Should we amend the Clean Air Act for Methyl Bromide?

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: Christopher D. Wolz (CN=Christopher D. Wolz/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

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

CC: Joseph E. Aldy (CN=Joseph E. Aldy/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Wendy A. Taylor (CN=Wendy A. Taylor/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

TEXT:
This is my understanding of the methyl bromide issue based on today's meeting with Katie McGinty:

Methyl bromide is a pesticide used widely as a fumigant for treating soil, quarantined imported commodities, and structures. EPA says it is an aggressive stratospheric ozone-depleter. The agricultural community says that no acceptable substitutes exist.

The international agreement on ozone-depleting chemicals, the Montreal Protocol, was revised last month to accelerate the schedule for banning methyl bromide to 2005 from 2015 for developed countries. I understand that current provisions of the Clean Air Act in turn require the US to unilaterally ban the product even earlier, in 2001. Thus, some members of Congress allied with agriculture are discussing a legislative fix to the Clean Air Act to delay the ban until it binds all other developed countries in 2005. They want to know whether the Administration will support them.

Arguments for legislation:
* The President may have stated in a Fresno, California stump speech to farm interests that the US would not "unilaterally disarm" on the use of methyl bromide.
* Some press editorials (e.g. Public Citizen) are calling for fulfillment of the promise.
* Farm interests are in a stew over the pending early ban.
* It would probably make economic sense to provide more time to develop

substitutes.

Arguments against legislation:
* It's not green, and we'll get socked by the enviromentalists.
* By forcing a vote on the matter, a bill would hard press friendly legislators who have big constituencies of both aggies and enviros.
* It would open the whole Clean Air Act up to amendments and create a mess.

How we left it: CEQ will research POTUS statements to clarify public commitments. We won't do anything for now, and we'll see what happens in the next two weeks until Congress recesses.

Labeling is not currently on the table: Katie did not mention any regulatory initiative to require labeling all products produced using methyl bromide, as some rumors suggested she would. She says that because methyl bromide is not exactly Class I, a legislative change to the Clean Air Act would be necessary to impose the same labeling requirements on methyl bromide that apply to Class I ozone-depleters.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Adele C. Morris (CN=Adele C. Morris/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:28-OCT-1997 10:55:50.00

SUBJECT: Reg reform bill

TO: Aaron S. Edlin (CN=Aaron S. Edlin/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: Randall W. Lutter (CN=Randall W. Lutter/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
I'll make a time with Alice when we can get together and talk about the reg reform bill, S. 981 and the Administration's markup. To give you a flavor of the kinds of things we see in the markup, you can read the attached list of ten examples of big loopholes the markup creates in the bill. The markup is thick with clever, superficially plausible language that guts the requirements. It may not be worth our trouble to try to fix it.

Adele

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D73]MAIL46941400W.316 to ASCII,
The following is a HEX DUMP:

Ten examples of problematic edits to Reg Reform Bill S.981

The following are ten examples, not necessarily the worst, of edits CEQ/OMB have made to the Senate draft regulatory reform bill, S. 981. There are probably two dozen more equivalent examples I could cite, but you'll get the picture from these:

1. **Cost Effectiveness** (Markup language):

> "The term 'cost effectiveness' means the least costly means of achieving a specified level of benefits, as identified by the agency."

This definition implies that *any* given policy option with distinct benefits could be made "cost effective" if done the least expensive way. For instance, Amy's idea of 1890 by 2010 could be cost effective if implemented in the cheapest (although still exorbitant) way *that would meet that goal.* Moreover, the agency decides what the benefits are, so each option can always be attributed distinct benefits.

The **markup bill exempts very big and important categories of rules** from cost-benefit analysis and risk assessment requirements. For example, the following two kinds of rules are exempt:

2. "A rule that implements an international treaty, trade agreement, or similar agreement;"

This would mean, for example, that CAFE standards and appliance energy-efficiency standards would not require cost-benefit analysis if they were proposed in furtherance of our climate change treaty obligations. If we have a fishing treaty with Canada or ban methyl bromide pursuant to the Montreal Protocol, none of the rules would come under cost benefit requirements. Similarly, anti-dumping and counter-vailing duties rules could be exempt.

3. "A rule or agency action that authorizes the introduction into, or removal from, commerce or recognizes the marketable status, of a product."

This enormous exemption could include bans, restrictions, and standards for: air bags, asbestos, medical devices and drugs, chemicals and pesticides, agricultural commodities, labeling requirements, quarantines and import quotas of all kinds, etc. Just about anything you can think of could pertain to the marketable status of a product.

4. **Current criteria for rulemaking prevails**: The markup adds the following language:

> "The requirements of this Act shall not alter the criteria for rulemaking otherwise applicable, and shall not diminish the range of discretion available to the agency under other statutes."

This language, read carefully, implies that administrative criteria for rulemaking would supersede the requirements of the Act. This could mean anything.

5. **Act would not apply to Clean Air Act:** The markup adds the following language:

> " The requirements of this subchapter shall not apply where the rulemaking is governed by a statute that sets forth specific requirements for the use of cost benefit analysis or risk assessment in the development of the regulation."

Certainly the recent PM/Ozone rule, because the Clean Air Act requires purely health based standards, would have been exempt from the cost benefit requirements of the Act. Any number of statutes may suggest cost benefit analysis cannot be the basis for the regulation, but that is no reason the public should not be informed of the costs and benefits of those rules.

6. **No alternative options required:** The markup strikes the word "reasonable" from the requirement that the agency evaluate "a reasonable number" of reasonable alternatives reflecting the range of regulatory options that would achieve the objective of the statute, and leaves to the discretion of the agency the number of alternatives they consider. Since one is a number, the agency need only examine one option for a given regulation.

7. **Markup creates a legislative supermandate:** Where feasible, the markup requires an agency to consider regulatory alternatives that are "more protective of children or other sensitive subpopulations, or populations exposed to multiple and cumulative risks." The choice of regulatory alternatives should be done on a statute by statute basis.

8. **Markup throws out full disclosure when benefits don't justify costs:** When the agency determines that the benefits probably don't justify the costs, the markup bill merely requires an agency to explain why the alternative chosen is *preferable* to the other reasonable alternatives. The Senate draft bill would require more analysis describing why the agency *couldn't chose* an option that was cost-effective, not just explain why the agency liked the cost-effective options less.

9. **Markup allows exclusive use of upper bound risk:** Senate bill would have required the presentation of the risk assessment to include the "most plausible estimate of the risk." The markup merely requires the "results of the risk assessment," which presumably could exclude central tendencies and modes and only present upper bound risks.

10. **Good cause exemption is anything they want it to be:** The markup bill could allow an agency to find that a cost benefit analysis is "impracticable, unnecessary, or contrary to the public interest" and then never do it if "substantial costs of compliance have been incurred or actions otherwise taken in reliance on the rules." The agencies think this whole exercise is unnecessary, and could always come up with some example of an action taken in reliance on the rule.

Withdrawal/Redaction Marker
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
002. email	brennan@rff.org to janet l. yellen at 14:11:25.00. Subject: shotgun marriages. (2 pages)	10/29/1997	Personal Misfile

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

FOLDER TITLE:
[10/21/1997 - 11/14/1997]

2013-0723-F
ab1273

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]
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: Jon D. Haveman (CN=Jon D. Haveman/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:30-OCT-1997 12:13:47.00

SUBJECT: MFA-Turkey Issue

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

TEXT:
Janet,
I talked to somebody over at USTR about the Turkey-MFA/EU gentlemen's agreement issue. Basically, unless a LOT of pressure is exerted, nothing is going to happen. I'm assuming that we're not willing to exert a LOT of pressure.

Jon

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:30-OCT-1997 13:20:30.00

SUBJECT: Kyoto discussion paper - for today's 2:00 mtg

TO: William J. Antholis (CN=William J. Antholis/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

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

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

TO: Kathleen A. McGinty (CN=Kathleen A. McGinty/OU=CEQ/O=EOP @ EOP [CEQ])
READ:UNKNOWN

TO: LAPHAM_N (LAPHAM_N @ A1 @ CD @ LNGTWY [UNKNOWN]) (CEQ)
READ:UNKNOWN

TO: Peter R. Orszag (CN=Peter R. Orszag/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

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

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

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

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

CC: Robert S. Kapla (CN=Robert S. Kapla/OU=CEQ/O=EOP @ EOP [CEQ])
READ:UNKNOWN

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

CC: Jonathan H. Adashek (CN=Jonathan H. Adashek/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TEXT:
Attached is a discussion paper for today's 2:00 meeting. (This reflects
minor changes from drafts most of you have seen previously.)=================== ATTACHMENT 1
===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D12]MAIL46959420F.316 to ASCII,
The following is a HEX DUMP:

DRAFT 10/30

DISCUSSION PAPER

I. State of Play

Reports from Bonn suggest we are in deadlock. No country has come forward to support the U.S. target; support for joint implementation is very limited; our position on developing country participation has won no backers. At the same time, no other proposal (EU, Japan, G-77) seems headed for consensus support.

Currently, the bidding is as follows:

- There is potential for common ground with a group of non-EU Annex I countries, including Canada, Australia, New Zealand, Japan and the FSU. None of these countries have embraced the EU targets. However, none have embraced our calls for developing country participation either. Several are insisting on "differentiated targets."

- The EU is seeking to claim the moral high ground with its steep reduction targets. It disputes vigorously our claim that their targets are unachievable and has held briefings in Bonn to explain how they plan to achieve their targets. The EU is not joining our call for developing country participation.

- G-77 has united disparate elements (small island states, OPEC) behind a proposal with steep reduction targets (the EU numbers plus a 35% reduction from 1990 levels in 2020) and "compensation" proposal (under which Annex I countries would pay the G-77 for lost revenues associated with meeting any target). Key developing countries (e.g. China, Brazil and India) emphatically reject our proposal that they agree at Kyoto to negotiate emissions limits in the future.

II. Strategy

There are, in concept, three possible outcomes for Kyoto: (1) a deal on substance; (2) a deal to keep process going despite no deal on substance; (3) no deal at all (breakdown). Our general strategic objective is to secure the first outcome on desirable terms, the second if a good deal isn't possible, and to avoid the third. Note that a hybrid of the first and second outcome is also possible -- a very limited deal on substance and an agreement to keep the process going.

To try to achieve our desired ends, there seem to be two main tactical alternatives to pursue, though the calendar dictates that, to the extent we think both make sense, we will have to pursue them simultaneously rather than in sequence.

Coalition with non-EU Annex I countries. Given the wide gap between us and both the EU and the G-77, one approach would be to try to forge a coalition with non-EU Annex I countries (e.g., Japan, Canada, Australia, New Zealand, FSU, Eastern Europe), then approach the EU and, if any ground for compromise existed to permit a broader Annex I coalition to form, try to move out to embrace the developing countries. Building such a non-EU coalition would arguably put us in stronger position to strike a deal either on substance or process. And even if no deal proved possible, we would probably do better in the breakdown scenario if we were part of a larger grouping than if we were alone.

Pursuit of common ground with EU. An alternative approach would be to deal directly with the EU to try to build a compromise package that would move us out of our current stalemate.

The G-77. It is unlikely that we'll be able to make any real progress with developing countries unless and until we have built some basis for agreement with other Annex I countries. Even then it isn't clear that we'd be able to make much headway. But, again, given the constraints of the calendar, this doesn't mean we shouldn't be exploring whatever G-77 avenues might be available.

Calendar. Starting tomorrow, we have a series of high-level diplomatic meetings with a broad range of countries. Key meetings include:

October 31: Tarullo/G-8 sherpas
October 31 - November 10: Talbott Asia trip (New Zealand, Australia, Indonesia, China, Japan, Korea)
November 1-7 (approximately) -- M. Kimble in Europe
November 4: Wirth & Eizenstat/EU Troika
[November 6: VP/Prescott]
November 8&9: informal climate change ministerial in Tokyo (two dozen key countries)
mid November: Zedillo State Visit
late November: APEC leaders meeting

The Kyoto conference opens less than five weeks from today.

III. <u>Main Issues</u>

Target:

- differentiation: countries would adopt different target and timetables, based on formulae (with criteria such as per capita emissions, energy efficiency, population growth); negotiated targets for each country; or common reduction targets with a choice of baseline years.
- second budget period reduction:

- earlier start of budget period;
- move our baseline forward;
- FSU and Eastern European issues: EIT baselines; paper tons

Flexibility

- restrict trading;
- restrict JI;
- banking and borrowing,
- EU bubble

Developing countries

- evolution
- volunteer budget commitments
- triggering only key countries, etc.

IV. Possible Packages for Substantive Deal

A. Form Non-EU Annex I Coalition

The primary strategic objective here is to broaden the base of support for the U.S. proposal; pressure the EU to come toward the targets supported by a bloc of other Annex I countries; and (if we are not able to seal a deal at Kyoto) define a favorable means for continuing the negotiations in the years ahead. To accomplish this, we will need to create several high-level diplomatic channels with key countries in the next two weeks; use Talbott visits to key countries; use the Tokyo ministerial; and use a significant fraction of leaders' time at APEC.

This strategy could lead to (a) a Kyoto agreement, based upon negotiations between the U.S.-led bloc, on the one hand, and the EU and G-77 countries on the other; or (b) a process agreement to continue discussions.

TARGET: Roughly at levels we have proposed. To bring others on board, we would likely need to:

- allow some form of differentiation. This could be on the basis of a defined formula (e.g. the Japanese proposal, which varies commitments depending on population growth, energy efficiency and per capita emissions), different negotiated levels for each country, or common reduction targets with a choice of baseline years.

- support Russians on "paper tons" and support EIT on 1987 baseline year

- support some (scaled-back) form of New Zealand sinks proposal

FLEXIBILITY: Unlimited Annex I trading and worldwide joint implementation for credit.

DEVELOPING COUNTRY PARTICIPATION: Support Japanese suggestion for review of commitments of both developed and developing countries, perhaps during next several years. Article 10 "volunteers category." **[WHAT IS ARTICLE 10??]**

B. Shape Deal that Could Gain EU and G-77 Support

TARGET: To gain EU support, we would at a minimum need to support targets that appear more stringent than those we have proposed. (EU politicians need to be able to market the Kyoto agreement as significant reductions.) We might also need, ultimately, to agree to reductions that are in fact more stringent. Options include:

> Annex I countries reduce emissions by 7.5% by 2008-2012. Countries could choose any baseline year between 1987 and 1995.
>
> 10% reductions from 1990 levels in second budget period (2013-2017)
>
> Start budget period in 2005

FLEXIBILITY: Unlimited Annex I trading. EU bubble. Joint implementation (a) within Annex I and with other countries who have accepted binding limits [on the assumption that several key developing countries could be persuaded to accept some kind of not very restrictive formula, such as per capita emission limits], or (b) with all countries, assuming no developing country acceptance of a binding formula.]

DEVELOPING COUNTRY COMMITMENTS: To gain commitments from key developing countries -- even the commitment to negotiate -- we would need to offer something they find attractive. To date, we have not done so. Theoretical possibilities include:

- new and additional money and technology (unlikely in the extreme).
- a formula emissions limit that would not appear to limit their growth potential. Treasury was going to work on possible alternative forumlas that might fit this bill. We need some analysis here. One theoretical possibility that developing countries might be most interested in is a formula that was keyed to per capita emissions, but we need analysis on what such a limit would mean substantively -- e.g., if it doesn't amount to *any* kind of restraint, it probably wouldn't do us much good.

A package might include Article 10 "volunteers category" and review of commitments for all parties at COP-4 (in 1998). We would work hard between now and Kyoto to get several major developing countries, especially China, to sign on by offering per capita emissions limits under Article 10.

V. Process Deal

At the same time that we are trying to piece together a substantive agreement for Kyoto, we need to be working on a process deal that would keep the parties talking, in one forum or another, and avoid a breakdown.

We need guidance from State on the different options here. For example, one option might be to extend the negotiating process under the Berlin Mandate. Another might be to develop a new negotiating mandate, with somewhat different parameters. We need to understand in very short order what the options are and how we might best pursue them tactically.

The most difficult issue here will likely be developing country commitments. As at Berlin, we will face widespread resistance to our efforts to add new developing country commitments to the agenda for any future discussions.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Jeremy B. Rudd (CN=Jeremy B. Rudd/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 1-NOV-1997 23:34:00.00

SUBJECT:

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

TEXT:
Dr. Yellen:

I left copies of the FRB briefing materials on a chair facing the door to my office (room 325). The door to my office sticks, so you will have to push hard to open it.

I did not include all of the FRB materials, since many of them were statistical tables, notes on country conditions, or Japan-related; I therefore "culled" the item.s that are relevant to what we are presenting (CPI bias, income distribution, &c.). I also enclosed the table of contents from Governor Meyer's briefing book, so you can see what else the FRB staff put together. I received copies of the entire briefing book, with the exception of some items about Japan, and can give you whatever else you want; I will also take the full book along to Paris.

I should be in the office tomorrow (Sunday) by 10.00 a.m.

- Jeremy

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME: 2-NOV-1997 14:41:27.00

SUBJECT: CPI Paper

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

TEXT:
Attached is the ~~(confidential)~~ CPI paper we prepared last spring. =================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D66]MAIL48173550M.316 to ASCII,
The following is a HEX DUMP:

1. PROFESSIONAL OPINION ON THE MAGNITUDE OF THE BIAS IN THE CONSUMER PRICE INDEX

In light of your commitment to ensure the most accurate measurement of changes in the cost of living, you asked your economic advisers to survey recent research on the cost of living and the consumer price index (CPI). This memo responds to that request. Recently, there has been a flurry of research by economists and statisticians in academia, business, at the Federal Reserve, and at the Bureau of Labor Statistics (BLS), the agency responsible for producing the CPI. The majority of this research has corroborated the notion that the CPI overstates increases in the cost of living by a substantial amount.

The Long History of Awareness of CPI Bias

Although recent advances in understanding and data availability have enabled us to more accurately quantify the bias in the CPI, the general awareness that the CPI overstates increases in the cost of living is not new. Some of the most influential economists of the 19th century wrestled with the difficulties inherent in producing a cost-of-living index. Similarly, the U.S. CPI has been subjected to a long series of critical reviews. One of the most influential reviews was conducted in 1959 by the Price Statistics Review Committee under the chairmanship of Professor George Stigler. With the exception of the outlet substitution bias, the Stigler Committee recognized all of the sources of bias identified by the recent Advisory Commission to Study the Consumer Price Index (the so-called Boskin Commission). These different sources of bias are discussed in the next section.

A Review of Recent Estimates of the Bias in the CPI

Brent Moulton, the Chief of the Division of Price and Index Number Research at the BLS recently published a compilation of estimates (shown in Table 1) of the overall bias according to published research and statements by experts in the area. Moulton noted that his compilation did not include input from many experts -- including several currently or formerly affiliated with the BLS -- who are critical of larger estimates, but have not come forward with their own estimates of the bias. On the other hand, the table does not include other experts -- such as Jerry Hausman of the Massachusetts Institute of Technology -- who believe the bias is substantially larger than 1.1 percent.

TABLE 1: RECENT ESTIMATES OF BIAS IN THE U.S. CONSUMER PRICE INDEX

Author(s)	Point Estimate	Interval Estimate
Advisory Commission to Study the CPI (1996)*	1.1	0.8 - 1.6
Michael Boskin (1995)*	1.5	1.0 - 2.0
Congressional Budget Office (1995)	0.5**	0.2 - 0.8
Michael Darby (1995)	1.5	0.5 - 2.5

W. Erwin Diewert (1995b)	1.5**	1.3 - 1.7
Robert Gordon (1995)*	1.7	-
Alan Greenspan (1995)	1.0**	0.5 - 1.5
Zvi Griliches (1995)*	1.0	0.4 - 1.6
Dale Jorgenson (1995)*	1.0	0.5 - 1.5
Jim Klumpner (1996)	0.4**	0.3 - 0.5
Lebow, Roberts and Stockton (1994)	1.0**	0.4 - 1.5
Ariel Pakes (1995)	0.8	-
Shapiro and Wilcox (1996)	1.0	0.6 - 1.5
Wynne and Sigalla (1994)	less than 1.0	-

* Indicates members of the Advisory Commission.
** Study did not supply a point estimate of the bias; this is the center of the range.
Note: Many of these estimates pre-date recent methodological revisions of the CPI that have fixed some sources of the bias -- up-dated estimates of the bias looking forward could be slightly smaller.

The Evidence from Recent Surveys

Surveys of expert opinion show that a broad range of professional economists agree that the CPI overstates increases in the cost of living. We know of three polls that have been conducted on this issue. The results are as follows:

- USA Today (January 20, 1997). Ninety-six percent of the 49 leading economists surveyed thought that the CPI overestimated increases in the cost of living. Fifty-three percent of respondents agreed with the Advisory Commission's estimate of a 1.1 percentage point bias.

- Wall Street Journal (February 25, 1997). Eighty-seven percent of the 320 academic economists surveyed stated that the CPI overstates increases in the cost of living. Fifty-six percent of those surveyed thought the bias was 0.6 percentage point or higher.

- Boskin Survey (February, 1997). Michael Boskin (the chairman of the Advisory Commission) conducted his own poll that, unlike the other surveys, was limited to recognized experts on the CPI. Based on 20 responses, the survey found a median estimate of the bias of 1.1 percentage points. No respondent's best estimate of the bias was below 0.5 percentage point.

2. THE DIFFERENT SOURCES OF BIAS IN THE CONSUMER PRICE INDEX

A Cost-of-living Index and Types of Bias

The ideal price index would measure changes in the cost of achieving a given standard of living. That is, it would calculate the relative expenditures required to achieve the same level of well being under two sets of prices, say the prices observed in this year and last year. The cost-of-living framework guides the BLS in making operational decisions about the construction of the CPI. The CPI, however, is an imperfect measure of the cost of living. In fact, the BLS must use certain procedures -- given the constraints of data, knowledge, and the rigors of producing an unrevisable monthly index -- that lead the CPI to overstate systematically increases in the cost of living. In addition, measurement techniques to quantify some of the known biases in the CPI may never be developed.

Total Bias in the Consumer Price Index

Researchers have identified 5 different types of bias in the CPI: upper-level substitution, lower-level substitution, quality, new goods, and outlet substitution. These are each described in some detail below. <u>The solid, broadly agreed upon evidence related to these biases adds up to a 0.6 percentage point per year overstatement of the increase in the cost of living</u>. The actual bias, many economists argue, is likely to be larger. Estimates of the additional sources of bias beyond the ones we explicitly identify vary greatly, however, and no single estimate commands broad agreement. Table 2 shows the breakdown of the 0.6, as well as the breakdown of the Advisory Commission's estimates.

TABLE 2: ESTIMATES OF THE BIAS IN THE CPI		
	Advisory Commission	Broad Technical Agreement
Upper-level Substitution	0.15	0.15
Lower-level Substitution	0.25	0.15
Quality & New Goods	0.6	0.3
Outlet Substitution	0.1	0.0
Total	**1.1**	**0.6**

Upper-Level Substitution Bias

There is a general consensus that the BLS's current procedure for aggregating prices at the upper level of the CPI overstates increases in the cost of living by 0.15 percentage point per year. We are not aware of any research that differs significantly from this assessment of the upper-level bias.

The CPI is constructed by aggregating the prices of thousands of goods and services. The aggregation occurs in two stages. First, prices of similar items are combined into a price index for the category as a whole. For example, the prices of different kinds of apples at the "lower level" of the CPI are combined into a price index for the apple category. The "upper level" of the CPI includes indexes for 207 different categories of items in each of 44 distinct geographical areas (9,108 component indexes). In the second stage of aggregation these different category indexes are combined to calculate the total CPI, a process called upper-level aggregation. At both levels the procedure used to aggregate prices assumes that consumers are locked into consuming a fixed bundle of goods and services; and to the extent that this assumption is not true, these procedures introduce bias. This subsection discusses the bias at the upper level of aggregation (e.g. apples and oranges); the next subsection discusses the bias at the lower level of aggregation (e.g. different kinds of apples).

The CPI prices a fixed market basket of commodities. At the upper level, shares of the commodities in the basket are based on spending patterns observed in a base period -- currently 1982-84. Economists have long understood that this type of index, called a Laspeyres index, will almost inevitably overstate increases in the cost of living.

Consumers do not buy the same basket of goods each year, as assumed in the construction of the CPI. They substitute between goods for a variety of reasons including taste, availability and price. For example, the fact that consumers often take advantage of sales will lead a Laspeyres index like the CPI to overstate changes in the cost of living. Suppose that there are only two goods -- apples and oranges -- each costing $1; in the first period a consumer buys 10 apples and 10 oranges. Suppose that in the second period an apple costs $2 but an orange only costs $0.50. In this case the consumer requires $25, or 25 percent more income, to buy exactly the same combination of apples and oranges as before. So with a 25 percent increase in income the consumer can be at least as well off as before. But because she could adjust her purchases to buy more oranges and fewer apples -- taking advantage of the fall in the relative price of oranges -- a 25 percent increase would actually make her better off than before.

Based on both economic theory and common sense, it is clear that upper-level substitution bias exists and is positive. But technical experts have also figured out ways to quantify the magnitude of this bias. The so-called "superlative indexes" take into account consumers' substitutions of one good for another in response to changes in relative prices, and hence are not subject to substitution bias. Superlative indexes do not make specific assumptions about the degree to which consumers are willing to substitute. Instead they employ information about changing consumption patterns by using data from both the beginning and the end of the period over which inflation is measured. For example, suppose that a consumer is very unwilling to substitute between goods. In this case, even if relative price movements were large, her consumption at the beginning of the period would be very similar to her consumption at the end of the period. A superlative index would then produce a measurement of the change in the cost of living that was very similar to a fixed-basket Laspeyres index. If, however, the consumer made large substitutions, her consumption basket at the end of the period would be very different from her consumption basket at the beginning of the period; the superlative index's measurement of the increase in the cost of living would take this into account.

Using one superlative index -- the Tornqvist index -- to aggregate the different expenditure categories, BLS researchers have calculated that, on average, annual inflation was 0.14 percentage point per year lower than the change in a fixed-weight CPI-like index from 1988 to 1995. Table 3 shows the comparison between inflation measured by a Laspeyres index very similar to the current CPI and a Tornqvist index that takes into account consumers' ability to make substitutions at the upper level. (The difference between the Tornqvist inflation and the actual CPI was greater for technical reasons.)

TABLE 3 - BLS ECONOMIST'S ESTIMATE OF THE UPPER-LEVEL SUBSTITUTION BIAS

	1988	1989	1990	1991	1992	1993	1994	1995	Avg
Laspeyres inflation	4.0	4.7	5.2	3.9	2.8	2.8	2.6	2.7	3.59
Tornqvist inflation	3.8	4.5	5.0	3.8	2.7	2.7	2.5	2.6	3.33
Upper-level Substitution Bias	0.1	0.2	0.2	0.1	0.1	0.1	0.1	0.1	**0.14**

Source: Based on data from the Bureau of Labor Statistics. Details may not add due to rounding.

Lower-level Substitution

Although there is a general consensus that lower-level substitution bias exists and is positive, estimating its exact magnitude is somewhat more difficult than estimating the exact magnitude of upper-level substitution bias. Research that is almost universally agreed upon has concluded that this bias is anywhere between a small positive number and somewhat higher than 0.25 percentage point per year. Although most experts, including the Advisory Commission, assume the bias is probably closer to 0.25 percentage point per year, a conservative estimate is 0.15 percentage point per year.

Lower-level substitution bias is conceptually parallel to upper-level substitution bias: the current procedure for combining the price changes of individual items within a category is unbiased only if consumers do not make substitutions and/or relative prices do not change. Unfortunately, superlative indexes cannot be used either to estimate the magnitude of the bias within categories, or to redress it, because the necessary data on spending patterns are not available at the level of individual items. Instead, estimates of the bias at the lower level must rely on assumptions about the degree of substitutability of different products. To date, relatively little research has been done to guide these assumptions, and most experts rely on intuition to guide their estimates.

The current procedure employed by the CPI, using an arithmetic mean to combine price indexes for individual items into the category index, implies the extreme assumption that goods are <u>not at all substitutable</u> within categories. In some categories there is indeed relatively little substitutability. For example, it might be difficult to substitute between different prescription drugs within the prescription drugs category, or between guitar picks and grand pianos in the "toys, hobbies, and music equipment" category. Even for these categories, however, some upward bias -- possibly very small -- arises from using an arithmetic mean.

An alternative procedure, now employed by the BLS in the agency's monthly "experimental CPI using geometric means" (CPI-U-XG) is to use geometric means to aggregate the prices of individual items at the lower level. This procedure is appropriate when goods within a category are <u>moderately substitutable</u> for one another. Within some categories, possibly apples or oranges, goods may be even more substitutable than the assumption employed in the geometric mean index and therefore even a geometric index overstates increases in the cost of living. But, for other categories, like prescription drugs, the geometric mean is likely to understate increases in the cost of living.

Between December 1990 and February 1997, the average annual rate of growth of the CPI-U-XG was 0.34 percentage point lower than the growth rate for the CPI-U-XL, a test CPI designed to be comparable to the CPI-U-XG. (The difference between the CPI-U-XG and the actual CPI was greater for technical reasons.) In 1995 and 1996 the difference narrowed to 0.25 percentage point -- the magnitude many experts expect to persist going forward. It is open to debate whether this 0.25 percentage point difference is higher, lower, or equal to the difference between the CPI and a cost-of-living index. An ongoing research program at the BLS is using a variety of data to answer this question. A conservative but reasonable estimate is that there is a lower-level bias of at least 0.15 percentage point per year.

Quality Bias

Most experts agree that the CPI does not adequately account for quality changes in existing goods and, as a result, overstates increases in the cost of living. The Advisory Commission's best estimate of the bias resulting from the treatment of quality and the treatment of new goods (a related problem discussed in the next section) is 0.6 percentage point per year. Like other experts, the Commission was very uncertain about this estimate, and stated that the actual quality and new goods bias could be almost twice as large as this estimate. Subsequent discussion has emphasized the degree to which this estimate is based on ad hoc judgements of the Advisory Commission. But at least 0.3 percentage point of the bias for quality and new goods rests on well-documented evidence. It is very likely that other difficult-to-document quality changes make the actual quality and new goods bias even larger than this estimate. Although many experts would endorse a larger estimate of the quality and new goods bias, it would not be based on broad agreement. Quality changes are discussed in this subsection and new goods are discussed in the next subsection.

The BLS tracks the price of individual items in the CPI on a monthly or bimonthly basis. Although the BLS tries to track exactly the same item, many items change or become unavailable during the 5 years in which they are in the sample. Altogether, about 4 percent of the 80,000 sample prices collected each month are for substituted items. In these cases, the BLS cannot just look at the change in the raw prices. Instead, it must choose an appropriate quality-adjustment procedure to distinguish between how much of the change in the raw price is due to changes in the underlying price and how much is due to changes in the underlying quality. If, for example, the cost of a car increases because cruise control becomes standard, then this is a quality improvement and should not be counted as an increase in the cost of attaining a fixed standard of living. If, however, a new model car combines minor cosmetic changes with a large price increase, then this should be reflected in the CPI as an increase in the cost of living.

In 1995, quality adjustment procedures attributed about 1 percentage point of the increase in raw prices to quality improvements and purged them from the CPI. Probably the most accurate method currently employed by the BLS is the direct-quality adjustment method. For example, the BLS makes direct quality adjustments for apparel by measuring the premium paid by the market for new features like zippers instead of buttons, or silk cloth instead of cotton. New features on cars such as cruise control are evaluated at the prices at which they could previously be purchased as an option. And new features on a variety of goods are adjusted using manufacturer-supplied data on their production costs. Finally, a special case of the direct-quality adjustment method is the overlap method, where both the old and new item are observed simultaneously and the price difference is taken as a measure of quality difference. Although these methods are necessarily imperfect, in general most experts do not think that they are prone to systematic bias. In total, however, only about 10 percent of replacement goods are adjusted by direct-quality methods.

The other general quality adjustment procedure for non-comparable new goods is the comparison method. The BLS assumes when using this method that the underlying price of an item changes by as much as the price of related items, and attributes the residual price change to quality. This can be based on other similar items (the class-mean imputation method) or the entire category (the link method).

BLS quality adjustment procedures are likely to understate improvements in quality and thus overstate increases in the cost of living for a number of reasons:

- Many goods are not subject to either of these quality adjustment procedures because they are considered "comparable" or the quality change is not even recognized. As a result many gradual improvements in quality may not be adequately detected by data collectors. For example, although the BLS tries to adjust for changes in features of telephone service like the introduction of call waiting, they do not take into account gradual improvements like better clarity of phone connections.

- Both the comparison method and the overlap method assume that a replacement good is a quality improvement over an old good by exactly the price differential between them. Often, however, the quality improvement in new goods is greater than their price differential with other goods. According to economic theory, this will be the case when, as often happens, the substitute item gains market share.

Although these general arguments lead to the presumption that the CPI is biased upward, they do not identify the magnitude of that bias. Also some economists have argued that some biases could lead the BLS to overadjust for quality improvements. For instance, if manufacturers try to disguise price increases by making them simultaneously with model changes, then the comparison method could result in too low an estimate of inflation. And in some cases, the BLS may introduce negative bias into the CPI by missing deteriorations in quality (many of which are disguised) in contrast to quality improvements (which are typically flaunted). Although most professionals agree that BLS occasionally overadjusts for quality (or misses quality deterioration), very little research has identified instances of substantial overstatement of quality in specific categories of the CPI.

The only way to quantify the extent of quality bias in the CPI is to compare, category-by-category and item-by-item, the quality improvements incorporated into the CPI to estimates of the actual change in quality. For many categories, although experts agree upon an upward bias, they must use subjective judgements to quantify the bias. In two areas, "appliances including electronic" and medical care, experts -- including those at the BLS -- agree that there is a large and well-documented bias which can be, to some degree, quantified. The Commissioner of the BLS has testified that "appliances including electronic" and medical care "clearly are components of the index in which the BLS faces particularly difficult measurement problems."

Based on the best available research, our estimates of the generally agreed upon bias in these two categories are as follows:

- "Appliances including electronic". Discussing the Advisory Commission's estimate of the bias in the "appliances including electronic" category, BLS economists recently wrote, "The Commission's estimate of bias for this category, 5.6 percent per year, is the largest of the estimates. It is also probably the best documented, with a number of academic and government studies that have developed hedonic quality adjustment models and have found upward quality bias for personal computers, television, video equipment, etc." The Commission's estimate of bias for this category is a conservative assessment of a number of studies of different appliances and electronic goods that conclude that the quality bias is 3 percentage points per year for appliances, 4 percentage points per year for TV-radio, and 15 percentage points per year for computers. We view these estimates as the reasonable conclusion of objective empirical research. Combining them with the shares of these goods in current expenditures implies a quality bias in the overall CPI of about 0.1 percentage point per year.

- Medical care. Although most Americans spend more and more money on medical care, much of the increased spending is the result of the increased quantity and improved quality of their medical care -- not the result of medical price inflation. Medical knowledge has increased so rapidly in recent years that the cost of treating particular conditions -- heart attacks, cataracts, and knee problems -- has fallen dramatically. Most of these quality improvements are missed by the CPI, which measures the price of medical inputs, not outputs. Although the price of a particular input (e.g. a visit to the doctor) may rise, if fewer inputs are required to achieve a certain medical outcome (e.g. amelioration of mild asthma or allergies) then an input-based price measure will substantially overstate increases in the cost of the treatment. Another example is MRIs and CT scans which can be used instead of invasive exploratory surgery as a more efficient and less painful way of discovering appendicitis, ruptured ovaries and ulcers. Studies by top economists of particular treatments have found that the CPI often attributes large price increases to treatments that have actually declined in price. We view the Advisory Commission's estimate of a 3 percentage point per year bias in the medical services portion of the medical care category as a conservative assessment of the existing research. Combined with the relatively large share of medical services in the CPI, this leads the CPI to overstate increases in the cost of living by about 0.2 percentage point per year. The BLS has, however, recently improved its procedures for calculating the medical portion of the CPI, so currently this bias is somewhat lower than 0.2 percentage point per year.

New Goods Bias

The constant expansion of the number of goods and rapid innovations in the processes for producing these goods leads to another, related type of upward bias: new goods bias. We have hard, generally agreed upon evidence for 0.02 percentage point per year of bias coming from the introduction of cellular phones alone. Incorporating the range of other new goods from cable television to frozen yogurt would lead to a higher estimate of the new goods bias.

The manner in which new goods are treated raises problems similar to those that arise in accounting for quality change: the CPI needs to find the appropriate procedure to link the old and new goods together in the sample. The constant appearance of new goods, however, leads to bias in two other ways: the delayed introduction of new goods into the CPI leaves much of their typical initial price decline unrecorded and the CPI, by construction, misses the welfare gains associated with the consumption of new goods. The new product bias is unambiguously an upward bias.

Delayed introduction. Prices of new goods typically fall -- or increase slowly -- for a period after their introduction. This phase of the "product cycle" comes not only from learning how to produce the product more efficiently but also from taking advantage of economies of scale or from lower markups caused by increased competition from new entrants. Because it usually takes a substantial amount of time for new goods to be introduced into the CPI, the CPI misses the initial price declines of these goods. The Advisory Commission cites two examples: "room air conditioners, which were widely sold in 1951, but not introduced into the CPI until 1964, 13 years later. More recently, the microwave oven was introduced into the CPI in 1978 and the VCR and personal computer in 1987, years after they were first sold in the marketplace."

Currently, the CPI is biased upward because it does not include cellular phones, despite their use by millions of consumers. By the time cellular phones are introduced into the CPI in January 1998, the CPI will have missed their large decline in price over the previous decade. BLS economists acknowledge that the CPI inflation rate could be 0.02 percentage point per year higher than it should be due to the omission of cellular phones. This is a substantial bias coming from just one good. The inclusion of other goods would raise the estimate of the bias from the delayed introduction of new goods.

Advantages of variety. If they have any effect on the standard of living, the introduction of new goods should only improve it and the disappearance of old goods should only make it worse. The upward bias in the CPI from the introduction of new goods most likely dwarfs the downward bias in the CPI from the disappearance of old goods for two reasons: (1) Empirically, many new goods and services rapidly gain a large market share and thus benefit large numbers of consumers. In contrast, most goods that disappear were used by relatively fewer people. (This is consistent with economic theory, which predicts that firms will not cease to produce profitable goods); and, (2) Variety is much greater today than it was in the past -- although horse and carriages have all but disappeared, they have been replaced by a large variety of other vehicles. (This is consistent with economic theory, which predicts that as the income of society increases, people want to spend that income not just on a greater quantity of the existing goods but also on better quality and a greater variety of new goods.)

In her recent testimony to the House Budget Committee, the Commissioner of the BLS discussed one example of the "advantages of variety" bias identified by the Advisory Commission in the food and beverages category: "the Commission's estimates of upward biases in these categories rest exclusively on not implausible, but unsubstantiated, judgements regarding the value to consumers of increased variety on grocery and liquor store shelves, together with the value of greater choice in restaurants" (emphasis added). Although everyone agrees that these new goods and services are an improvement that is not accounted for in the current CPI, it is difficult for experts to use anything other than judgement to assess the degree to which they bias the CPI. It would be even more difficult for the BLS -- which is committed to producing a relatively judgement-free CPI -- to incorporate the effects of these improvements in the CPI.

Other examples of new goods and services that have greatly enhanced the options and convenience of consumers are new features for telephone service (call waiting and voice mail), new ways of playing music (compact disc players), new financial conveniences (automatic teller machines), the spread of 24-hour stores, and a variety of new medical treatments and prescription drugs. Together with myriad other examples, these certainly have increased the standard of living in ways that are not reflected in the methods used to calculate the CPI. Although professionals agree that this bias is positive, they find it very difficult to assess its exact magnitude.

Outlet Substitution Bias

There is no professional agreement on the existence or magnitude of outlet substitution bias. It is almost certainly positive but very small -- probably between 0 and the Advisory Commission's best guess of 0.1 percentage point per year.

Outlet substitution could also be called the "Wal-Mart" phenomenon. The BLS's method for computing the CPI implicitly assumes that the lower prices offered by discount outlets reflect lower-quality service -- and therefore should not be measured as true price declines. The Advisory Commission argued that if the cheaper prices were fully offset by lower quality then low-priced outlets would not be gaining market share. The Commission estimated that growth in the CPI would be 0.1 percentage point lower each year if it took account of the increased opportunities for discount shopping.

Some have argued that outlet substitution bias may be negligible. One way existing outlets compete with new outlets is by lowering both the price of the good and the quality of their service. The price decline gets picked up but the quality decline goes unnoticed, resulting in the CPI understating increases in the cost of living. Although this interpretation is logically possible, little evidence exists to support it.

Overall, it is likely that the CPI does not adequately take into account the benefits that consumers derive from being able to shop at new, low-priced outlets. (If the lower prices at these stores were fully offset by lower quality of service then they would not have gained the huge market share they have in recent years.) It is generally agreed, however, that the resulting bias is less than 0.1 percentage point per year. The safest, most conservative estimate of expert opinion is to assume that outlet substitution bias is too small to be accounted for in this analysis.

3. IMPROVING THE CPI: WHAT IS AND IS NOT POSSIBLE

Although in principle the BLS would like the CPI to measure the cost of living, in practice, limitations in data and understanding force the BLS to weigh other considerations, including "timeliness, understandability, reproducibility, objectivity or variance," in making decisions about the construction of the CPI. The BLS itself has taken the lead in identifying and quantifying most of the generally agreed upon biases in the CPI. It has also been very active in redressing many of these problems. Some biases, like upper-level substitution, that the BLS has identified with reasonable accuracy cannot be addressed on a timely basis in the CPI. And other biases, like new goods bias, may be impossible to address in a fully objective and reproducible manner and thus may never be redressed in the measurement of the CPI.

It may be helpful to consider each type of bias separately, to explore what steps are possible and when:

- Upper-level substitution bias. Although addressing upper-level substitution bias is straightforward in principle, data limitations make it difficult to calculate an appropriate superlative index in a timely fashion. According to the Commissioner of the BLS's recent testimony, "The BLS currently produces these measures on an experimental basis, and would be happy to produce them to a higher standard of precision and reliability," but she cautions that it "cannot be produced until the fall following the year to which it applies." Upper-level substitution bias is sufficiently stable (see Table 3 earlier) so that a lagged estimate would be, for any practical purpose, extremely close to the actual bias. For the calculation of the CPI itself, however, the BLS does not plan to correct upper-level bias because such a correction would necessitate the use of small approximations which would not later be subject to revision.

- Lower-level substitution bias. The BLS is currently studying the appropriateness of geometric aggregation for different categories of the CPI. According to a recent statement, "By the end of 1997, BLS will announce the findings of its research, including its determination of which CPI basic indexes are best calculated with the geometric mean formula and when the implementation of any change will take place. The likely date for that implementation is with the release of the January 1999 CPI data." Again, the evidence indicates that this source of bias is relatively stable. It will be possible to estimate the extent of the lower-level substitution bias once it is decided which basic indexes should be computed using geometric means. Ultimately such bias will be redressed in the CPI.

- Quality bias. The BLS is constantly improving the way in which it deals with quality adjustment. It is very likely that, over the medium term, the BLS will be able to use direct-quality adjustment methods and improved sampling of new products to estimate quality change in the "appliances including electronic" category. The BLS also attaches a high priority to improving the accuracy of their measurement of medical care price inflation and has recently implemented some major improvements. These revisions will certainly improve the estimates of quality in this category, but according to BLS economists, "these changes are not a panacea for the difficult measurement issues in these categories." As the Commissioner of the BLS said in her testimony, it is easy to know that knee surgery techniques have improved but "there is no obvious or clearly objective way to quantify that value." Just because the quality bias cannot be quantified, however, does not mean it does not exist -- just that it may not be possible to take account of it in the measurement of the CPI.

- New goods bias. With increased funding, the BLS will be able to introduce new goods more quickly into their sample. This will improve the accuracy of the index and enable it to capture the decline in price that often follows the introduction of new goods. However, the initial welfare gains attendant upon the introduction of these goods will not be captured in this way. The other source of new goods bias -- the value of variety -- is certainly positive. It is, however, extremely difficult to assess its magnitude or implement procedures to incorporate this effect into the CPI. According to the Commissioner of the BLS's recent testimony, "We are, however, a very long way from being able to reflect the value of increased variety in the monthly CPI."

We are confident that the CPI is likely to become increasingly accurate with more time and resources. But, as the Commissioner of the BLS said, "I do not believe it to be possible to produce a perfect cost-of-living measure. This means that those who use the data we are able to produce should recognize the limitations of those data and exercise judgement accordingly concerning whether and how the data ought to be used." It is crucial that the BLS continue to produce the CPI in the most objective manner possible. As major users of the data, however, the Federal government must recognize that the BLS cannot correct all the biases and the government may need to make further adjustments based on the principles of sound judgement and broad agreement.

4. DO DIFFERENT GROUPS FACE DIFFERENT COST-OF-LIVING CHANGES?

Many government programs that are now indexed to the CPI affect particular demographic subgroups of the U.S. population, such as the elderly or the poor. A key question in designing an indexation strategy is whether the cost of living of these various groups increases at the same pace as for the total population. Most programs are constructed with the working hypothesis that different age and income groups experience similar rates of increase in their cost of living. In fact, our survey of the evidence shows no basis for predicting large, systematic differences between cost-of-living changes for different income classes, age groups, or other demographic groups.

We recognize the limitations of the available studies which do not fully reflect what these groups buy, where they buy it, and what prices they pay. The most relevant data thus far have been constructed by the BLS: the experimental CPI-E (for the elderly) produced on a mandate from Congress, and the experimental price indexes for poor consumers. The BLS and its research staff note that these indexes only partially reflect consumption patterns and thus may not fully measure the cost of consuming a fixed market basket. Although their upper-level weights are based on consumption by the elderly or the poor, they employ the consumption patterns of the entire urban population to determine the items priced within the lower-level strata. More importantly, these indexes do not capture the prices paid by poor who are more likely to use coupons or by the elderly who often receive senior-citizen discounts. Finally, the goods priced in the CPI-E and the experimental indexes for the poor are based on the shopping patterns of the entire urban population; the elderly and poor populations are distributed differently and may patronize different stores (e.g. discount outlets) disproportionately.

The growth of these experimental indexes has been very similar to the growth of the CPI. Over the last 6 years, the CPI-E has grown 0.2 percentage point per year faster than either the CPI-U or the CPI-W. This difference is not surprising: the consumption basket of the elderly includes a significantly higher share of medical care (12 percent) than that of the average consumer (7 percent), and the medical care component has risen faster than other prices. Because the medical share for the elderly is larger, however, correcting the quality bias would lower the growth of CPI-E by more than it would lower the growth of the CPI. If medical care inflation was overstated by 3 percentage points a year, a reasonable estimate, then the CPI-E, the CPI-U, and the CPI-W would have grown at roughly the same rate.

According to a recent study by BLS economists, the different indexes for the poor either grew at the same rate as the index for all consumers or, in one case, grew 0.1 percentage point more slowly. This study also found that the magnitude of the upper-level substitution bias did not differ between poor consumers and average consumers. This finding makes sense: Anecdotal evidence suggests that the elderly and the poor are more likely to increase their purchases of sale items and temporarily switch away from items that have increased in price. Like everyone else, the elderly and the poor can switch between different brands of apples (lower-level substitution) or between apples and oranges (upper-level substitution).

These studies did not estimate the magnitude of quality bias in the CPI-E or the experimental indexes for the poor. The most substantial and well documented instances of quality improvements that the CPI misses -- in medical care and "appliances including electronic" -- almost certainly apply to all groups in society. The elderly, for example, benefit from quality improvements in a large range of medical procedures from new and relatively inexpensive treatments for arthritis to hip replacement surgery. Also, many of the items in the "appliances including electronic" category are owned by large fractions of the population. Nearly all poor families have access to a refrigerator, stove, and color television. In addition, three-fourths of poor households have telephones, and nearly two-thirds have microwave ovens and VCRs.

5. CONCLUSION

There is now broad agreement among professional economists and statisticians that the consumer price index (CPI) overstates the increase in the cost of living by at least 0.6 percentage point per year. This conclusion derives from our review of the research of economists and statisticians at the BLS, the Final Report of Advisory Commission to Study the Consumer Price Index, and the work of other experts in this area.

One reason -- commanding universal agreement -- that the existing CPI overstates the increase in the cost of living is that it measures the impact of price changes on the cost of a fixed market basket of goods. By construction, this type of index does not reflect the extent to which people substitute less expensive items for more expensive items as relative prices change. Index formulas which do take these substitutions into account are being produced by the BLS on an experimental basis and provide a method for determining the magnitude of the total substitution bias. A conservative estimate of that magnitude is 0.3 percentage point per year.

In addition, the CPI suffers from biases resulting from the treatment of quality changes and the introduction of new goods, both of which are far less amenable to accurate quantification. Most experts agree that by not taking adequate account of improvements in the quality of services like cataract surgery, or the introduction of new goods, like vaccinations for the measles, mumps and rubella or cellular telephones, the CPI overstates increases in the cost of living. The broadly agreed upon evidence suggests that the quality and new goods bias in the CPI is at least 0.3 percentage point per year. We believe that it may be impossible ever to eliminate fully bias from this source in the computation of the CPI.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Randall W. Lutter (CN=Randall W. Lutter/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 3-NOV-1997 16:54:50.00

SUBJECT: suggested research ideas for OECD

TO: Adele C. Morris (CN=Adele C. Morris/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: Joseph E. Aldy (CN=Joseph E. Aldy/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:
==================== ATTACHMENT 1 ====================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D81]MAIL42153660S.316 to ASCII,
The following is a HEX DUMP:

Proposed Outline for OECD Climate Change Research

OECD has not researched the economics of climate change mitigation policies since its 1995 book *Global Warming: Economic Dimensions and Policy Responses*. This book provided useful information but has apparently not been influential along the path to Kyoto because it addressed the merits of climate change policies generally, and only indirectly the set of targets and timetables under consideration. Given the attention focussed on the upcoming Kyoto meetings, another research project, if timely, could be valuable.

I. Taxes vs. Quotas:[1] What are the relative merits of taxes (or permits with price caps) compared to a permit system in which there are no restrictions on permit prices.

II. Targets and Timetables:
How does the timing of emissions reductions affect the overall cost?

A. What are the economic costs of emissions reductions proposed for Kyoto?

B. Efficiency within countries:
Assuming efficient implementation, how do economic costs change with

Faster or slower timetables?

More or less stringent targets?

C. Equity among countries: to what extent do the burdens of meeting an emissions goal of x percent of 1990 levels by the year y differ among OECD member countries?

D. Effectiveness:

How much reduction in warming by 2100 or 2200 do we get with alternative targets and timetables?

How much reduction in warming results from participation of developing countries?

E. International Trade Issues

Competitiveness: How would action by Annex I countries alone affect competitiveness with the rest of the world, measured, e.g., by the current account?

[1] The relative merit of extensively reevaluating taxes (or permits with price caps) as well as alternative emissions targets and timetables could be usefully reassessed after the Kyoto meeting in December. In the event that the meeting in Kyoto produces no clear agreement such a re-evaluation may be worthwhile.

Terms of trade effects: how much will declines in the world price of oil benefit OECD importing countries?

III. Implementation:
How do alternative policy instruments compare in terms of cost and effectiveness?

A. Cost effectiveness of different policy instruments: What is the relative cost-effectiveness of the various policy instruments used to reduce energy use in OECD countries?

--"Technology options": energy efficiency standards, renewable energy programs (e.g "Green Lights"), corporate average fuel efficiency,

--Sector specific measures:

- Transportation: carpooling, public transit, tire labeling, etc.

- Housing: building standards,

--Excise taxes on energy

B. International trading: What key features of a policy to permit international trading of emissions permits are needed for it to be successful?

Administration: Trading in permits would require verification of their validity, monitoring of emissions reductions and enforcement measures to ensure adequate compliance. Would these administrative concerns reduce gains from trade?

Brokering: Efficient international markets may require private brokering of trades through private entities. What limits should be imposed on private brokering?

Participation of countries with no (or different) trading systems:

- Under what circumstances could countries without domestic permit trading programs participate in international trades?

- How could different trading systems be integrated? (E.g., could permits to *emit* be traded with permits to *market* fossil fuel?)

C. Joint implementation: What protocols in international agreements might best facilitate cost-effective implementation of "joint-implementation"?

D. Comprehensiveness: What are the cost-savings from expanding the scope of control policies to address non-carbon greenhouse gases, sequestration efforts, and geo-engineering.

E. "Border taxes": what would be the effects on trade, and on emissions reductions of "border taxes" imposed on the carbon content of goods?

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Steven N. Braun (CN=Steven N. Braun/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 3-NOV-1997 10:11:17.00

SUBJECT: Proposed comments on CPI for EPC mtg.

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.D66]MAIL46887360R.316 to ASCII,
The following is a HEX DUMP:

Steven Braun

Remarks on the CPI for use at the EPC Meeting (11-6-97)

The U.S. Experience

The U.S. has been through a three-year period in which the accuracy of the CPI and its links to the government budget have been under scrutiny. Many more Americans have become aware (if they weren't already) that

1) the CPI is not a true cost-of-living index,

2) that there is a plausible case for some biases, and

3) these biases may have large and significant budget consequences because our tax, government pension, and social security systems are indexed to the CPI. If the CPI were biased upwards by one percent per year, then this bias could cost the Federal budget one trillion dollars (check) over the next ten years.

On the surface, pricing a fixed market basket, is a simple and transparent concept. But one thing that we have learned from the American experience is that the CPI is neither as simple nor as transparent as it appears.

For example, what happens when a surveyor from the statistical agency looks for a designated product on the shelf and finds that it has gone? This is a very common experience that, each year affects almost half of the 70,000 items quoted in our CPI. If a new product is selected, what should the agency do with the difference in price between the new and the old product? It turns out that the possible responses to this problem are largely responsible for the so-called "quality bias" or lack of it. And it is a subject about which much has been written, and to which much research is now being directed.

A second example of the complexity of the CPI is the recent discovery and correction by our statistical agency of a bias in linking the new stores rotating into the sample . The problem was so obscure and esoteric that it was invisible--until it was discovered by a few dedicated civil servants at our statistcal agency.

A third example of complexity is the quality adjustment of medical care. We have had a system that largely measures the price of medical inputs--such as an hour of a physicians' time, an overnight stay in the hospital, and so on... Although it is obvious that a system based on medical outcomes would be more consistent with a cost-of-living index, we have thus far taken only small steps in this direction.

Results of OECD Survey: What have we learned?

Against this background, it was useful for the Secretariat to design, distribute, and summarize a survey of OECD countries--so that we could learn from each other's experiences.

There seems to be general agreement that more use of geometric aggregation would alleviate substitution bias at the lower level. The U.S. will impliment more of this in 1999, and the fact that Canada and Sweden have already done so, will make it easier for us.

Many countries report uncertainties in the measurement of housing costs--especially that of owner-occupied housing. Although the Secretariat's paper stops short of saying this, more use of rental-equivalence formulas would be helpful.

One curious conclusion of the Secretariat is that the statistical agencies of member countries seem to be more comfortable with the current construction of the CPI than the economists who use it. Perhaps this tension is reason enough to pursue the issue further.

On reading the paper prepared for WP1, we were surprised to find that many countries minimized potential problems with substitution bias because their basket was updated frequently-- and dismissed problems with outlet-substitution bias because new stores were included on a regular basis. Although these efforts help, they do not suffice. The only complete fix for substitution bias would use information from the current-year market basket--as in the so-called superlative indexes. Similarly, outlet substitution might still be a problem unless the lower prices at the new outlets at the time they are introduced are directly linked to the old product. In contrast, in the U.S., the entire price differential is assumed to reflect quality of service (which may or may not be true).

Policy Implications

As for policy implications, almost everyone agrees that a CPI bias is of little import for monetary policy--so long as it is both known and stable over time. But the same line of reasoning requires that CPI biases ought to be evaluated--if they have not been already.

As for fiscal policy, a bias in the CPI has large and obvious connections with the budgets of those countries that index their tax, pension, and social security systems. According to the Secretariat's survey, fifteen OECD countries report some indexation. But even in countries where indexation of the tax and benefit system is not automatic--but rather determined by the legislature--I would guess that recent inflation is considered an important factor in the legislative outcome. As a result, the possibility that fiscal effects may result from a biased CPI cannot be dismissed out of hand.

[this paragraph is not important] Because the CPI is used in all of our National Accounts, a CPI bias would work its way into productivity statistics. Thus we should be mindful of the possibility that the post-1973 productivity slowdown could be an artifact of the CPI bias. However, I am not aware of any research which suggests that any biases in the CPI are any worse now than they were before 1973, and the possibility that the productiivity slowdown in a statistical artifact is remote.

Perhaps the most interesting policy question is whether a CPI bias has implications for wage-setting behavior. The recent behavior of prices is certainly an important consideration in any wage negotiation. It is worth some thought whether a biased CPI could be a cause of real wage rigidity--especially as elevated levels of unemployment linger in many OECD countries.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Jeremy B. Rudd (CN=Jeremy B. Rudd/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 3-NOV-1997 12:45:23.00

SUBJECT:

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

TEXT:
Here are the stage management talking points for the CPI bias and income distribution topics. I also left print copies with Alice.

Also, I talked to Martine Durand and John Weeks this morning. Durand sent me a revised stage management, and John sent me talking points for the Secretary-General's working lunch. I gave copies of both items to Alice.

I am still working on the Euro-country questions, and will have them done shortly. I will also send you the income distribution statement after Dr. Blank and Maria have seen it.

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D52]MAIL40078460M.316 to ASCII,
The following is a HEX DUMP:

Policy Implications of CPI Bias

Our next topic this morning concerns biases in the CPI, a subject that was discussed during the most recent WP-1 meeting on the basis of country submissions. As most of you know, this is a topic that has recently been of considerable interest in the United States. Indexation of the tax and transfer system in the United States implies that biases in the CPI can have significant ramifications for the government's budget; similar budget effects exist for other countries as well. Countries with widespread wage indexation in the private sector must also be concerned with the possible presence of bias in their price statistics. Finally, accurate price measurement is a precondition for accurate measurement of other economic statistics, including real output and productivity.

I would like to invite Mr. Murray of Canada to lead off the discussion, and then to open the floor to all delegates for a general discussion of the topic. Some of the issues on which delegates might wish to comment include the following:

- Given that rates of inflation are currently very low in many OECD countries, does this make CPI bias of more concern to policymakers?

- Do policymakers see CPI bias as problematic in terms of the conduct of monetary and fiscal policy? In terms of wage indexation?

- How concerned are policymakers with the possibility that CPI bias spills over into the measurement of other statistics, such as real output?

Income Distribution and Poverty

In this session, we will consider issues related to income distribution and poverty, particularly in the context of policy responses to income inequality. Following the productivity slowdown in the early 1970s, income inequality and poverty began to rise in many OECD countries; this trend has been a major concern of policymakers. More recently, the dictates of fiscal consolidation and general perception that antipoverty and income redistribution programs have had only limited success in attaining their goals in a cost-effective manner have led many countries to rethink how they assist their neediest citizens.

The Secretariat's paper documents trends in inequality and poverty across a number of OECD countries, and discusses a number of issues related to how governments have responded to these trends. I would invite delegates to pay especial attention to the latter topic, with a focus on the lessons they have learned from their own countries' experiences. In particular, delegates might wish to address the following questions:

- How can governments mitigate the economic disincentives associated with tax-transfer programs? Are transfers targetted on the basis of nonincome criteria a reasonable solution? What sorts of problems might nonincome transfers face?

- What is the scope for proactive policies, such as training and education programs, in mitigating income inequality?

- Can wage subsidies improve the position of low-wage workers? Does the type of subsidy--that is, employer-based *versus* employee-based--make a difference?

- What place, if any, does a statutory minimum wage have in an antipoverty program?

I would like to invite Mr. Delbecque of Belgium to open up our discussion concerning income distribution and poverty. Following the introduction, we will have a general discussion of the topic.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Jeremy B. Rudd (CN=Jeremy B. Rudd/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 3-NOV-1997 15:37:54.00

SUBJECT:

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

TEXT:
Statement on income distribution and poverty for EPC meetings (Dr. Blank has seen this and I have incorporated her comments, so this is the final version pending your approval). I left a print copy with Alice.

- Jeremy

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D2]MAIL44119560P.316 to ASCII,
The following is a HEX DUMP:

The Secretariat's paper raises a number of interesting and important questions; but it is, unfortunately, impossible to do full justice to them within the time allotted for a statement. I would therefore like to focus my remarks on several issues that have been foremost in U.S. policymakers' minds during their most recent attempt at welfare reform.

A typical cash assistance program guarantees a given amount of money to those who receive no income, and then phases out this benefit as income--that is, labor income--rises. Such a program discourages work, and these work disincentives have been a major concern--perhaps *the* major concern--of U.S. policymakers. Today, policymakers have concluded that there is really no way to correct these disincentives *so long as we confine ourselves to considering policies that are similar to the cash assistance program just outlined.* We therefore have to broaden the menu of policies that are up for consideration.

One way to avoid the work disincentive effects of the canonical cash assistance program involves closely tying benefits to a work requirement. In particular, one can either mandate a work requirement directly, or else structure programs so as to provide strong incentives for work. For example, a welfare program might directly require a potential recipient to work for a given number of hours per week, or it might make eligibility for certain benefits conditional on employment. Experimental versions of these programs are presently being pursued at the regional level in the United States.

This kind of policy has its own problems, however. In particular, it makes no real allowance for those who *cannot* work. In addition, if it is to be successful such a program requires a large administrative infrastructure in order to provide for extensive employment-support services and supervision of participants. While this raises program costs, it does permit the welfare authority to obtain a better idea as to whether a person cannot find a private-sector job, in which case other provisions can be made (such as public-sector employment or a disability pension).

A second way to mitigate the disincentive effects of a standard cash assistance program involves constructing a program that subsidizes the wages of low-income workers. This type of program has recently been expanded as part of the U.S. government's current welfare reform initiative, and is known as an "earned income tax credit," or EITC. Under the EITC, low-wage workers with children receive a credit against their earned-income tax liability; this credit is rebated in cash if the worker's tax liability is zero.

An EITC-style program is quite different from a typical cash assistance program in that benefits are zero under the EITC for those who do not work and rise as earnings increase (up to some threshold earnings level). The EITC therefore largely eliminates the disincentive effects that face low-wage workers in the standard cash assistance program.

This program represents a wage subsidy that is paid out to employees. In general, such a subsidy is probably superior to one that is paid to *employers* if income assistance is the subsidy's primary goal. First, it is easier to target *family* income with an employee-based subsidy, since an employer-based subsidy is received by *all* low-wage workers, including those (such as secondary earners or teenagers) who might not be members of a needy family. Second, a wage subsidy paid to employers is probably more likely to result in wage reduction, while a subsidy paid to employees is less likely to do so, as it is largely hidden from employers. (Such wage reduction makes an employer-based wage subsidy a less attractive policy from an income assistance standpoint.)

I would note that the minimum wage complements and interacts with an EITC-style program in an important way. Using the minimum wage by itself in order to guarantee a subsistence level of income is problematic in that it requires the minimum wage to be very high, which discourages employment. On the other hand, using the EITC alone in order to guarantee an income floor requires payment of a large subsidy that must then be phased out slowly in order to minimize disincentive effects. This makes the program much more costly. Hence, the minimum wage and the EITC must be employed jointly in designing an optimal assistance package.

The Secretariat's paper discusses a separate class of policies that involves transfers that are targetted according to nonincome criteria. I would conclude by adding to the comments made by the Secretariat's paper with a couple of comments of my own. First, a basic problem with this type of policy is that very few nonincome criteria can be targetted in a nonproblematic manner. Consider, for example, a policy that provides income support to single-parent families with children. In the United States, this sort of program would be (and has been) criticized on the grounds that it can adversely affect family formation by encouraging the creation of single-parent households. It can even be difficult in practice to target criteria that are in principle free of an incentive problem--witness the high rates of disability that are reported in countries with generous disability pensions. That said, the potential does exist in the U.S. for narrow targetting of transfers that could likely have a high impact with only limited cost. For example, targetting children who live in inner-city areas might represent a beneficial and relatively inexpensive antipoverty program. However, these sorts of policies do raise important equity issues; for example, why should a child in an inner city enjoy assistance as opposed to a child in a rural area if both are poor? It is also unclear whether a similar potential exists for narrowly targetted transfers in other OECD countries.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Jeremy B. Rudd (CN=Jeremy B. Rudd/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 3-NOV-1997 18:21:27.00

SUBJECT:

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

TEXT:
Question relating to policy in the prospective EMU countries (German tightening and general structural reform). I put your edits through, and will confer with Ellen Meade as to whether the question is sufficiently diplomatic.

- Jeremy

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D32]MAIL41248660L.316 to ASCII,
The following is a HEX DUMP:

I would like to ask two questions related to policy developments in the prospective Euro area. The first is quite specific, and pertains to the recent increase in the repurchase rate by the Bundesbank. My question is whether this rate increase was seen as warranted by the current German economic situation, that is, whether the increase represents a "preemptive strike" against incipient price acceleration, or, rather, if this step was taken with EMU in mind. And, how will the twin policy considerations of domestic stabilization and EMU convergence be balanced going forward?

My second question is more general, and relates to the pace of structural reform in prospective EMU countries. For the United States, which has a relatively high degree of labor market flexibility, evidence indicates that negative demand shocks do not induce wage adjustments that are large enough to counter adverse employment effects. Since labor market rigidities are arguably more significant in many European countries, one might reasonably expect that the adjustment process to a demand shock would be even more painful. Because EMU will constrain the role that monetary and/or fiscal policy will be able to play in cushioning shocks, this would seem to suggest that the pursuit of policies that promote labor market flexibility is essential for prospective EMU countries.

I would therefore like to ask whether the pace of structural reform in EMU countries is proceeding at a sufficiently rapid pace, and in a sufficiently balanced manner. I would also like to enquire as to whether workweek-reduction policies such as those that have been advanced in two prospective EMU countries can reasonably be seen as contributing to labor market flexibility, or if the motivation behind these policies is unrelated to the goal of long-run structural reform.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: John W. Ahlen (CN=John W. Ahlen/OU=OSTP/O=EOP [OSTP])

CREATION DATE/TIME: 5-NOV-1997 14:11:03.00

SUBJECT: EOP Clearance of Proposed President's Memorandum regarding the United States Innovation Partnership to the Heads of Federal Departments and Agencies

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

CC: Angela Phillips Diaz (CN=Angela Phillips Diaz/OU=OSTP/O=EOP @ EOP [OSTP])
READ:UNKNOWN

TEXT:
I haven't received any comment from you regarding the Subject memo. I plan to finalize the draft later this week and just wanted to give you another chance to make any comments you may have.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Beverly K. Hartline (CN=Beverly K. Hartline/OU=OSTP/O=EOP [OSTP])

CREATION DATE/TIME: 6-NOV-1997 07:58:34.00

SUBJECT: PCAST Energy R&D Report

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

TEXT:
Janet,
Have you received a copy of the full report? It was released
(prepublication version) yesterday afternoon, and I will bring you down
one (or more) copies, if you lack them.
Bev Hartline

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME: 7-NOV-1997 16:57:22.00

SUBJECT: Naming company names in ERP

TO: Charles F. Stone (CN=Charles F. Stone/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: Aaron S. Edlin (CN=Aaron S. Edlin/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:
Below is the e-mail I got from Michael Treadway, the CEA's ERP editor.
Aaron, do you agree? If yes, then I say that we go with this as the
rule. Does anyone else think otherwise?
Thanks.
Michele

---------------------- Forwarded by Michele Jolin/CEA/EOP on 11/07/97
04:53 PM ---------------------------

MTreadway @ aol.com
11/07/97 01:02:00 PM
Record Type: Record

To: Michele Jolin
cc:
Subject: Naming company names in ERP

Hi Michele--

I looked over the antitrust chapter pages you faxed. I think that by using various editorial tricks and circumlocutions, the naming of companies in these passages can be avoided. The resulting language would be a bit cumbersome, but not unduly so. To do otherwise--i.e., to name names-- would require the explicit and considered OK of the Chair, because it would be a clear departure from past CEA policy (which may for all I know also be general EOP policy).

The main reason for the ERP's traditional avoidance of naming company names is to avoid any suggestion that we are endorsing private companies. Another valid reason is, in a sense, the opposite: to avoid charges of libel. Of course, not naming the person or company you are smearing is not a defense against libel (e.g., to say "the CEO of the nation's largest brewer pees in the bottles at random" is libelous--anyone can figure out who you're talking about); I guess one could make a parallel rebuttal against the avoiding-endorsement argument. In any case we should be sternly vigilant against all libel, named or unnamed; since no one is likely to sue us over a perceived endorsement, we could in principle be a little more lax.

I doubt that any ERP author has ever intended to endorse or libel any company. Both dangers are more hypothetical than real. The real reason for the blanket avoidance of company names is, to borrow from John Hicks, to provide ERP writers and editors a quiet life. Of course, life during ERP season is anything but quiet, but by simply proscribing the naming of names we avoid spending having to decide each case on its merits, and so buy ourselves a little precious time. We stay well clear of any worry about puffery or slander and can devote our attention to more important matters, such as dangling participles. (I am, by the way, paraphrasing Alicia Munnell's position here.)

Exceptions are sometimes made nonetheless. The principal one enters the picture when it becomes too cumbersome to say "the Nation's leading sport utility vehicle automatic sunroof manufacturer" over and over. Since the first law of editing is "Do not distract the reader," this is a real concern.
However, this derogation has rarely been invoked: to my knowledge the only two companies named in the ERP during the 1990s have been AT&T and Blue Chip Economic Indicators. (I regret having allowed the latter--I didn't know at the time it was a private firm. But neither, apparently, did my predecessor: the name also appears in the '93 ERP.)

Getting down to cases: the list of company names in the first paragraph of the antitrust chapter (Microsoft etc.) can easily be avoided by something like "leading companies in the software, semiconductor, [etc.] industries." Likewise the mentions of telephone companies on the fourth page and the other passing mentions on the next few pages. I obviously can't say whether names can be avoided in the "interesting historical examples" yet to be written (p 6). I can also see ways to get through the office superstores case and the aerospace case. The discussion of the RBOCs would be the hardest; an exception might be appropriate here, since we have already named AT&T in the past. The Time Warner-Turner case can be circumlocuted if we can come up with a generic name for the industry: "entertainment conglomerates"?

I hope this settles the question once and for all, or at least until next year. Please call or e-mail with any questions or rebuttals. This looks like an interesting chapter, by the way. I look forward to working on them all.

Also by the way, you and I should discuss with Cathy Fibich the issue of
whether we should continue to code the chapter files that we send to GPO.
It's an extra step that involves considerable time and labor (not mine,
fortunately). There must be an easier way. Maybe we can talk about it on
the
14th--is the meeting on for that day?

Regards

Mike

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

TEXT:
RFC-822-headers:
Received: from conversion.pmdf.eop.gov by PMDF.EOP.GOV (PMDF V5.0-4 #6879)
id <01IPQ9HB5T3400UY1Y@PMDF.EOP.GOV> for jolin_m@a1.eop.gov; Fri,
07 Nov 1997 13:03:28 -0500 (EST)
Received: from storm.eop.gov (storm.eop.gov)
by PMDF.EOP.GOV (PMDF V5.0-4 #6879) id <01IPQ9H6Y5ZK00VLH3@PMDF.EOP.GOV> for
jolin_m@a1.eop.gov; Fri, 07 Nov 1997 13:03:25 -0500 (EST)
Received: from mrin58.mail.aol.com ([198.81.19.168])
by STORM.EOP.GOV (PMDF V5.1-7 #6879)
with ESMTP id <01IPQ9GQXJ02000FKN@STORM.EOP.GOV> for jolin_m@a1.eop.gov; Fri,

07 Nov 1997 13:03:01 -0500 (EST)
Received: (from root@localhost) by mrin58.mail.aol.com (8.8.5/8.7.3/AOL-2.0.0)

id NAA11510; Fri, 07 Nov 1997 13:02:54 -0500 (EST)
================== END ATTACHMENT 1 ==================

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Steven N. Braun (CN=Steven N. Braun/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:11-NOV-1997 12:12:30.00

SUBJECT: I forwarded a copy of the OECD's CPI paper ...

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

TEXT:
...to the BLS with the attached note:

Enclosed is a copy of the OECD Secretariat,s review of the CPI in member countries. This paper was one of three topics for discussion at a WP-1 meeting last October 9-10. (We received the paper about 10-days earlier.) It was an oversight not to have forwarded a copy to you earlier; please accept my sincere apology.

Although the paper has many redeeming characteristics, I am unhappy with it in its present form--as it seems to be an attempt to dismiss the CPI controversy as an American problem. See the enclosed note that I wrote to the Secretariat and handed to the American delegation.

Most of the delegates at the WP-1 meeting proposed that this paper be put in the public domain--to which the U.S. delegation, Christopher Carrol (CEA) and Dick Freeman (FRB), objected. At last week,s EPC meeting (where attendees are of Cabinet or sub-Cabinet rank) , the Swedish delegate, objected to the U.S. objection--and so the issue remains in play. I will keep you posted.

Sincerely,

Steven Braun
Director of Macroeconomic Forecasting
phone: 395-4666
E-mail: Steven_N._Braun@oa.eop.gov

cc: Katherine Abraham

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Randall W. Lutter (CN=Randall W. Lutter/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:12-NOV-1997 16:55:26.00

SUBJECT: Trading of NOx emissions credits under existing legal authority

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

TEXT:
To: Janet Yellen
From: R. Lutter
Re: NOx Trading
Date: November 12, 1997

In a public meeting last week, EPA presented its plans for a &model trading rule8 to authorize trading of NOx emissions credits in selected Eastern States under existing statutory authority. EPA believes the model trading rule, which it intends to propose early next year, will yield cost savings of as much as $500 million annually relative to EPA,s recent proposal calling for States in the Ozone Transport Assessment Group (OTAG) area to submit State Implementation Plans (SIPs) to limit NOx emissions. Apart from the potential savings of $500 million annually, trading of NOx emissions would provide a second example, after SO2 trading, of the superiority of market-based approaches to air pollution over command and control alternatives. Based on my review of the plans EPA presented in its meeting, however, I believe that the likely cost-savings will be much smaller than the potential savings. Below I summarize key concerns with EPA,s announced plans and conclude with recommendations.

Overall neglect of cost-effectiveness: EPA,s &goals8 and &keys to success8 neglected both cost and improvements in air quality.

Although the President,s July Implementation memo to Administrator Browner stressed cost-effectiveness in implementing the new health-based air quality standards, EPA,s presentation did not mention cost-effectiveness or air quality. Instead, EPA,s emphasis on particular sources (large, stationary, utility boilers) as a way of assuring validity, consistency and accountability of the emission trading program in lieu of cost-effectiveness is likely to raise the costs of the program without accompanying air quality benefits.

No reference to "discounting" by distance: EPA neglected to acknowledge in its presentation that emissions from different locations have different impacts on air quality in nonattainment areas.

Independent research suggests that the effect of emissions on downwind ozone concentrations in a specific location may vary by a factor of 10 over relevant distances. Structuring the trading rule to reflect the effects of distance (e.g., identifying sub-regions and providing for discounts on trades between sub-regions) may yield greater improvements in air quality for given costs. This important topic is more integral to this trading rule than to EPA,s recent OTAG SIP call, and deserves public discussion in these early meetings.

Emphasis on selected emissions sources: Although the SIP call was silent on how States should achieve emission reductions, EPA,s plans for trading focussed on emissions reductions from utilities with little evidence that this is cost-effective.

--EPA,s first goal is to "Meet the budget by achieving emissions reductions from large combustion sources." Since power plants contribute a relatively small share of NOx emissions, (33 percent; utilities contribute about 70 percent of total SO2 emissions), more cost-effective control opportunities may well exist in the other sectors. The identification of these opportunities should be left to the market.

--Eligibility criteria would restrict participation to large electric utility power plants covered by the acid rain program and other boilers and turbines of capacity greater than 250 mm Btu/hour.

--EPA,s emphasis on accurate and consistent monitoring, in the form of continuous emissions monitoring, will impose large direct costs relative to reasonable alternatives sufficiently accurate to preserve the integrity of the program, thereby excluding from the cap and trade program many small or mobile emissions sources.

--Discouraging of opt-in: So as to avoid shifting of emissions to sources that are not subject to the cap, EPA would require all sources in a source category to be capped in order for any source to participate in the trading program. In fact such shifting may in many instances be negligible. This categorical prohibition against including some sources should be dropped and replaced by a case-by-case evaluation based on cost-effectiveness.

Recommendations: Although we will have an opportunity to share our views with EPA during interagency review of its draft proposed rule early next year, I suggest we now contact senior EPA officials to ask that EPA announce in its next public meeting that it will emphasize cost effectiveness. Apart from being more consistent with the President,s Implementation memo, such an alternative approach is feasible, consistent with legal mandates, and would not necessarily involve any deterioration in air quality.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Stacie Spector (CN=Stacie Spector/OU=WHO/O=EOP [WHO])

CREATION DATE/TIME:12-NOV-1997 18:25:18.00

SUBJECT: wrap up amplif. plans

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

TEXT:
FYI - this is from a discussion today and Ann L. thought you would be a good person to possibly brief with Gene/Erskine/Bruce, just a brainstorm, we will know more tomorrow. Call me if you have questions. 62683.
Stacie (Comm. dep. dir. - I don't think we have met)
---------------------- Forwarded by Stacie Spector/WHO/EOP on 11/12/97 06:21 PM ---------------------------

Stacie Spector
11/12/97 06:13:56 PM
Record Type: Record

To: See the distribution list at the bottom of this message
cc: See the distribution list at the bottom of this message
Subject: wrap up amplif. plans

here is an updated version of the memo I did earlier outlining the different plans for moving our end of the legislative year message. If there is a mistake or assignment error please let me know. Again the timeline for completed documents is the basic accomplishments with SOTU context COB (NEC time) tomorrow, state by states general tomorrow, more partisan accomplishments late tomorrow (for political), early next week accomp by constituency. Thanks for everybody's help on this. I guess sending the document might help(sorry!)

Message Sent
To:
Craig T. Smith/WHO/EOP
Thomas D. Janenda/WHO/EOP
Stacie Spector/WHO/EOP
Amy W. Tobe/WHO/EOP
Elisa Millsap/WHO/EOP
Stephen B. Silverman/WHO/EOP
Christa Robinson/OPD/EOP
Jake Siewert/OPD/EOP
Jonathan A. Kaplan/OPD/EOP
Michael Waldman/WHO/EOP

Fred DuVal/WHO/EOP
Lynn G. Cutler/WHO/EOP
Emily Bromberg/WHO/EOP
Lorraine A. Voles/OVP @ OVP
Christopher J. Lavery/WHO/EOP
Darby E. Stott/WHO/EOP
Suzanne Dale/WHO/EOP
Lori L. Anderson/WHO/EOP
Marjorie Tarmey/WHO/EOP
Katherine Hubbard/WHO/EOP
Laura K. Capps/WHO/EOP
Lisa J. Levin/WHO/EOP
Mona G. Mohib/WHO/EOP
Sky Gallegos/WHO/EOP

Message Copied
To:____

Jonathan Orszag/OPD/EOP
Robin J. Bachman/WHO/EOP
Ann F. Lewis/WHO/EOP
Ruby Shamir/WHO/EOP
Barry J. Toiv/WHO/EOP
Michelle Crisci/WHO/EOP
Katherine Hubbard/WHO/EOP
Janet Murguia/WHO/EOP
Eli G. Attie/OVP @ OVP
=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D29]MAIL44697751V.316 to ASCII,
The following is a HEX DUMP:

GOOD NEWS FOR WORKING FAMILIES

Legislative wrap up plans for '97: Roll out will begin this Friday and activities will last through early next wk.

Needs: Talking points for overall message (comm w/ research), document of accomplishments and SOTU promises (research w/ NEC), specific issue/constituency accomplishments (Robin), updated state by state accomplishments (Robin), Accomplishments with partisan edge (Robin).

Staff Press Briefing: Erskine/Bruce/Gene/Janet M. policy brief /overview of accomplishments.

Cabinet: Do press on their issue areas touting the Pres's successes, push while traveling in each individual location. One on one press calls and conference calls to all major regional papers.

DNC: State chairs all do press conferences possibly with members. They initiate and run a talk radio, letters to the Editor (with real people who benefit from the accomp's), and Op-Ed's in local and statewide papers. Radio talk shows wherever possible.

D Members: each do press conferences when they get home. We could send them any public documents or packets for the DCCC or the House Dem Caucus to distribute.

Specialty press: pitch stories based on legislation that affects specific constituencies. And, give paper on accomp's for each particular constituency.

Web: The map on the web will have updated accomp. sheets to click on, and then beginning of the week we will add creative game or activity to highlight accomp's.

OPL: Have their constituencies groups do amplification press conferences independent of our efforts touting the Pres' s work. Thank you letters to heads of org's from POTUS?

Intergov.: Gov's: Press conferences/conference calls on how the President's accomp's on federal legislation will affect their state with State by state numbers. Have them send out packets to their municipal electeds (including Mayors) about how the federal efforts will benefit real people in their area. They can participate in the L to E and Op-Ed and radio campaign as well.

Other Principals: Provide them packets to tout accomplishments in conjunction with their travel. They can mention this at stops and press can get release with and talk points with state numbers at all stops.

Senior Staff: Have Ann, Mike, Rahm, Doug, John P., Ginny, Susan L., Marsha and whoever else pitch interesting angles to the news mag's to run a wrap up with a hook, other than our own good news. We could also use this as a hook with the Women's mag's to have them come in and hear our good news for children and families as we close the year out.

Radio actualities: Press folks working on picking up a piece of the Labor HHS bill signing tomorrow. Then on Friday have the VP record an overview of accomp. to put up, and then on Saturday the VP would possibly do immigration.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Adele C. Morris (CN=Adele C. Morris/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:13-NOV-1997 15:54:46.00

SUBJECT: GCC documents on which comments are due

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

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

CC: Joseph E. Aldy (CN=Joseph E. Aldy/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

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

TEXT:
I just left with Alice a copy of the documents of which we speak.

TJ and DOE are organizing a process to convert elements the President's speech on climate change into action items -- tax cuts or spending programs. Due Friday are comments on the organizational structure of the discussion, about which we probably don't care that much. I'd like to add to the process more emphasis on evaluating program accomplishments with respect to a sensible baseline, choosing projects efficiently, and preventing the projects from turning into pork as soon as Congress gets ahold of them. Please let me know if you have any further thoughts on this.

I asked Peter to encourage DOE or others to better describe the potential list of projects, and I expect some of that information will come in this week. There is a big time crunch to get some of this into the 1999 budget, currently under construction.

I gather that there is a parallel but higher-level process that is determining which items will appear as tax cuts and which as direct expenditure. Are we involved in that at all?

Adele

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:13-NOV-1997 09:43:18.00

SUBJECT: POTUS on Trade, Globalization and Pensions

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 11/13/97
09:43 AM ---------------------------

Peter R. Orszag
11/13/97 09:31:53 AM
Record Type: Record

To: Michele Jolin/CEA/EOP, Janet L. Yellen/CEA/EOP
cc:
Subject: POTUS on Trade, Globalization and Pensions

POTUS is citing CEA again on sources of job loss...
---------------------- Forwarded by Peter R. Orszag/OPD/EOP on 11/13/97
09:43 AM ---------------------------

Jake Siewert
11/13/97 09:29:58 AM
Record Type: Record

To: See the distribution list at the bottom of this message
cc:
Subject: POTUS on Trade, Globalization and Pensions

Remarks from DNC Dinner

But if you think about what I've been doing, a lot of what I've been trying to do is to prepare a way for us to get into the future so that that young man and people in his generation can feel a sense of social security in a time dominated by global economics, global technology, rapid changes and, oftentimes, big changes in the workplace.

One of the reasons we had as much trouble with the fast track as we did -- and I still believe we'll succeed in getting some fast track authority in this Congress -- but one of the reasons we had the trouble we did is that people feel, even though it might have nothing to do with trade, they pick up the paper three days before the vote and see that Levi Strauss is laying 10,000 people off. And then today they see Eastman Kodak is laying 10,000 people off. And one man in Louisiana who said, I'm an ardent free trader, had to deal with the fact that one company laid 2,400 people off in his congressional district right before he got ready to vote on this.

Now, how do we create an atmosphere of security there? Everybody knows that the economy is in good shape today, but they're still looking at tomorrow. The one thing we cannot do is to say we're not going to trade with the world, we're going to run away, we're going to freeze everything in place, because we can't freeze everything in place. We can't.

We did a study, the Council of Economic Advisors did, which said that 80 percent of our job loss was due to technological change; 20 percent due to trade and business failures, where people just stop buying your product or service. So a lot of this is just intrinsic to the changing economy, which means we have to have a new definition of security in a more dynamic world. What would that be? First of all, everybody's got to have access to a good education, and people have to have access to education for a lifetime. If people my age lose their jobs, they have to be able to get a good education to go back to work. You have to set up a system of lifetime learning that operates at higher levels of excellence at critical points than sometimes it does today.

Secondly, people have to have portability of health insurance and portability of retirement. It's not enough to secure Social Security because most people can't live on just Social Security; at least they can't maintain their lifestyle on Social Security.

Now, we have actually done quite -- I've been trying, under Democratic and Republican Congresses now, for five years to pass what I called my G.I. Bill of Rights which would set up -- go a long way toward setting up a system of lifetime learning, because if you're eligible for public aid and you lose your job, what I think we ought to do, since nearly everybody in America lives within driving distance of a community college, is just give people a certificate and let them take it wherever they want and get whatever training they want. And take a lot of the government programs out of it and let the educators and the marketplace decide. That's what -- I'm trying to do that.

The tax credits that we gave to college students, though, or to their parents to pay the cost of college also go to adults who have to go back to school. We have made health insurance somewhat more portable with the Kennedy-Kassebaum bill, although there is increasing evidence that there are people, lots of people, working in America where their employers are offering health insurance, but they still don't feel they can afford to buy it. And there are a lot of younger people now who are worried sick that they work in places where they can't buy health insurance, and they don't need it most of the time, but if they have a car wreck or develop a serious illness, they'll really be in trouble if they don't have health care. So I intend to keep doing more on that. We're going to add five million kids to the rolls in this budget. We're going to do more.

Perhaps in an area kind of unheralded where we've done the most good in the last five years is in protecting and making more portable pension plans. In December of '94, I signed the legislation which stabilized 40 million people's pensions and outright saved 8.5 million people's pensions that were under water. Since then, we have slowly but surely added provisions that make it easier for people to get pensions, private pensions, 401K plans and take it around if they move from place to place.

Message Sent
To:____

Jonathan A. Kaplan/OPD/EOP
Emil E. Parker/OPD/EOP
Peter R. Orszag/OPD/EOP
Russell W. Horwitz/OPD/EOP
Anne H. Lewis/OPD/EOP

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:13-NOV-1997 09:42:12.00

SUBJECT: 7:45am WH Staff Meetings, 11/5-7

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 11/13/97
09:41 AM ---------------------------

Jeffrey A. Frankel
10/31/97 09:35:28 AM
Record Type: Record

To: Janet L. Yellen/CEA/EOP, Michele Jolin/CEA/EOP
cc:
Subject: 7:45am WH Staff Meetings, 11/5-7

Janet and Michele,
See question below. I am happy either way.
BY THE WAY; I HAVE TO BE IN CHICAGO NEXT FRIDAY 11/7, WHEN THE EMPLOYMENT REPORT IS RELEASED. MICHELE AND BECKY CAN HANDLE THE ANNOUNCEMENT (including the 7:45 mtg. that day) CAN'T YOU/THEY?
I'm sorry I forgot to make the connection when Janet brought it up yesterday.
JF
---------------------- Forwarded by Jeffrey A. Frankel/CEA/EOP on 10/31/97
09:28 AM ---------------------------

LISA D.
BRANCH
10/31/97 09:27:30 AM

Record Type: Record

To: Jeffrey A. Frankel/CEA/EOP
cc:
Subject: 7:45am WH Staff Meetings, 11/5-7

While Janet is in Paris, will you attend all the meetings or will you and Becky alternate?

---------------------- Forwarded by Janet L. Yellen/CEA/EOP on 11/13/97 09:41 AM ---------------------------

From: Jeremy B. Rudd on 11/02/97 05:52:32 PM
Record Type: Record

To: Janet L. Yellen/CEA/EOP
cc:
Subject:

Draft statement on U.S. fiscal/structural policy, for OECD EPC meetings.

---------------------- Forwarded by Janet L. Yellen/CEA/EOP on 11/13/97 09:41 AM ---------------------------

Steven N. Braun 11/03/97 10:11:21 AM

Record Type: Record

To: Janet L. Yellen/CEA/EOP
cc:
Subject: Proposed comments on CPI for EPC mtg.

---------------------- Forwarded by Janet L. Yellen/CEA/EOP on 11/13/97 09:41 AM ---------------------------

From: Jeremy B. Rudd on 11/03/97 12:45:27 PM
Record Type: Record

To: Janet L. Yellen/CEA/EOP
cc:
Subject:

Here are the stage management talking points for the CPI bias and income distribution topics. I also left print copies with Alice.

Also, I talked to Martine Durand and John Weeks this morning. Durand sent me a revised stage management, and John sent me talking points for the Secretary-General's working lunch. I gave copies of both items to Alice.

I am still working on the Euro-country questions, and will have them done shortly. I will also send you the income distribution statement after Dr. Blank and Maria have seen it.

- Jeremy

---------------------- Forwarded by Janet L. Yellen/CEA/EOP on 11/13/97 09:41 AM ---------------------------

Stephanie S. Streett
11/03/97 02:53:54 PM
Record Type: Record

To: Karin Kullman/WHO/EOP
cc: See the distribution list at the bottom of this message
Subject: Re: February 5, 1997

I would like to emphasize what Karen said about timely responses to the sched. office with accurate information regarding dates the White House proposes for events and meetings. THis is especially important when dealing with the Congress and Foreign Governments. Mistakes like this not only reflect poorly on White House staff but more importantly on the President and First Lady.
Message Copied
To:

Mickey Ibarra/WHO/EOP
Gene B. Sperling/OPD/EOP
Bruce N. Reed/OPD/EOP
John Podesta/WHO/EOP
Erskine B. Bowles/WHO/EOP
Thurgood Marshall Jr/WHO/EOP
Virginia Apuzzo/WHO/EOP
John L. Hilley/WHO/EOP
Michael D. McCurry/WHO/EOP
Rahm I. Emanuel/WHO/EOP
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Kathleen A. McGinty/CEQ/EOP
John H. Gibbons/OSTP/EOP
Kevin S. Moran/WHO/EOP
Douglas B. Sosnik/WHO/EOP
Terri J. Tingen/WHO/EOP
Rebecca A. Cameron/WHO/EOP
Nancy V. Hernreich/WHO/EOP
Phillip Caplan/WHO/EOP
Cecily C. Williams/WHO/EOP
Russell W. Horwitz/OPD/EOP
Christa Robinson/OPD/EOP
Cathy R. Mays/OPD/EOP

Sara M. Latham/WHO/EOP
Jason S. Goldberg/WHO/EOP
Ronda H. Jackson/WHO/EOP
David S. Beaubaire/WHO/EOP
Marjorie Tarmey/WHO/EOP
Maria Echaveste/WHO/EOP
Craig T. Smith/WHO/EOP
Christopher J. Lavery/WHO/EOP
Patricia Solis-Doyle/WHO/EOP
Tracy B. LaBrecque/WHO/EOP
kimberly h tilley/ovp @ ovp
Sylvia M. Mathews/WHO/EOP
June G. Turner/WHO/EOP
Capricia P. Marshall/WHO/EOP
Eric P. Hothem/WHO/EOP
Michael D. Malone/WHO/EOP
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Jeffrey A. Forbes/WHO/EOP
Darby E. Stott/WHO/EOP
ansley jones/ovp @ ovp
Elisa Millsap/WHO/EOP
Todd Stern/WHO/EOP
Jennifer M. Palmieri/WHO/EOP
Lori L. Anderson/WHO/EOP
Michelle Crisci/WHO/EOP
Andrew Friendly/WHO/EOP
Shelley N. Fidler/CEQ/EOP
Beth A. Viola/CEQ/EOP
Michele Jolin/CEA/EOP
Melinda N. Bates/WHO/EOP
Ruby Shamir/WHO/EOP
Jonathan A. Kaplan/OPD/EOP
Jonathan Foster/OSTP/EOP
Paul E. Begala/WHO/EOP
Eleanor S. Parker/WHO/EOP
Victoria Radd/WHO/EOP
Michael Waldman/WHO/EOP
Charles F. Ruff/WHO/EOP
Edward F. Hughes/WHO/EOP
Roberta W. Greene/WHO/EOP
Susan A. Brophy/WHO/EOP
Alan P. Sullivan/WHO/EOP
davies_g @ a1 @ cd @ lngtwy
kerrick_d @ a1 @ cd @ lngtwy
Bob J. Nash/WHO/EOP
Amy W. Tobe/WHO/EOP
Dan K. Rosenthal/WHO/EOP
ron klain/ovp @ ovp
donald h. gips/ovp @ ovp
susan m. liss/ovp @ ovp
Janet L. Yellen/CEA/EOP
Franklin D. Raines/OMB/EOP
Lawrence J. Haas/OMB/EOP---------------------- Forwarded by Janet L. Yellen/CEA/EOP on 11/13/97 09:41 AM ---------------------------

From: Jeremy B. Rudd on 11/03/97 06:21:08 PM
Record Type: Record

To: Janet L. Yellen/CEA/EOP
cc:
Subject:

Question relating to policy in the prospective EMU countries (German tightening and general structural reform). I put your edits through, and will confer with Ellen Meade as to whether the question is sufficiently diplomatic.

- Jeremy

---------------------- Forwarded by Janet L. Yellen/CEA/EOP on 11/13/97 09:41 AM ---------------------------

Alice H. Williams
11/10/97 09:13:52 AM
Record Type: Record

To: All CEA Users
cc:
Subject: CEA Staff meeting

Staff meeting will begin at 9:30 a.m.

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D72]MAIL41076361K.316 to ASCII,
The following is a HEX DUMP:

The U.S. economy's current expansion has entered its 80th month, making it the second-longest peacetime expansion in history. Growth has been led by private--not public--demand, especially by increases in business investment and exports. In the best way possible, the U.S. economy is currently a "high-pressure" economy, in which the twin goals of stabilization policy--high growth and low unemployment combined with low and stable inflation--have been attained.

It is difficult to oversell the economic and social significance of a sustained return to full employment. A tight labor market encourages participation by those who would otherwise be forced to sit on the sidelines, and makes it easier to absorb less-productive workers--such as those who are less-skilled, or younger workers--into the workforce. This gives labor-market entrants much-needed job training, including the skills required in order to hold down a job successfully in the future. It seems plausible that short-term economic conditions can affect long-term structural unemployment, and although the idea that the natural rate of unemployment can increase as the result of a recession is typically invoked to explain labor-market conditions in European countries, the same phenomenon might well exist in the United States, albeit perhaps in a less widespread and more hidden form. Running a high-pressure economy, therefore, may be one of the best ways to ensure that we do not consign a large fraction of our citizens to long-term joblessness and economic marginalization. A tight labor market can also improve workers' well-being by encouraging upward mobility, that is, by giving workers the ability to "trade up" their job by moving to a different job for which they are better suited.

In all fairness, much of the economy's recent performance reflects factors that are largely beyond policymakers' control. For example, inflation has been moderate in part because import price inflation has been low. And structural changes in the labor market appear to have lowered the rate of unemployment that is consistent with stable inflation. That said, I do believe that fiscal policy played an integral part in creating the present favorable macroeconomic situation. In particular, fiscal consolidation has freed up room in the economy for rapid growth in capital investment, which has in turn helped to dampen inflation by expanding capacity.

Given the current state of the U.S. economy, the question arises as to what role government policy should play in the future. Policymakers in the United States have largely eschewed fiscal policy for purposes of cyclical stabilization, except inasmuch as certain components of fiscal policy act as "automatic stabilizers" in a downturn. But there is still an important part to be played by fiscal policy--as well as by other government policies--in setting a foundation for sustained long-run growth. I would like to spend the remainder of my allotted time in order to enlarge upon this point.

The most important thing government policy can do in order to enhance the economy's growth prospects is to encourage investment. In the long run, private investment is fostered by fiscal consolidation; in the short-run, of course, rapid fiscal consolidation can adversely affect investment by depressing economic activity. (In the U.S., we were fortunate in that the economy's cyclical position was such that when we began reducing the budget deficit, the short-run effects were not severe. However, this will not be the case for every country at every time.) It is also extremely important to ensure that fiscal consolidation does not encourage private investment at the expense of public investment; that is, policymakers must take care that deficit reduction does not cut into government's own investment, particularly in human capital. For that reason, our recently concluded budget agreement contains expanded spending and tax initiatives for education and training (many of which are extended to *workers* in recognition of the fact that learning and training must be lifelong activities in a contemporary industrial economy).

An important priority for future budget policy will be to ensure that fiscal consolidation proceeds as planned over the next five years, while also ensuring that future budgets address public policy goals such as income support and expanded government investment in human and physical capital. Soon, however, we will also have to consider the long-run issue of entitlement reform, namely reform to our old-age pension and government-run medical insurance systems. These problems are far from insurmountable, and we are currently making important progress toward identifying our options. But the time is coming when we will have to make choices as well.

In addition to fiscal consolidation, the U.S. government has continued to pursue two additional initiatives aimed at placing future economic growth on a firmer footing. The first has been in the area of regulatory reform, which has most recently involved the areas of telecommunications, electricity, and financial markets (mainly banking). Regulation is one of the most intrusive forms of government activity, and the current administration has attempted to ensure that the necessary regulatory duties of government are pursued in a manner that has the smallest adverse effect on economic efficiency. In practice, this involves: first, constructing regulatory initiatives that complement--rather than oppose--the market; second, recognizing the effects of government regulation on economic incentives; and third, making the regulatory process responsive to innovation, which is imperative in industries where technological change is rapid.

In addition to opening domestic markets through regulatory reform, the present administration has also acted to open up markets abroad through the aggressive pursuit of freer international trade. Free trade encourages economic efficiency (thus raising the *level* of output) and may even encourage innovation (thus affecting economic *growth*). At present, a major Administration initiative in the area of free trade involves the renewal of its "fast track" authority for negotiating trade agreements; this will be used both to expand existing trade agreements as well as to negotiate new agreements in such areas as government procurement and information technology.

Steven Braun

Remarks on the CPI for use at the EPC Meeting (11-6-97)

The U.S. Experience

The U.S. has been through a three-year period in which the accuracy of the CPI and its links to the government budget have been under scrutiny. Many more Americans have become aware (if they weren't already) that

1) the CPI is not a true cost-of-living index,

2) that there is a plausible case for some biases, and

3) these biases may have large and significant budget consequences because our tax, government pension, and social security systems are indexed to the CPI. If the CPI were biased upwards by one percent per year, then this bias could cost the Federal budget one trillion dollars (check) over the next ten years.

On the surface, pricing a fixed market basket, is a simple and transparent concept. But one thing that we have learned from the American experience is that the CPI is neither as simple nor as transparent as it appears.

For example, what happens when a surveyor from the statistical agency looks for a designated product on the shelf and finds that it has gone? This is a very common experience that, each year affects almost half of the 70,000 items quoted in our CPI. If a new product is selected, what should the agency do with the difference in price between the new and the old product? It turns out that the possible responses to this problem are largely responsible for the so-called "quality bias" or lack of it. And it is a subject about which much has been written, and to which much research is now being directed.

A second example of the complexity of the CPI is the recent discovery and correction by our statistical agency of a bias in linking the new stores rotating into the sample . The problem was so obscure and esoteric that it was invisible--until it was discovered by a few dedicated civil servants at our statistcal agency.

A third example of complexity is the quality adjustment of medical care. We have had a system that largely measures the price of medical inputs--such as an hour of a physicians' time, an overnight stay in the hospital, and so on... Although it is obvious that a system based on medical outcomes would be more consistent with a cost-of-living index, we have thus far taken only small steps in this direction.

Results of OECD Survey: What have we learned?

Against this background, it was useful for the Secretariat to design, distribute, and summarize a survey of OECD countries--so that we could learn from each other's experiences.

There seems to be general agreement that more use of geometric aggregation would alleviate substitution bias at the lower level. The U.S. will impliment more of this in 1999, and the fact that Canada and Sweden have already done so, will make it easier for us.

Many countries report uncertainties in the measurement of housing costs--especially that of owner-occupied housing. Although the Secretariat's paper stops short of saying this, more use of rental-equivalence formulas would be helpful.

One curious conclusion of the Secretariat is that the statistical agencies of member countries seem to be more comfortable with the current construction of the CPI than the economists who use it. Perhaps this tension is reason enough to pursue the issue further.

On reading the paper prepared for WP1, we were surprised to find that many countries minimized potential problems with substitution bias because their basket was updated frequently-- and dismissed problems with outlet-substitution bias because new stores were included on a regular basis. Although these efforts help, they do not suffice. The only complete fix for substitution bias would use information from the current-year market basket--as in the so-called superlative indexes. Similarly, outlet substitution might still be a problem unless the lower prices at the new outlets at the time they are introduced are directly linked to the old product. In contrast, in the U.S., the entire price differential is assumed to reflect quality of service (which may or may not be true).

Policy Implications

As for policy implications, almost everyone agrees that a CPI bias is of little import for monetary policy--so long as it is both known and stable over time. But the same line of reasoning requires that CPI biases ought to be evaluated--if they have not been already.

As for fiscal policy, a bias in the CPI has large and obvious connections with the budgets of those countries that index their tax, pension, and social security systems. According to the Secretariat's survey, fifteen OECD countries report some indexation. But even in countries where indexation of the tax and benefit system is not automatic--but rather determined by the legislature--I would guess that recent inflation is considered an important factor in the legislative outcome. As a result, the possibility that fiscal effects may result from a biased CPI cannot be dismissed out of hand.

[this paragraph is not important] Because the CPI is used in all of our National Accounts, a CPI bias would work its way into productivity statistics. Thus we should be mindful of the possibility that the post-1973 productivity slowdown could be an artifact of the CPI bias. However, I am not aware of any research which suggests that any biases in the CPI are any worse now than they were before 1973, and the possibility that the productiivity slowdown in a statistical artifact is remote.

Perhaps the most interesting policy question is whether a CPI bias has implications for wage-setting behavior. The recent behavior of prices is certainly an important consideration in any wage negotiation. It is worth some thought whether a biased CPI could be a cause of real wage rigidity--especially as elevated levels of unemployment linger in many OECD countries.

Policy Implications of CPI Bias

Our next topic this morning concerns biases in the CPI, a subject that was discussed during the most recent WP-1 meeting on the basis of country submissions. As most of you know, this is a topic that has recently been of considerable interest in the United States. Indexation of the tax and transfer system in the United States implies that biases in the CPI can have significant ramifications for the government's budget; similar budget effects exist for other countries as well. Countries with widespread wage indexation in the private sector must also be concerned with the possible presence of bias in their price statistics. Finally, accurate price measurement is a precondition for accurate measurement of other economic statistics, including real output and productivity.

I would like to invite Mr. Murray of Canada to lead off the discussion, and then to open the floor to all delegates for a general discussion of the topic. Some of the issues on which delegates might wish to comment include the following:

- Given that rates of inflation are currently very low in many OECD countries, does this make CPI bias of more concern to policymakers?

- Do policymakers see CPI bias as problematic in terms of the conduct of monetary and fiscal policy? In terms of wage indexation?

- How concerned are policymakers with the possibility that CPI bias spills over into the measurement of other statistics, such as real output?

Income Distribution and Poverty

In this session, we will consider issues related to income distribution and poverty, particularly in the context of policy responses to income inequality. Following the productivity slowdown in the early 1970s, income inequality and poverty began to rise in many OECD countries; this trend has been a major concern of policymakers. More recently, the dictates of fiscal consolidation and general perception that antipoverty and income redistribution programs have had only limited success in attaining their goals in a cost-effective manner have led many countries to rethink how they assist their neediest citizens.

The Secretariat's paper documents trends in inequality and poverty across a number of OECD countries, and discusses a number of issues related to how governments have responded to these trends. I would invite delegates to pay especial attention to the latter topic, with a focus on the lessons they have learned from their own countries' experiences. In particular, delegates might wish to address the following questions:

- How can governments mitigate the economic disincentives associated with tax-transfer programs? Are transfers targetted on the basis of nonincome criteria a reasonable solution? What sorts of problems might nonincome transfers face?

- What is the scope for proactive policies, such as training and education programs, in mitigating income inequality?

- Can wage subsidies improve the position of low-wage workers? Does the type of subsidy--that is, employer-based *versus* employee-based--make a difference?

- What place, if any, does a statutory minimum wage have in an antipoverty program?

I would like to invite Mr. Delbecque of Belgium to open up our discussion concerning income distribution and poverty. Following the introduction, we will have a general discussion of the topic.

I would like to ask two questions related to policy developments in the prospective Euro area. The first is quite specific, and pertains to the recent increase in the repurchase rate by the Bundesbank. My question is whether this rate increase was seen as warranted by the current German economic situation, that is, whether the increase represents a "preemptive strike" against incipient price acceleration, or, rather, if this step was taken with EMU in mind. And, how will the twin policy considerations of domestic stabilization and EMU convergence be balanced going forward?

My second question is more general, and relates to the pace of structural reform in prospective EMU countries. For the United States, which has a relatively high degree of labor market flexibility, evidence indicates that negative demand shocks do not induce wage adjustments that are large enough to counter adverse employment effects. Since labor market rigidities are arguably more significant in many European countries, one might reasonably expect that the adjustment process to a demand shock would be even more painful. Because EMU will constrain the role that monetary and/or fiscal policy will be able to play in cushioning shocks, this would seem to suggest that the pursuit of policies that promote labor market flexibility is essential for prospective EMU countries.

I would therefore like to ask whether the pace of structural reform in EMU countries is proceeding at a sufficiently rapid pace, and in a sufficiently balanced manner. I would also like to enquire as to whether workweek-reduction policies such as those that have been advanced in two prospective EMU countries can reasonably be seen as contributing to labor market flexibility, or if the motivation behind these policies is unrelated to the goal of long-run structural reform.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Rebecca M. Blank (CN=Rebecca M. Blank/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:14-NOV-1997 14:49:56.00

SUBJECT: Regular meeting with Treasury

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

CC: Lisa D. Branch (CN=Lisa D. Branch/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:
Janet and Jeff --

I had lunch with Dave Wilcox today. He would like to establish a once-a-month meeting between his group (and probably Karl Scholz) and the CEA, to talk about the issues we're working on in common. Given that we're often dealing with the same issues, he wants to coordinate our efforts when we're all in agreement and clarify the disagreements when they occur. His image of this is that it would be himself, Jon Gruber, and Karl, along with the 3 of us, and then any additional staff that make sense given the topics under consideration. We could do this alternating between OEOB and Treasury, maybe meeting over lunch or at any other time that seems convenient.

What do you think? I'd find such occasional meetings useful, I suspect. If we want to establish this as a regular meeting, we'll probably want to establish a consistent time (i.e,. at noon on the first Monday of the month).

Becky

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:14-NOV-1997 15:03:24.00

SUBJECT: Joe Nye

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

TEXT:
Bill said Joe Nye was an Undersecretary at the Department of Defense. He couldn't remember exactly what Nye's title was, but something like Undersecretary for Politics and Strategic Planning (I guess the equivalent of the State Depts Policy & Planning office)

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:14-NOV-1997 18:13:27.00

SUBJECT: Sat. 2:00 GCC mtg.

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

TEXT:
The main topic of the meeting is new versions of JI proposals. The idea is that two of our guys are going to Brazil this weekend, supposedly to try to work out a compromise between our versions of JI and theirs.
I have left two related memos on your chair.
JF

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Aaron S. Edlin (CN=Aaron S. Edlin/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:14-NOV-1997 14:32:44.00

SUBJECT: college loans

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

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

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

TEXT:
please tell me if you have any objections to my planning to participate in and possibly heading up a group that makes the college loan market more of a market, and less of a regulated industry.
Since education is an important concern for this administration, I thought it especially important to apprise you of my ideas and plans in this area to make certain you have no objections, and think this is something worth pursuing.
I started this by attending a meeting on college loans, where a paper from Treasury was presented that tried to calculate an appropriate rate of return for lenders. This seemed like a bad idea, so I sent the email below two Jonathan Gruber and Bob Shireman (NEC).
--Aaron

Jon,
My thoughts on the financial aid meeting on Friday follow. I suspect you will agree with me about what should be done, though you may believe that it is to difficult politically to bother.

I apologize in advance for the fact that some words will be misrecognized by my speech recognition system. In fact, many more will be misrecognized than you see, but I will correct those that seem particularly problematic and Scratch that that I catch.

Rate of return regulation is notoriously difficult. So difficult, that the United States is trying hard to abandon it even in industries long thought to have increasing returns to scale, industries where competition is not viable or involves inefficient replication of fixed costs.

Why, then, should we continue to use rate of return regulation in student loans, an area where there are multiple competing lenders. Instead of spending a huge amount of time trying to find an appropriate rate of return, and probably getting it wrong, shouldn't a system be created in which lenders bid to the government or to students to provide loans at low interest rates? Competition could drive banks toward the break-even point far better than regulation, despite treasury's admirable efforts.

The only real worry that I am able to conjure is a "cream skimming". Lenders might try to only loan to good repayment risks (economizing on debt collection costs and the two percent of the loan that isn't guaranteed). Presumably, this could be regulated easily. Lenders could be required to lend to all eligible borrowers. This wouldn't fully solve the problem, because lenders would try to only amortized to good risks. This problem is also probably controllable, however. Lenders could be required to provide an 800 number, and the department of education or college financial aid officers could provide a list of lenders phone numbers to each eligible student.

Do you know of any sound reason why we shouldn't go the free-market route?

-- Aaron

****
Email composed using speech recognition software.
Misrecognized words are common.
****
=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

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Do you know of any sound reason why we shouldn't go the free-market route?

-- Aaron

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:14-NOV-1997 14:26:32.00

SUBJECT: draft of yen bloc article

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

TO: Jon D. Haveman (CN=Jon D. Haveman/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

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

CC: HOPKINS_M (HOPKINS_M @ A1 @ CD @ LNGTWY [UNKNOWN]) (CEA)
READ:UNKNOWN

TEXT:
John and/or Mark should fill in some statistics (abundantly available in my papers, tho some updating might be desirable. I will send Jon a brand-new paper by Kathryn Dominguez giving stats on general use of the yen, in addition to my papers).
At any stage where editing is desirable, Janet has offered.=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D46]MAIL44684571G.316 to ASCII,
The following is a HEX DUMP:

Yen bloc in East Asia, or dollar bloc in the Pacific?

Recent proposals from Tokyo for an Asian Monetary Fund have revived fears that Japan is seeking to establish a "yen bloc" in East Asia. Such a bloc would presumably constitute a geopolitical rival for the U.S.-centered Western Hemisphere bloc and the Germany-centered Europe bloc. Whether the yen bloc hypothesis is interpreted in monetary terms or trade terms, however, these fears can easily be overstated.

{OR: One frequently hears that a yen bloc is forming in Asia -- that Japan is tying the developing countries of East Asia to it through disproptionately strong trade links and currency links. The statistics tell a different story, however. It is more correct to say that East Asia is part of a large dollar bloc, than a yen bloc. Indeed, recent events have highlighted the extent to which East Asian currencies have been tied to the dollar.}

Currency links While the use of the yen outside Japan, particularly in East Asia, has increased since the early 1970s, the trend has not kept up with the increase in the size of Japan's output and trade. Most trade in East Asia continues to be invoiced in dollars, not yen. Hong Kong is firmly pegged to the dollar, and no country is pegged to the yen. Korea, Malaysia, and Thailand -- who seek to stabilize their exchange rates, but for occasional devaluations like the recent ones -- give weights of 10 percent or less to the yen and 80 percent or more to the dollar *{source: F& Wei papers and e.g., 97 WEO, p.82}*. It is for good reason that the currencies of Hong Kong, Taiwan and Singapore [as well as Australia and New Zealand] are called the dollar. Other measures of financial links show similarly large influences of the dollar relative to the yen. *{Could also give stats on foreign exchange trading, CB holdings of forex reserves, financial flows, interest rate correlations...}*

Trade links One version of the yen bloc hypothesis emphasizes the growing trade links among East Asian countries. The intra-East Asian share of trade has indeed risen, from __ in 19__ to _ in 19__. [see table] This trend can be explained, however, by the rapid growth of the countries over this period. It is not surprising that, for example, Malaysia has increased its trade with Japan. Almost every country in the world has increased its trade with Malaysia and its trade with Japan, so why shouldn't the two increase their trade with each other? Measures that take into account the size of trading partners' economies show no residual tendency for trade to become increasingly concentrated within Asia. *[Author's note: My preferred documentation for these statements are the results from the gravity model of bilateral trade. Other findings include that: (i) the trend is toward increased regionalization in Europe and the WH (and within such RTAs as ASEAN, Mercosur, the Andean Pact and the EU), and (ii) the level of intraregonal bias, as opposed to the trend, is high in East Asia, and a bit lower in the other two continental blocs.]*

A trans-Pacific dollar bloc? The finding that East Asia's currency links are tighter with the dollar than with the yen are mirrored on the trade side. Trade within the APEC, like trade with East Asia, is very high and growing. Unlike with East Asia, the increase in trade exceeds what can be explained by natural determinants such as income growth. The level of intra-APEC trade is all the more striking when one takes into account the large distances involved.

Finally, while the Pacific Rim has the APEC forum, East Asian regional institutions are less far advanced. Prime Minister Mahatir's proposal for an East Asian Economic Caucus did not go far. The recent Japanese proposal for an Asian Monetary Fund has also met stiff resistance.

Conclusion Thus, whether the criterion is monetary, trade, or institutional, the evidence suggests that -- so far, at least -- an American-led APEC bloc is a more powerful force than a Japan-led Asia bloc.