Withdrawal/Redaction Sheet
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	Joseph E. Aldy to Michele Jolin, Jeffrey A. Frankel, Rebecca M. Blank, and Janet L. Yellen at 00:17:00.00. Subject: ICEED Conference on Kyoto. (partial) (1 page)	04/24/1998	b(6)
002. email	Jeffrey A. Frankel to Janet L. Yelln and Blank_R. Subject: reading newsclips in the a.m. WH mtgs. (1 page)	05/04/1998	b(6)

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

FOLDER TITLE:
[04/16/1998 - 05/14/1998]

2013-0723-F
ab1277

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

CREATION DATE/TIME:16-APR-1998 15:05:22.00

SUBJECT: RE: On Geo press briefing

TO: Peter R. Orszag (CN=Peter R. Orszag/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: Rebecca M. Blank (CN=Rebecca M. Blank/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:
---------------------- Forwarded by Steven N. Braun/CEA/EOP on 04/16/98
03:04 PM ---------------------------

Montgomery Edward <montgomery-edward @ dol.gov>
04/16/98 02:56:47 PM
Record Type: Record

To: Steven N. Braun/CEA/EOP
cc:
Subject: RE: On Geo press briefing

Steve,
I was at the briefing. There were questions on; superlative indices
;what a break out of the .20 decline by item strata would look like
(CBO); any future plans for changing the cpi; view on a david levine
article on within strat price volaltility; the cumulative magnitude of
changes made since 1996; and what other countries use geomeans. There
were about 30 people there and the crowd was not hostile.
ed

From: Steven_N._Braun@cea.eop.gov [SMTP:Steven_N._Braun@cea.eop.gov]
Sent: Thursday, April 16, 1998 12:30 PM
To: Montgomery Edward
Subject: On Geo press briefing

Dear Ed,

Were you at the BLS press briefing this morning? If so, were there
any public relations issues that we need to know about?

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:16-APR-1998 15:00:29.00

SUBJECT: Sweden memo

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

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

TEXT:
Thank you for the very interesting memo you prepared in preparation for my meeting with Dr. Ostros. I found it quite useful. He is an extremely interesting and well informed person.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:17-APR-1998 18:17:15.00

SUBJECT: Re: POTUS and per-mile premiums

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

TEXT:
the rumor apparently is connected to the old auto choice memo. Not the web. Tom is vague, but says maybe he heard the president circled or noted the section on per mile premiums.

Janet L. Yellen
04/17/98 05:33:14 PM
Record Type: Record

To: Aaron S. Edlin/CEA/EOP
cc:
Subject: Re: POTUS and per-mile premiums

I had not heard anything at all about POTUS's reaction to per mile premiums. I would certainly be in favor of setting up a working group to look at it more closely--in response to the NOW initiative of independent of it. Feel free to pursue this as you see fit.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:17-APR-1998 12:24:08.00

SUBJECT:

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

TEXT:
Janet,
Enclosed is a draft letter in response to a letter from National Council of La Raza about Chapters 3 and 4 of the ERP. Maria and I each wrote responses to comments on our individual chapters. Becky, Michele, and Sarah have read the response and provided comments. I also spoke briefly about the La Raza letter with Julie Fernandes of DPC. Julie is willing to look it over if you would like; Michele thinks it would be a good idea after you have had a chance to look at it. Let me especially draw your attention to some "personal" material about growing up in New York City that I added at the end of the letter which you may wish to delete.

Sandy

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D84]MAIL45090560J.126 to ASCII,
The following is a HEX DUMP:

April 20, 1998

Sonia M. Pe'rez
Director
Poverty and Employment Projects
National Council of La Raza
1111 19th Street NW
Washington, DC 20036

Dear Dr (?) Perez:

Thank you for your detailed letter regarding the *1998 Economic Report of the President.* I hope in my response to clarify any misunderstandings about the Report, and to assure you that this Administration remains committed improving the economic well-being of the least fortunate among us. Your letter raises a number of important considerations that I address in the remainder of this letter.

Your first point is that Chapter 3 (on children) should have included a more detailed consideration of how changes in poverty rates differed for Hispanic children, especially as they relate to family composition, region, and adult labor market outcomes. I agree that a consideration of these issues would have enhanced the chapter, and would have provided a more nuanced interpretation of poverty trends for different populations.

You also express concern about "the role given to immigration, to the exclusion of other serious factors, in determining Hispanic economic outcomes, which we believe overstates the case dramatically." The Report does stress that one must understand how immigration affects measures of changes over time in the economic status and educational attainment of Hispanics as a group. In no way did we intend to dismiss other important factors that may be barriers to economic success of Hispanics. For example, the chapter states several times that there is evidence that minorities continue to face discrimination in many parts of the economy; for example, on page 153 we wrote "...the incidence of unfavorable treatment in the housing market was 23 to 30 percent higher for a black or Hispanic auditor than for his or her `matched' white counterpart." Nonetheless, your letter serves as an important reminder of the importance of other barriers, and we intend to give further consideration to such barriers in our subsequent research efforts on behalf of the President's Initiative on Race.

You state that "the use of data which include Hispanic immigrants to make statistical comparisons between Hispanics and non-Hispanics may slightly overstates the differences that exist between these groups." In fact, I believe it fundamentally alters trends in these comparisons in some important instances. The most prominent example is educational attainment. Over the 1980s there was little evidence of increases in high school attainment among Hispanics, but very significant increases among blacks. These trends indicate that blacks have nearly closed the gap in high school completion with non-Hispanic whites, but progress for Hispanics was much slower. In fact, the appearance of a black-Hispanic divergence is almost entirely due to immigration. If one looks at high school attainment by birth cohorts, the improvement in high school attainment among blacks and native-born Hispanics is very similar (see Robert Mare, 1996), although both groups remain less likely than non-Hispanic whites to complete high school.

You also state that "the high school and college completion rates of native-born Hispanics has not improved over the past 20 years." This statement is difficult to reconcile with data from the 1980 and 1990 Census that show that, between 1980 and 1990, the percentage of 18-21 year olds who were neither enrolled in nor completed high school fell from 30 to 23 percent among native-born Hispanics, but remained at 47 percent for foreign-born Hispanics (page 134); and that the proportion of 18 to 24 year olds enrolled in college increased sharply--from 18 to 28 percent--among native-born Hispanics, but remained at 16 percent for foreign-born Hispanics (page 135). I would be interested to see any information you have that could clarify this difference.

I agree that low educational attainment is an important source of wage and income disparities between Hispanics and others. For example, as Table 4-2 of the report shows, the overall Hispanic to white ratio of median weekly wages of full-time workers (0.63 for men and 0.71 for women) is below the corresponding black-to-white ratios. But if we compare workers with similar levels of education, the Hispanic-to-white ratio rises above the black-to white ratio, and it appears that more than half of the Hispanic-white gap in pay is explained by differences in educational attainment alone. This conclusion is based on the simple cross-tabulations presented in the Report, but it is consistent with detailed work by economist Stephen Trejo on the wages of Mexican workers, published in the *Journal of Political Economy* in 1997. He concludes that more than 3/4 of the Mexican-white male wage gap results from human capital factors such as education and language skills. Likewise, an article published in the Bureau of Labor Statistic *Monthly Labor Review* confirms your point that Hispanics are more likely than non-Hispanic whites to be displaced from jobs in recessions. However, that analysis showed that the difference in displacement rates was not statistically significant when the authors controlled for education.

You say that the Report exaggerates the importance of immigration in population growth over the past 20 years, and that "natural increase" (births minus deaths) accounts for fully half of population growth. The Census bureau estimates that, as of 1996, there were about 28.4 million Hispanics, 10.8 million of whom were not native born. Between 1980 and 1996, the Hispanic population increased by about 13.7 million. In the 1996 population, there were 7.0 million Hispanics who were foreign born and who entered the U.S. after 1980. So slightly more than half of the increase in the Hispanic population from 1980 to 1996 is accounted for by foreign-born persons who entered the country after 1979. In addition, while it is true that today the majority of Hispanic population growth is due to natural increase, many Hispanic births are births to immigrants. Whether one calls the portion of natural increase that results from births to immigrants "the result of immigration" is a philosophical and political issue. In any case, at least half of estimated population increase between 1980 and 1996 is due to immigration.

You raise concerns about the Report's discussion of racial/ethnic trends in poverty rates. A key issue for the chapter is whether the dramatic increase in Hispanic poverty rates that took place in the 1980s (surpassing the rate for blacks in the early 1990s) is importantly affected by immigration. One way to answer this question is to examine whether there was a similar increase, relative to blacks and to non-Hispanic whites, in the poverty rate of Hispanics that were resident in the US throughout the 1980s. My staff has conducted an analysis of the National Longitudinal Survey of Youth to answer this question. The NLSY cohort represents a constant population, so it does not include immigrants who entered the country after 1979 (or their children). The results apply to only one cohort, but I think you will agree that they are very interesting.

	NLSY				CPS		
Year	1978	1990			1978	1990	
Age	13-19	25-31	change	13-16	24-34	change	
Hispanic	33.2	19.7	-12.5		27.2	23.8	-3.4
Black	40.6	29.2	-11.4		40.1	26.4	-13.7
White	9.4	8.7	- 0.7		10.0	10.0	-0.0

(Note: CPS data for whites and blacks include Hispanics; NLSY data do not.)

Over these ages, poverty rates for minorities fell sharply over the 1980s. And in the NLSY, which follows a constant population, the poverty rate for blacks and Hispanics fell by more than 10 percentage points each. The CPS cross-sections show similar decline to the NLSY for blacks over this period, but only very moderate progress for Hispanics. The substantial "convergence" of black and Hispanic poverty rates over time that characterizes the CPS does not appear in the NLSY. I believe the most plausible explanation for the differences between the two sets of results is that post-1979 immigrants (and their children) are represented in the CPS, but not the NLSY. Again, taking account of the role of immigration in this way fundamentally alters the interpretation of trends in the relative status of Hispanics as compared to non-Hispanic blacks and non-Hispanic whites.

I agree with your characterization of the family structure and labor market behaviors and outcomes of Hispanics. In fact, the labor market for Hispanics has improved remarkably in the present recovery. For example, the most recent BLS employment report shows that the Hispanic unemployment rate is at its lowest level since the Department of Labor began publishing data on the labor market status of Hispanics in the early 1970s.

When I review these facts, I must respectfully disagree with your conclusion that the report overemphasizes the importance of immigration in understanding time trends in Hispanic socio-economic status. I also do not feel the report reinforces a myth that most Hispanics are foreign born. It never says this. However, I am convinced that the majority of recent Hispanic population growth is the direct result of immigration. That said, I strongly agree with you that we must examine carefully all causes of poverty and social inequality in order to formulate effective public policies, and I have directed my staff to do so in their ongoing research efforts in assistance with the President's Initiative on Race.

Let me also assure you in the strongest possible terms that we did not and do not intend to communicate to policy makers or any other readers of the Report that the CEA or the Administration supports ending immigration of Latinos. This Administration is committed to improving the employment prospects, working conditions and pay of all of our nation's workers. As you know, the President has fought for such measures as the Earned Income Tax Credit and the minimum wage, which have raised the earnings of workers in families with low incomes.

Finally, on a more personal note, I was puzzled by your concern that immigrants are closely linked to negative stereotypes. I do not share that concern, perhaps because I grew up in New York City among immigrant families from around the world. In my experience, many Americans associate immigrants with hard work and strong family and community values. I count myself among those who feel that immigrants are the embodiment and fullest expression of the American dream.

In closing, let me again thank you for your thoughtful letter.

Sincerely yours,

Janet Yellen
Chair

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Christopher D. Carroll (CN=Christopher D. Carroll/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:17-APR-1998 17:43:29.00

SUBJECT:

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

TEXT:
Janet:

I've added a couple of paragraphs about impacts on the US, protectionism, and the like, and dashed off a rather hokey and unsatisfactory final paragraph summarizing. I can do more early next week if you have reactions/suggetions.

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

TEXT:
WPC
0oFc^ddy2>Hx.=q^fdv##({h1=Hj>nl{U?u>$x"PTBS !YG}7aTV*T4X{B*,l|$",?0!@toXott@h87
j!?*XsZZmUAlaeH5>nRTgz6fi'Y;[yNR#8r|qbs H<G)
0{jKw"O3ni<4BQ]5S
_aF>th_AUUGSl

5&,Q.HDaF`F1lH8utk+xz%:&Gk (#~UN %0(2w@74wLocal PrinterWINSPOOL,,,,,,0(9 Z6T
imes New Roman RegularX($C:\PROGS\WP\STANDARD.WPT
EE{{$3|x
!TheImpactoftheEastAsianCrisisontheU.S. JanetYellen,ChairCouncilofEconomic AdvisersApril24,1998HartfordCollege-Iwouldliketospendmytimetodaysharingwithyoum ythoughtsabouttherecenteconomiccrisisinAsiaandwhatlessonsthatcrisismayhaveforth eroleoftheUnitedStatesandinternationalfinancialinstitutionsinfuturecrises.Let mestartwithalittlerecenthistory.Thepasttenorfifteenyearshaveseenanunprecedented expansionintheextenttowhichthecountriesoftheworldaretiedtogether,bothbyinstantc ommunicationandbyinternationaltrade,institutions,andmarkets,includingfinancialm arkets.Onthewhole,thisprocessofglobalizationhasbeenanenormouslypositivedevelopm ent.Ithasopenednewmarketsandprovidednewopportunitiesforworkers,farmers,andbusin essesaroundtheworld.Forexample,morethan40percentofUSexportstodayareabsorbedbyde velopingcountries,anextraordinaryincreaseoverpastexportpatterns,andthejobsassoc iatedwiththeseexportsarehighpaying,goodjobs.Theincreasingproductivityofourtradi ngpartnershashelpedkeepinflationdownandimprovestandardsoflivingintheUnitedState s.AndoutsidetheUS,literallyhundredsofmillionsofpeoplehavebeenliftedoutofpoverty aroundtheworldbytheeconomicgrowthandtradeoverthepasttwentyorthirtyyears.Inthi snewglobaleconomy,countriesaremoretightlylinkedthaneverbeforetoeach @-(, others fates.Adecadeago,acollapseinthecurrencyofasmall,distantcountryslikeThailandwoul dhavebarelyhaveratedamentioninthetypicalAmericannewspaper.Lastyear,however,that currencycrashtriggeredacrisisinotherEastAsiancountriesthathasdominatednewscover ageinawaythatnootherforeignfinancialcrisishaseverdonebeforeinthiscountry.Ther

easonforthechangeisthatwenowhavemoreatstakethaneverbeforeintheeconomicperforman
ceofthesecountries.Notonlyaretheymajorcustomersforourproducts,therichcountriesa
nddevelopingcountriesareincreasinglylinkedbyfinancialties.In1996,thedevelopedco
untriesincludingtheUSinvestedmorethan$250billioninemergingmarketscomparedtoroug
hly$20billiontenyearsearlier.Muchofthismoneywasfrombanks(especiallyinJapanandEu
rope),althoughUSmutualfunds,pensionfunds,andindividualinvestorsalsoparticipated
.Butwhateveritssource,theextentofthisinvestmentmeansthateconomicturmoilinEastAs
iahasadirectfinancialimpactonthedevelopedworldscapitalmarkets,includingourown.I
ndeed,abriefplungeinUSstockslastOctoberwaswidelyattributedtoturmoilintheHongKon
gstockmarketthatwas,inturn,linkedtothecrisissetoffbyThailandscurrencycrash.Ih
opethatIhaveconvincedyouthatwecannotaffordtobeindifferenttotheEastAsiancrisisbe
causeindifferenceandinactionwouldundermineourowninterests.Buttoidentifythepropе
rresponsetothecrisis,itisnecessarytodetermineitscausewhichisnoeasytask.Attempts
toidentifythefundamentalcausesofafinancialcrisisalwayssufferfromtheproblemofdis
tinguishinginsightfromhindsight.Manyafinancialjournalisttodaycantellyouthatthec
risiswastheinevitableconsequenceofsomepieceofeconomicsjargon:overvaluedexchange
rates, @-(, largecurrentaccountdeficits,shorttermcapitalinflows,opaquefinancial
systems,oroneofseveralothersupposedlyfatalflawsinEastAsiancapitalism.Butitseems
fairtosaythatayearagonobodysuspectedthatacalamitylikewhatwehaveseenwaspossible,
althoughallofwhatarenowdescribedasthefatalflawsoftheEastAsianeconomieswererеaso
nablywidelyunderstoodeventhen,atleastbyexperts.Indeed,asrecentlyastheearly1990s
economistsweredebatingvigorouslywhethertheJapanesemodelofcapitalmarketsthatwasa
doptedinEastAsiawassuperiortotheAmericanmodel.Thereasonfortherecentwidespread
admirationofEastAsianeconomiesisobvious:thesecountriesmusthavebeendoingsomethin
gveryright,becauseoverthelastthirtyyearsor H sotheyachievedthesinglegreatestspu
rtofeconomicgrowthinthehistoryofmankind.Thereislittledisputeabouttheimportanceo
fsomeofthethingsthesecountriesgotright:highsavingrates,rapidlyincreasinglevelso
feducation,andhardwork.Theroleofthesecountries'financialsystemsinfosteringgrowt
hmaybemoremurky,butitisatleastclearthattheflawsofthosefinancialsystemswerenotsu
fficienttopreventsomeremarkableaccomplishments.Akeyelementinanysuccessfulexplan
ationoftheEastAsiancrisismustthereforebeananswertothequestionofhowasystemthatwo
rkedsowellforsolongcouldsuddenlyfail.Oneproblemincomingupwithanoverarchingexp
lanationoftheEastAsiancrisisisthattheafflictedcountriesdifferfromeachotherinman
yimportantrespects.InsortingthroughthemanyandconflictingstoriesaboutWhatWentWro
nginAsia,Ifindithelpfulasapreliminarytogobacktothebasicquestionofwhatcapitalmar
ketsdo:theytransformfinancialsavingsintophysicalinvestments.Thistransformationi
sdifficultforthreereasons:first,thepeoplewith @-(, savingsgenerallywantconvenie
ntandguaranteedshorttermaccesstothem(thatis,theywantliquidity);second,almostall
investmentopportunitiesrequirealongtermcommitmenttoyieldagoodreturn,andcanbeliq
uidatedonlyataheavyloss;and,finally,thegathering,processing,andcomprehensionofi
nformationaboutinvestmentprojectsarecostlyandtimeconsuming.Thetraditionalsolu
tiontothissetofproblems,isabank,whichacceptstheshorttermdepositsofsavers,gather
sandprocessesinformationaboutpotentialborrowers,and(ifthebankisfunctioningprope
rly)offerslongtermloanstothoseborrowersjudgedtobesufficientlylikelytorepayatasu
fficientlyhighinterestrate.Thehattrickofprovidingsaverswithshorttermliquidityba
ckedupbyilliquidlongtermassetsisaccomplishedbyrelyingonanassumptionthatallthesa
versarenotlikelytowanttowithdrawtheirdepositsatthesametime.Aslongasthisassumpti
onholdstrue,smallreservesofcashcanmeetthedemandsofwhateverdepositorshappentowan
ttowithdrawtheirsavingsonagivenday.However,evenawellrunbankcanbedestroyedover
nightiftoomanypeopledecidetowithdrawtheirsavingsatthesametime.Oncethebank'scash
reservesaregone,intheabsenceofsomeoutsidehelpitmusteithertelldepositorsthatthey
cannotwithdrawtheirsavings,oritmustselloffitsilliquidassets,likelyatahugeloss,a
nddistributetheinadequateproceedstotheremainingunsatisfieddepositors.Theremar
kablepointinthisstoryisthatevenforawellrunbanktheoutcomeisaselffulfillingprophe

cy:Ifeverybodybelievesthebankissound,itsreserveswillbesufficienttomeetliquidity demands,andthebank,itsdepositors,anditsborrowerswillallreaptheirjustrewards. @-(, Butifforsomereasondepositorsbegintosuspectthattoomanyotherdepositorsmaytryto withdrawtheirdeposits,theneachdepositorhasanincentivetorushtothebankandtrytow ithdrawtheirownsavingsfirstcausingabankrun.Ifeveryonedoesthis,thebankcollapses. Evenworse,ifthefailureofonebankmakesdepositorsinotherbanksthinkthattheirsavings maybeatrisktoo,thereisarealpossibilityofacontagioninwhichonebankfailurepromptsm anymore.Abankrunwillnothappenifdepositorsareabsolutelycertainthattheywillbeab letowithdrawtheirfundsupondemand,andsothesimplesolutiontotheproblemofbankrunsis tocreatealenderoflastresortoradepositinsuranceagencywhocanstepintoprovidethenec essarycashincaseofabankrun.Andhereiswheretheproblemeconomistscall moralhazardre arsitsuglyhead.Ifdepositorswillbebailedouteveninthe worstofcircumstances,thebank willhaveanincentivetotakeexcessiveriskswiththedepositors'money,becausefromtheba nkspointofview,iftheriskpaysoff,thebankkeepstheprofits,butiftheriskyinvestments gobad,thegovernmentbailsoutdepositors.Its headsIwin,tailsthegovernmentloses.Thu s,itisessentialtotiedepositinsuranceprotectionto prudentialbankregulationandmon itoring,wheretheword prudentialconveysthatthepurposeoftheregulationistopreventb anksfromtakingunduerisks.ThusfareverythingIhavesaidisstraightfromMoneyandBank ing101,andIapologizetoanyoneforwhomitmaybereview.Butsettingoutthestoryexplicitl yisusefulbecauseithighlightstwoessentialwaysinwhichhumanjudgemententerstheprobl em.Firstisthatacollapseinthebeliefsofdepositorsthattheirmoneyissafecanleadtoban krunsandpossiblyto @-(, severeeconomicconsequencessuchasbankfailuresorthetermin ationoflongterminvestmentprojectsatheavylosses.Thesecondchannelofjudgmentisthep rocessbywhichbankmanagersdecidehowtodispensetheirloanablefunds.Inmyview,mostoft heplausiblestoriesaboutwhathappenedinEastAsiacanbeinterpretedasstoriesaboutthes etwochannelsofjudgementandtheirinteractions.Andrealizingthatrealeconomicoutcome sdependcriticallyonchangeablehumanjudgementshelpstoanswerthequestionthatmanylay peopleandjournalistshaveaskedaboutthiscrisis:whydidnttheexpertsontheseeconomies knowbeforehandthatsomethingwaswrong?Partoftheansweristhatthecrisisreflectsawhol esale,andselffulfilling,changeofopinionamonginvestorsaboutwhetherEastAsianinves tmentsaresound.Nobodypredictedthecrisispartlybecauseitisverydifficulttoanticipa tesuchaprofoundchangeinotherpeoplesjudgements.Thisemphasisontheimportanceofju dgementleadsnaturallytothequestionofhowpeoplemakejudgements.PatrickHenryoncesai d Iknownowayofjudgingthefuturebutbythepast.IfPatrickHenryhadbeenamoneymanagerin theearly1990shewouldprobablyhavebeenveryenthusiasticaboutinvestmentinEastAsia.A ndthereinmaylielargepartoftheproblem.Considertwoalternativemethodsofmakinginve stmentdecisions.ThefirstistoadoptPatrickHenry'smethodandinvestininvestments sim ilartowhateverhasperformedwellinthepast,withoutbotheringtoomuchaboutwhatlaybehi ndthisgoodperformance;becauseyoucanthinkofthismethodasbasingfutureexpectationso nchartsofpastperformance,Iwillcallthisinvestmentmethod chartism.Thesecondmethod ofjudginginvestmentsistogatherlotsofrelevantfinancialinformationaboutalternativ einvestments,considerthecircumstancesunderwhicheachislikelytoperformwellandhowl ikelythosecircumstancesaretoprevail,andchoose @-(, accordingly.Thisstrategy,whi chIwillcall fundamentalismbecauseitreliesonananalysisofthefundamentalfinanciali nformationthatdeterminesuccessorfailureoftheinvestment,isdifficultandcanrequire largeamountsofdataandexpertisetoimplementandisimpossibleifaccurateandcarefulfin ancialinformationaboutalternativeprojectsissimplyunavailable.Withthesethought sinplace,letmestartwiththesimpleststoryaboutthenatureoftheEastAsiacrisis:thatit wasconceptuallynomorethanseriesofgiantbankruns.Tounderstandthisstoryitisnecessa rytorealizethatforeignbankshadextendedenormousamountsofshorttermloanstobanksand companiesintheEastAsiancountries,andthattheseshorttermloanswerethenusedtofinanc elongterminvestments.Becausethelenderalwayshastheoptionnottorenewashorttermloan ,suchloansposeexactlythesamekindsofproblemthatbankdepositsdo:ifalllenderssudden lydecidethattheirshorttermloansareriskierthantheyhadthought,theywillnotbewillin gtorenewthoseloanswhentheyexpire.Thesuddenunwillingnesstorenewshorttermloansisl ikeasuddendecisionofalldepositorstowithdrawtheirbankdeposits:itcanleadtoacollap seoftheborrowingbankorcorporation,whichhaslikelyusedtheproceedsoftheshorttermlo antofinancelongterminvestmentsthatcannotbeliquidatedexceptataveryheavycost.Th estory,roughlyspeaking,isthatthecollapseoftheThaibahtinJuly,andthesubsequentclo singofalargenumberofThaifinancialinstitutionswhichforeignlendersmightpreviously havesupposedweresafeborrowers,spurredafearthatsimilarshorttermloanstootherEastA sianborrowerswerenotsosafeaslendershadsupposed.Sincethoseloanshadbeenmadeatinte restratesbarelyaboveratesavailableintrulysafeinvestmentsathome,evena @-(, modes tincreaseindoubtwasenoughtoinducetheforeignlenderstowanttobringtheirsavingshome .Butbecauseitwasimpossiblefortheborrowerstorepayalloftheshorttermloanssimultane ously,acrisisensued.Theproponentsofthis bankrunviewofthecrisisdenyquiteexplicit lythatthelongterminvestmentsmadebyborrowerbanksandcorporationsweregenerallyunso und(ofcourse,theydonotdenythattherearesomespecificexamplesofbadlending,buttheyd odenythattherewasamajordeteriorationinthequalityoflongtermlendingdecisions).If

thisstoryisright,thenthemainpolicyerrorinthecrisiswasafailureofgovernmentautho ritiestopromiseapromptandunconditionalbailouttoallbankdepositors.Itseemsfairt osaythatthisisnotthemajorityviewofthecrisis.Certainlythejournalisticfocushasbee nonexamplesofpoorlongterminvestmentdecisions,fromtheIndonesiannationalcarprojec ttowidespreadoverinvestmentinrealestatetotheextraordinaryempirebuildingofsomeKo reanconglomerates.Alloftheseexamplesstronglysuggestthattherewassomething amis sinthesecondstageofthefinancialprocess,wheredecisionsaremadeaboutwhichreallongt erminvestmentsareworthfinancing.Thereareseveralkindsofstoriesaboutwhatwasamis sthere.Letmestart,again,withthesimplest:astraightmoralhazardstory.Inthisview,th eessentialproblemwasinsufficient(ornonexistent) prudentialbanksupervision,givin gthebankstheclassic headsIwin,tailsthegovernmentlosesincentivestooverinvestinhi ghrisk,highexpectedreturnventures.Themostconvincingapplicationofthismodelistoth elargevolumeofloanstorealestateprojects.Inhindsight,muchofthislendingseemsobvio uslyfoolish;whybuildhugeofficetowersincitiesthatalreadyhavesubstantialofficevac ancyrates?Butpropertypriceshadbeenrisingquicklyfor @-(, years,andaslongastheyco ntinuedtorise,suchloanscouldbeveryprofitable.Iflendersdidrecognizesomeprospecto fapossiblecollapseintherealestatemarket,realestateloansareexactlythekindofhighr isk,highreturninvestmentsthatwouldbeexpectedfromabanksubjecttoamoralhazardprobl em.Althoughthestandardmoralhazardstorymaybeapotentialexplanationfortheoverinv estmentinrealestate,itdoesnotcapturesomeoftheotherkindsofcapitalallocationprobl emsthatseemtohavebeencommonintheEastAsianeconomies.Onecategoryofsuchproblemshas beendesignated cronycapitalism;inthisview,banksandotherfinancialintermediariesa llocatedcapitalonthebasisofpersonal,business,orgovernmentalconnectionsratherthа nonthebasisofanyinformationtheyhadaboutthefundamentaleconomicvalueofthespecific investmentprojectstheywerefinancing.OnethingwemayhavelearnedfromtheEastAsiane xperienceisthatinthelongrun,relianceonsuchbehindthescenesrelationshipsforcapita lallocationmayleadtoincreasinglypoorinvestmentdecisions.Oneplausibleexplanation mightcomefromsupposingthatatearlystagesofdevelopment,therearemanyobvioushighret urninvestmentstomake;butatlaterstages,afterthelowhangingfruithasbeenplucked,exp ectedreturnsfrominvestmentprojectsarebothlowerandhardertoperceive. Relationship lendingwouldworkatearlystagesofdevelopmentbecausetheborrowerstandstoreaplargeec onomicrewardsfrompursuingthehighreturnprojects,butsuchlendingpracticesmightbrea kdownatlaterstageswhenoveralleconomicreturnsarelowerbecausetheborrowermaybetemp tedtoindulgeinprojectswithnoneconomicsidebenefitssuchasempirebuildingorinternat ionalprestige,orevendirectmonetary @-(, compensationstotheborrowerlike commissi ons.Thisbringsmebacktothedistinctionbetweenthe chartistandthe fundamentalistm ethodsofmakinginvestmentdecisions,becauselendingtopartieswhorepaidpastloanswith outrequiringcarefulfinancialanalysisofthenewloanisaformofchartism.Similarly,for eignlendersprovidingshorttermloanstoEastAsianbankswerealsoengaginginchartismift heyassumedthattheirloansweresafesimplybecausesimilarshorttermloanshadbeenrepaid inthepast.Indeed,giventhepoorfinancialdisclosurerulesandlaxregulationthatcharac terizedthebankingsectorsinsomeEastAsiancountries,itishardtobelievethatthemassiv eshorttermloanstobanksinthesecountriescouldhavebeenbasedonanyinformationotherth anpastperformance. H IthinkthatperhapstheclearestlessonoftheEastAsiancrisisis thatasystembasedonrelationshiplendingandpastperformance,ratherthanfundamentalin formation,isextraordinarilysusceptibletocollapseiftheprovidersofcapitalbegintos uspectthatsomeborrowersorsomebanksmayhavemadebadinvestments.Iftheonlyinformatio nalenderhasaboutaborroweristhatsimilarborrowershaverepaidinthepast,thenthenewst hatsomesimilarborrowersaresuddenlynotrepayingcanhaveadevastatingeffectonconfide nce,andthereforeonthefinancial 0" systemandtheeconomyasawhole.Ifforeignlending toEastAsianbankswasbasedonchartism,isnothardtoseehowthefailureofafewThaibanksin thesummerof1997couldhavetriggeredawidespreadlossofconfidenceinEastAsianbanks. Thisstory,orsomethinglikeit,seemstomethemostplausibleexplanationofthebroadchara cteristicsoftheEastAsiancrisis.Anditisclearlydistinguishablefromthesimplebankru n @-(, ormoralhazardstoriesinitsdiagnosisthattheseverityofthecrisisisdueinlarge parttoatendencyintheseeconomiestoallocatecapitalnotonthebasisofsoundfinancialin formationbutratheronthebasisofrelationshipsandpastexperience.Iturnnowtotheque stionofwhathasbeenandshouldbedonetocontainthecrisisandtopreventsimilarfuturecri ses.NewspaperheadlinesabouttheInternationalMonetaryFund'seffortstoaddresstheE astAsiancrisistendtofocusontheenormoussumsofmoneythatareinvolvedrangingupt oasta ggering$57billionintheKoreanrescuepackage.Intruth,theamountsofmoneythathavebeen directlyprovidedbytheIMFtotheafflictedcountriesaremuchmoremodesttheheadlinefigu resincludeallpossiblefuturecommitmentsbyboththeIMFandothercountriesparticipatin gintherescueplans.Indeed,despitetheheadlinefocusondollars,therealnewsabouttheIM F'sprogramsinEastAsiawasthattheseplansdifferedfromanypreviousIMFrescuepackagein severalcriticalrespectsmostnotablyintheirnovelemphasisonstructuralreformsinthef inancialsectorsoftheaffectedcountries,reformsdesignedpreciselytoaddresstheprobl emsofrelationshiplending,laxbanksupervision,andpooraccountingandtransparencytha tlhavejustarguedweretherealreasontheEastAsiancrisiswassoswiftandsosevere.Onec onsequenceofthehighvisibilityoftheIMFprogramsisthevisibilityofcriticismsoftheIM F.AmemberofthepublicmightwellconcludethatsomethingmustbeseriouslywrongwiththeIM Fonthegroundsthat wheretheressmoke,theresfire.Whatisnotobviousexcepttoexperts,h owever,isthatmostofthecriticismsoftheIMFarematchedbyequalandopposite @-(, criti cismscomingfromtheotherdirection.Ofcourse,thefactthattheIMFisbeingattackedfromb othsidesonmostissuesdoesnotnecessarilyprovethatitspoliciesrepresenttherightbala nce,andinhindsightitdoesappearthattheIMFmayhavemadesomemistakesinitsinitialreac tionstothecrisis.Butwiththeaidofhindsightalmostanypolicydecisioncanbesecondgues sed.Badasthecrisishasbeen,IhavenodoubtthatitwouldhavebeenfarworseiftheIMFhadnot beentheretoadministersomemuchneededgoodadviceandtohelprestoreatleastsomedegreeo finvestorconfidenceintheaffectedcountries.Idisagree,particularly,withthosecri ticswhosaythatboththeUSandtheworldwouldbebetteroffiftheIMFdidnotexist.Themainar gumentthatthesecriticsmakeisthatthemereexistenceoftheIMFencouragesinternational investorstorecklesslylendmoneywithoutworryingaboutwhethertheborrowingcountryorb ankiscreditworthy,ontheassumptionthatanIMFpackagewillbailthemoutiftheinvestment provestohavebeenbad.Thisisanotherexampleofthe moralhazardargumentmadeearlier,bu tnowtheentityaccusedofprovidingabailoutisnotanationalgovernmentbuttheIMF.WhileI heartilyagreethatirresponsiblelendersshouldnotbebailedout,itturnsouttobeextraor dinarilydifficulttopunishsuchlenderswithoutcausingcatastrophicconsequencesinthe affectedcountriesandperhapselsewhere.Onceagainthelackoftransparencyinthefinanci alsystemisacriticalproblem,becausepotentialsuppliersofnewcapitalstillcannotdist inguishthegoodborrowersfromthebad.Ifexistingdebtisdefaultedon,thelikelyeffectwo uldbetocauseacompletewithdrawalofcapitalfromtheaffectedcountrypotentiallyleadingtoacompletefinancialmeltdown.ItissimplynotacceptabletosaythatThailandshouldbedestroyedinordertopunishJ.P.Morgan.ItisevenmoreunacceptablegiventherealdangeroffinancialcontagionthatcouldspreadfromsuchacalamityeventotheUS. @-(, RecallthatinOctoberasharpplungeintheUSstockmarketwasattributedtofinancialturmoilinHongKongthatwasinturndirectlyrelatedtotherestoftheEastAsiancrisis.WhiletheUSstockmarketrecovered,wehavenoguaranteethatthingsmightnothaveturnedoutmuchworseiftheIMFhadnotbeenaroundtoprovidesomeassistancetoThailandandtheotherstrickenEastAsianeconomies.Andevenasidefromthepossibilityoffinancialmarketcontagion,economiccollapseinEastAsiawouldseverelydamageourtradewiththatregion,hurtingUSexportersintheshortrunandtheUSstandardoflivinginthelongrun.Finally,therearepowerfulgeopolitcialreasonsthatweshouldcareabouteconomicstabilityinEastAsia.TheUSstillhas37,000troopsinKorea,andhasstrongmilitaryandpoliticaltieswithJapanandothercountriesintheregion.WethereforehaveseriousnationalsecurityreasonsinadditiontoeconomicreasonstocareabouttherecoveryoftheEastAsianeconomies.TheEastAsiancrisishasstrainedtheIMF'sfinancialresourcesnearlytotheirlimit.ThismeansthatifacrisisshoulderuptinanotherbigcountryoriftheEastAsiancrisisshouldtakeaturnfortheworse,theIMFmightnotbeabletoprovideacrediblerescuepackage.Theresultingfinancialcollapsecouldspread,justasThailand'scrisisspread,andthedamagetotheglobalfinancialsystemcouldbesevere.AsaresultIbelieveitisciritcalthattheCongressquicklyapprovetheAdministration'srequeststoincreasetheIMF'sfinancialreserves.Thisshouldbeaneasydecision,becausethesearenotbudgetexpenditurestheyarejustlinesofcreditfortheIMF,andsoaremoreakintoinvestments.SuchIMFfundingincreaseshavenevercosttheUStaxpayeradime,andtheproposedincreasesinIMFreserveswillalsocostnothing.AndtheyprovidearealmeasureofincreasedsecurityfortheUSandtheworld'sfinancialsystem. @-(, FundingincreasesfortheIMF,however,areonlythefirstandmostobviouspriorityinrespondingtothecrisis.Weneedtotakestepstoreducethelikelihoodthatsimilarcriseswillleruptinthefuture,andtominimizetheconsequencesofsuchproblemsasdooccur.Itseemstomethattherearethreeelementsthatshouldbepartofanyreformeffort.Thefirstistoimprovetheinformationavailable,sothatinvestorscanmaketheirlendingdecisionsonthebasisofaninformedassessmentofthefundamentals.Tobewellinformed,aninvestorneedstoknowagreatdealaboutboththespecificborrowerandabouttheeconomiccircumstancesoftheborrowerscountry.Wethereforeneedtostronglyencouragecountriestorequireimprovedaccountingandreportingfromtheirbusinesses,andwealsoneedtomakesurethatdataareavailableonthefinancialpositionofthecountryasawhole.Particularlyimportantinthisrespectaregooddataoncentralbankreservesandmoregenerallyontotalshorttermforeigndebt.Investorsalsoneedgoodqualitativeinformationonrisk,includingassessmentsofthequalityofcountriesbankingsupervision,bankruptcyprocedures,judicialsystems,andanyotherinstitutionalarrangementsthatcanhaveanimportanteffectonrisk.Second,manycountriesneedtostrengthentheirnationalfinancialsystems.Thereareseveralproposedinternationalstandardsforbankingsupervisionandregulationthatcouldbeadopted;ataminimumthereshouldbesomeregularsystemofassessmentandsurveillenceofbanksandotherfinancialinstitutions.ThereisausefulanalogyfromRobertMerton,arecenteconomicsNobelPrizewinner.Todaysglobalfinancialmarketsarelikesuperhighways:Theygetyouwhereyouwanttogofast.Bythis,Imeantheyareuseful:theyhelpcountriesfinanceinvestmentandthereforegrowth,andtheyhelpbufferandsmoothawayeconomicfluctuations. @-(, Butwhenbuildinganexitrampfromasuperhighwaytoanewvillage,itisessentialforthevillagetopavetheroads,installstreetlights,andmakesurethepedestriansunderstandthenewrulesofthegamebeforeopeninguptheexitramp.Anddriversshouldexercisecautioninnavigatinginnewandunfamiliarterritory.Idonotknowhowthemonitoringandreportingonfinancialandbankingsystemsshouldbeimplemented,thoughthereareseveralalternativeproposals.Onepossibilityisthatregulatorsincountrieswithstrongfinancialsystemscouldprohibitbanksfromcountrieswithinadequateregulatoryregimesfromparticipating.Regulatorsmightalsorequiregreaterriskbasedcapitalreservesforloansextendedtoborrowersincountrieswithpoorfinancialregulatorysystems.Final

ly,weneedtodevelopmechanismssothattheprivatesectorbearstheconsequencesofitsowninvestmentdecisionsmorefully.Perhapsthemoststraightforwardsolutionwouldbetoencouragecapitalflowstotaketheformofstockandbondinvestmentsratherthanbanklendinginaforeigncurrency.Pricesinstockandbondmarketsadjusttochangesinperceivedriskautomaticallyandinwaysthatcanposesubstantiallylesssystemicriskthanforeigncurrencydenominatedshorttermloans.Thissolutionfitswellwiththeotherreformpieces,becauseinordertofunctionwell,stockandbondmarketsrequiretimely,honest,andcrediblereportingoffirms'financialcircumstancesinotherwords,atransparent,wellregulated,andwellfunctioningsetofpubliccapitalmarkets.Buildingsuchmarketsisalongtermchallenge,notashorttermfix. @-(, Iturn,finally,totheimplicationsofthecrisisfortheUnitedStateseconomy.Intheshortterm,USexportstoEastAsiaarelikelytodropsharply,bothbecausethedropinincomeinEastAsiancountrieswillmakethosecountriescurtailspendingofallkinds, andbecausethesharpdropinEastAsiancurrenciesmeansthatUSgoodsarenowmuchmoreexpensiveforEastAsianstobuy.Atthesametime,ourimportsofgoodsfromEastAsiaarelikelytorise,becausethedropintheircurrenciesmakestheirgoodscheaperforustobuy.Theneteffectofareductionofourexportsandanincreaseinourimportswillbeasubstantialwideningofthe UStradedeficitwithEastAsia;indeed,preliminaryfiguresreleasedjustafewdaysagoalreadyshowasubstantialincreaseinourtradedeficitwithwithEastAsiancountries.Whileanincreaseinthetradedeficitmayseemalarming,itisreallyjustanaturalandappropriateadjustmentoftheeconomicsystemtotheEastAsianevents.Infact,manyeconomistsarguethattheslowdowninexportstoEastAsiamayhaveabeneficialeffectfortheUS.Forthepasttwoyears,theUSeconomyhasbeengrowingatapaceinexcessofitsestimatedlongtermtrend,withlabormarketsbecomingincreasinglytight.TheconsensusamongforecastersisthattheEastAsiancrisiscouldserveasthebrakethatsubduesgrowthtowardamoresustainablepace,preventingoverheating,andpermittingcontinuedjobgrowthwithamoremoderatepathforinterestrates.ThereisthefurthersidebenefitthatthesharpdeclinesinAsiancurrenciesandtheconsequentdeclineinthedollarpriceofimportsfromthatregionwillprovideatransitorydampeninginfluenceoninflation.Ofcourse,thereareresksattachedtothisoptimisticassessment;andadeterioratingtradebalancecancauseapoliticalbacklashevenifaggregatemacroeconomiceffectsaremodestorpositive.TheAdministrationwillneedtobepreparedtofighthardtokeeptheUSfromreactingtothosepressuresincounterproductivewayssuchasby @-(, increasingprotectionistbarrierstotrade.Insum,theAdministrationremainsdeeplycommittedtomaintainingandbuildingontheworldsincreasinglyopentradingsystemandtheinternationalinstitutionsthatpreservethatsystem;giventheoverallstrengthoftheUSeconomyitseemslikelythatanypoliticalconsequencesofarisingtradedeficitwillbemanageable.WithrespecttothelongtermimpactofthecrisisontheUSandtheworld,Iamanoptimist. Thecrisiscountrieshaveexpressedremarkablystrongcommitmenttomaintainingopentrade.KoreaandThailandhavetakenstrongstepstomaketheireconomiesmoreopenandfree,andKoreascourageousnewpresidentKimDaeJunghasshownapassionatecommitmenttobuildingasocietyinwhichbehindthescenesdominationoftheeconomyandsocietybygovernmentandbusinessconglomeratesbecomesathingofthepast.AtthispointitseemsreasonabletohopethattheultimatelongrangeeffectoftheEastAsiancrisiswillbetobuildastrongerandmoreopenworldeconomicsystem.Ifso,theUScanlookforwardtoafutureinwhichtheincreasinglyprosperoustradingpartners,inEastAsiaandelsewhere,developingcountriesbothbecomeabletobuymoreandmoreofourexports,andprovideusbetterandcheaperproductsinastheirownproductivityimproves.Suchafutureisbynomeansinevitablebuildingarobustfinancialinfrastructureforthe21stcenturywillrequireseriouscommitmentbyallthetradingcountriesoftheworld.ButsuchcommitmentseemstobeemergingascoutnntriesrearoundtheworlddigestthelessonsoftheEastAsiancrisis.Andso,Ilrepeat,Ilamanoptimist.================ END ATTACHMENT 1
================

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:17-APR-1998 11:11:09.00

SUBJECT: POTUS and per-mile premiums

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

TEXT:
Tom Freedman of the DPC says that he heard through the grapevine that POTUS likes per-mile idea!
Do you know anything about this? Maybe there is hope. Do you think we could ask DPC or NEC to set up a working group to consider the National Organization of Women proposal to allow people the **choice** of per Mile or per Year Premiums, or alternative ways to encourage per mile premiums? I can ask Tom if he would be interested in running such a thing.

I could prepare a proposal for a working group after doing the antitrust outline.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:20-APR-1998 11:05:26.00

SUBJECT:

TO: Jeremy B. Rudd (CN=Jeremy B. Rudd/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.D16]MAIL49054490U.126 to ASCII,
The following is a HEX DUMP:

Talking points on Japanese macroeconomic policy

If the Secretariat's forecast for 1998 proves correct, then this year Japan's economy will have grown at an average rate of about one percent per year over the past seven years. This would be a worrisome situation at any time, especially for a country that enjoyed real growth of roughly four percent per year over the preceding decade. What adds particular urgency to the situation in this case is Japan's position as the largest economy in Asia; simply put, economic recovery in Japan is a precondition for recovery in the region as a whole.

What to do is clear: Japan must undertake an aggressive, activist macroeconomic policy in order to expand its economy. The cornerstone of such a policy must be large-scale fiscal stimulus. We have abundant evidence that fiscal policy can have a pronounced effect on economic activity in Japan; over the past seven years, quarters in which fiscal policy was stimulative saw faster growth, and contractionary fiscal policy has assuredly acted to slow the economy. The situation in Japan provides a textbook case for expansionary fiscal policy: Japan faces a large (and growing) output gap, and monetary policy is extremely loose.

A fiscal stimulus package will most likely have to be large--perhaps as large as two percent of GDP. This reflects the depth of the slump the economy is presently in, the need to counteract what fiscal contraction is already planned for the near term, and the need to convince observers that the government is committed to sustained growth led by domestic demand. Moreover, a significant, *permanent* tax cut may have to be a part of such a stimulus package. Temporary tax cuts will have only transitory effects.

Finally, monetary policy should be kept as stimulative as possible. Obviously, with nominal interest rates as low as they are now, monetary policy will be unable to bear the full burden of promoting an expansion. But there is still some room to cut interest rates further, and no reason not to do so given that inflation is hardly a danger at present.

We frequently hear it asserted that Japan cannot afford to engage in expansionary fiscal policy because of a need to prepare for the demands of an aging population. I would like to challenge this assertion, however. It hardly seems plausible that maintaining anemic growth will better help the government prepare for future drains on the public pension system. And Japan has plenty of room to maneuver inasmuch as net government debt is less than 20 percent of GDP.

Expansionary fiscal policy is one of three critical steps that the Japanese government must take immediately in order to promote a recovery. In addition, longer-term emphasis must be placed on structural reforms in the areas of regulation and competition policy. The Japanese government's stated commitment to reform in these areas is very welcome, and implementation of such reforms will certainly raise Japan's output in the long run. But it is important to keep in mind that these types of policies will serve as complements--not substitutes--for substantial fiscal stimulus.

Finally, it is crucial for Japan to resolve outstanding problems in its financial sector. I would like to defer the remainder of my time to my colleague, Governor Meyer, who will discuss this point in detail.

Statement on private savings

The Secretariat's *Main Issues for Discussion* paper correctly points out that the United States' current account deficit has widened recently despite progress toward fiscal consolidation which we anticipate will be sufficient eliminate the Federal budget deficit in 1999 if not sooner. The question that arises, therefore, is whether, in spite of the attainment of a balanced federal budget, national saving is still insufficient, because levels of private saving are in some sense "too low."

This is a complicated question that involves a number of issues. First, I would address the point made regarding recent changes in the current account deficit. It is quite true that the U.S. current account has recently widened in absolute terms. However, as a share of GDP the current account is less than two-thirds as large (2.1%) as its 1987 peak (3.5%). This is not meant to dismiss the importance of recent changes in the current account deficit, but rather to point out first, that fiscal consolidation has been an important influence in raising the national saving rate (which has in turn reduced the relative size of the current account deficit), and second, that a longer-term perspective may be more useful in assessing changes in national saving.

From 1979 to the present, U.S. national saving as a share of GDP has dropped by about four percentage points. Of this decline, roughly eight-tenths of a percentage point has been the result of a lower public saving rate: although Federal government saving as a share of GDP has returned to its 1979 level, the saving rate of state and local governments has fallen. The remainder of the decline in the overall saving rate, therefore, has been the result of declines in the private saving rate, virtually all of which are in turn due to lower rates of personal saving.

Should we be concerned about this situation? We can approach this question in two ways. First, macroeconomic theory provides a useful analytical tool for determining whether a country's rate of saving is optimal--the so-called "golden rule." In essence, the golden rule implies that a country should save more if the net rate of return that individuals can receive on their additional saving is high enough to compensate them for deferring their consumption. Based on what we know--or think we know--about the rate of return on capital and other characteristics of the U.S. economy, it would appear that the rate of saving in the U.S. is well below the golden-rule level--that is, national saving is too low given existing investment opportunities in the U.S. economy.

If attractive investment opportunities are available at home but domestic saving is insufficient to pursue them, foreign investors can step in, and the resulting excess of investment over national saving is manifested in a current account deficit. In recent years, this has benefitted the U.S. inasmuch as it has allowed high rates of investment in capital equipment despite a low national saving rate. However, maintaining national investment over national saving comes at a price: growing indebtedness to foreign investors. In the long run, increased foreign indebtedness means that a larger fraction of future output will have to be transferred abroad in order to compensate foreign investors. Given the demands that will be placed on the U.S. economy over the next 30 or 40 years by the aging of its population, and given that many of the countries lending to the U.S. will face similar challenges in the future, a strong argument can be made that it would be better to finance more of our investment through higher national saving and less through borrowing abroad.

Second, from a microeconomic perspective the low personal saving rate is a problem if it indicates that individuals are not saving enough for their retirement. Available evidence suggests that a substantial fraction of the "baby boom" cohort is *not* adequately preparing for retirement, in the sense that they will not be able to maintain their pre-retirement standard of living after they retire. Once again, this indicates that the personal saving rate is "too low."

What are reasonable policy responses to this situation? On the macroeconomic side, further improvement in the government's budget position can help by directly raising national saving. Additional government saving will help to close the current account deficit; moreover, by encouraging capital formation this will also ease the burden on younger workers--who will be taxed to provide old-age pensions to retirees--by making them more productive. As we consider alternative methods to secure the financial viability of our old age pension system (Social Security) over the coming year, as the President has proposed, the Administration will be mindful of the benefits which could attach to accomplishing this in a way that raises the national saving rate.

While the current administration is receptive to implementing policies that encourage individuals to save, experience indicates that such policies are not easily found. In particular, it is unlikely that any single policy would be able to reverse the long-run downward trend in the personal saving rate. Obviously, this is an area in which knowledge of cross-country experiences would be extremely valuable.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:22-APR-1998 14:42:56.00

SUBJECT: Bankruptcy

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

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

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

TEXT:
Janet --

I just returned from a Deputies discussion of the pending bankruptcy reform legislation on the Hill. The Administration is trying to decide how to get involved in the legislative discussion, and what it wants to support/oppose.

There are a bunch of quite technical issues here, which I would be glad to brief you on. By the end of the Deputies meeting, there was broad agreement on the recommended Administration approaches to these issues. I am to let NEC know by noon tomorrow whether or not our Principle's want to discuss this, or whether they're comfortable lettting the NEC move directly into legislative discussions right away, based on the consensus among the Deputies. You have 3 choices:

1. I don't want to hear about it; there's too much else going on. No need for a Principle's meeting on this issue. (In this case we can immediately respond to NEC.)

2. The Principle's should discuss this issue regardless of where the Deputies came out -- it's an important one and we need discussion at the highest level. (In this case we can immediately respond to NEC, and I can brief you before the next NEC meeting when this would be discussed -- probably Thursday night.)

3. I want to hear where the Deputies came out and then will decide whether or not I think a Principle's meeting is required. (In this case I need to brief you this afternoon or tomorrow morning so I can get back to NEC by noon tomorrow.)

Let me know your pleasure.

Becky

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Donald R. Arbuckle (CN=Donald R. Arbuckle/OU=OMB/O=EOP [OMB])

CREATION DATE/TIME:22-APR-1998 20:05:59.00

SUBJECT: EPA OTAG SIP call rule

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 left in your office the language worked out between OIRA and EPA that would be added to the SNPRM, which EPA wants to publish very soon. It indicates that they will be evaluating subregional alternatives in the months to come. Fred Hanson, the Deputy Administrator, has promised a full and fair debate on the issue during the summer when more modelling data are done. (Some runs are due to be completed in early-mid may; others later in summer, perhaps July.)

The timing of this is not ideal, to say the least. But EPA feels very strongly it must try to meet the President's promise to complete this rulemaking by September this year. Fred argues that they need to publish now (rather than await the additional data and the debate we are likely to have on what it means), so that, should EPA decide to continue on the uniform trading approach, they can meet the September deadline. He has clearly committed to a debate with us on the merits of a subregional approach when the data are in, and the preamble language states that if, as a result of that debate EPA changes its approach, it will issue another SNPRM.

If you could look this language over, I would very much appreciate it. It is not as strong as I would prefer, but think its about the best we can hope for. For example, we tried to get EPA to acknowledge in the preamble that the September date may slip depending on the outcome of the dialogue on subregionalization. However, Fred felt this would be undermining EPA's effort to meet the September deadline, and, in any case, he has promised to debate the issue within the Administration. Please call if you would like to chat about this. I would like to get back to EPA on this as soon as possible. Thanks.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: William J. Antholis (CN=William J. Antholis/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME:22-APR-1998 16:41:41.00

SUBJECT: Toyota Prius Briefing

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

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

TO: Randall W. Lutter (CN=Randall W. Lutter/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:
which one of you economists is the free rider? (or am i getting this backwards, and there's really no such thing as a free ride?) see the attached
---------------------- Forwarded by William J. Antholis/OPD/EOP on 04/22/98 04:36 PM ---------------------------

Paul Risley <risley_p @ btgcinema.com>
04/22/98 07:36:51 PM
Please respond to risley_p@btgcinema.com
Record Type: Record

To: William J. Antholis/OPD/EOP, Peter R. Orszag/OPD/EOP
cc:
Subject: Toyota Prius Briefing

Briefing by senior toyota execs and engineers on Prius. 2-3 pm, tomorrow, Thursday, April 23, 722 Jackson Place. test rides and demo of car between noon and 5 pm. Please join us. Toyota specifically requested nec/cea participation if possible.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:23-APR-1998 23:44:38.00

SUBJECT: CDM vs T&T

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: Randall W. Lutter (CN=Randall W. Lutter/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:
Attached is a 2-page analysis Randy and I have worked on comparing CDM and target and trade. We would like to talk about it on Friday if possible.
(Janet and Jeff, I already left hard copies for you.)

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D62]MAIL467110316.126 to ASCII,
The following is a HEX DUMP:

CDM vs. Target and Trade

Inspired by comments that CDM is equivalent to target and trade, this analysis seeks to provide information about how CDM should be designed and its merit relative to a target and trade approach. This note presents an illustrative calculation suggesting that CDM, by focusing on "large" emissions reductions opportunities on a case-by-case basis, would likely generate fewer emissions reductions than the target and trade approach. Thus a target and trade approach should continue to receive priority over CDM in U.S. diplomatic strategy. For the purposes of this calculation, we address the CDM in the context of new investment in Chinese electricity generation, the sector where it might be most successful.

Electricity Generation in China

In 1996, China generated 925 billion kilowatt-hours of electricity, of which about 3/4 came from coal-fired power plants. Electricity consumption in China is projected to increase 5.8% annually between now and 2010. To generate this increase in consumption, EIA projects more than $300 billion of electric power investments over 1995-2010 in China, with about 72% going to new coal-fired plants and 22% for renewable (primarily hydroelectric). New gas-fired plants account for less than 1% of investments. Over this period, an annual average of 73 billion kilowatt-hours of generation would come on-line.

Carbon-Lean and Carbon-Free CDM Projects in China's Electricity Sector

Suppose that through the CDM, 10% of all new electricity generation in China is natural gas-based instead of coal-based. In 2001, this would be about 7 of the 70 billion kilowatt-hours, and in 2012, 13 of the 130 billion kilowatt-hours of new generation. Using the differential in carbon emissions per kilowatt-hour between natural gas-fired plants and coal-fired plants in the U.S. of 0.106 MMTCE/billion kilowatt-hours, CDM projects resulting in this 10% shift to natural gas over 2000-2012 would yield total annual emissions reductions of 15 MMTCE during 2008-2012. This shift to natural gas would reflect investments 34 times greater than the projected natural gas investment in China.

If the CDM projects stimulated a shift of 10% of all new electricity generation in China to nuclear instead of natural gas, then the nuclear investments would yield total annual emissions reductions of 39 MMTCE during the first commitment period. This shift to nuclear would result in more than 2 ½ times the projected BAU investment in nuclear in China.

The emissions reductions under both fuel switching scenarios are less than the SGM estimate that with international trade in permits priced in world markets at $26/ton, and a target at BAU, China reduces 275 MMTCE annually during the first commitment period. Only if 97% of all coal investments is diverted to nuclear, would CDM projects conducted through the electricity sector achieve the same level of emissions reductions.

The following chart illustrates the carbon emissions credits generated if CDM projects divert investments from coal-based power to natural gas or nuclear. It should be recognized that these calculations ignore offsetting increases in emissions that may result as more CDM projects lower coal prices and raise natural gas prices.

Electric Power Investments by Fuel in China, 1995-2010

Scenario	Coal	Natural Gas	Nuclear	Renewable	Emissions Credits during the Commitment Period (MMTCE)
EIA BAU (IEO98)	72%	0.3%	6%	22%	0
10% to Natural Gas	62%	10.3%	6%	22%	15/yr
10% to Nuclear	62%	0.3%	16%	22%	39/yr
70% to Natural Gas	2%	70.3%	6%	22%	108/yr
70% to Nuclear	2%	0.3%	76%	22%	270/yr

Implications for CDM

1) While present joint implementation rules assess emissions reductions on a year-by-year basis, awarding emissions credits by summing the entire stream of emissions reductions relative to the baseline at the time the project goes on-line could improve the attractiveness of CDM. Assuming that power plant projects have a life of 40 years and all 40 years of emissions reductions are credited on day one of the project, a shift to natural gas equal to 92 times the projected investment in natural gas would be necessary for CDM emissions credits to equal emissions allowances sold to developed countries under the target and trade approach. Under the same line of reasoning, nuclear power investments would need to nearly triple for CDM to equal target and trade. It is not clear that a tripling of nuclear power would be reasonable for a well-run CDM program.

More importantly, this approach raises three issues. First, since an effective CDM will require such large changes that calculating the baseline becomes critically important, especially since the CDM will result in changes in relative fuel prices that would offset some of the emissions reductions. Second, this approach creates a moral hazard problem. Since emissions credits are awarded on the first day of the project, an operator may shut down the plant prior to the end of its scheduled 40-year lifetime. Third, this approach is essentially emissions borrowing and so may draw a negative diplomatic response, since borrowing was rejected in Kyoto.

2) To achieve emissions credits in excess of these, efforts will need to focus on other sectors. However, the diverse nature of those sectors may present difficulties in developing a standardized approach to projects to minimize transaction costs.

Target and trade deserves continued high diplomatic priority because CDM is apparently significantly inferior to target and trade approaches in terms of potential carbon reductions.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:23-APR-1998 14:35:09.00

SUBJECT: Bankruptcy

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

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

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

TEXT:
Janet --

There is no agenda item tonight at the NEC meeting on bankruptcy, although they plan to hand out several piecees of information (including the background memo received the Deputies several days ago.) So I'm not sending you any information, assuming you'll get much of this tonight as a handout.

Instead, there is now a Principal's meeting on Monday scheduled to discuss this topic. Evidently the senior people at Treasury are not entirely comfortable with the current proposal, and want to propose harder rules (i.e., less discretion.) Essentially, they want to go with a "softer formula" approach rather than a "harder guidelines" approach.

This will all be discussed on Monday. I guess you should decide who you want to attend the Monday Principal's meeting.

Becky

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:24-APR-1998 00:17:00.00

SUBJECT: ICEED Conference on Kyoto

TO: Michele Jolin (CN=Michele Jolin/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: Rebecca M. Blank (CN=Rebecca M. Blank/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:
From Sunday night through Tuesday of this week I attended the 25th International Energy Conference sponsored by the International Research Center for Energy and Economic Development (ICEED) in Boulder, CO. The title of the conference was "After Kyoto: Implications for Energy Demand and Policy Choice". It was an excellent opportunity for me to meet individuals from industry and from other countries interested in climate policy. Below I provide a short review.

Issues addressed by conference

The conference included sessions on: climate change science (panelists: scientists from NCAR, NOAA) , the world energy outlook and Kyoto economic analyses (senior analyst with International Energy Administration, OECD), regional perspectives (economic reps from governments of Japan, Germany), economic outlook for Uzbekistan (Uzbek Ambassador to the U.S.), the Asian economy and energy use (MIT Ctr for Intl Studies, Indonesian Governor to OPEC), Industry after Kyoto (Enron, MIT Ctr for Intl Studies), Arab fin ancing agencies role in meeting future electricity demand in developing countries (Kuwait Fund for Arab Economic Development), oil producers perspectives of Kyoto (rep of Saudi Arabian government, consultant for Kuwaiti government), challenge of short-term oil prices and OPEC (large panel).

Comments I made during sessions

During the Q&A period of the first session on the science of climate change and how it affects policy-making, a rep of Enron asked about the U.S. experience with the SO2 program. One of the speakers I had met during dinner the night before fielded the question but he immediately suggested that it would be best for the representative from CEA to answer it. I gave a several minute overview of the program and its success to date along the lines of what we wrote in the ERP.

Withdrawal/Redaction Marker
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	Joseph E. Aldy to Michele Jolin, Jeffrey A. Frankel, Rebecca M. Blank, and Janet L. Yellen at 00:17:00.00. Subject: ICEED Conference on Kyoto. (partial) (1 page)	04/24/1998	b(6)

COLLECTION:

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

FOLDER TITLE:

[04/16/1998 - 05/14/1998]

2013-0723-F
ab1277

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]

On Tuesday morning, a representative of the British Embassy (Christopher Whaley) and I had a dialogue during a Q&A period on international emissions trading. He did grant that the EU position to constrain trading would result in higher costs, but said that the EU was concerned that the U.S. would not do anything at home, and then pointed out that the Administration's CCTI appeared to be in trouble on the Hill. We had a rather long pleasant talk after that session on this issue.

In addition, I made comments about the opportunities for CDM investment during the session on Arab financing agencies and future electricity demand in developing countries.

Contacts

I know more about the fuel cell than I ever thought I would. Several reps from Toyota spoke with me at length about their fuel cell technology, for both cars and electricity generation. In fact, if you saw the email regarding the Toyota hybrid car test drive in front of CEQ today, I am the "free-rider" mentioned by Bill Antholis. Further, I met with several economists, including Tom Rutherford (we spoke for a while about the latest round of EMF exercises, which he is participating in) and Jack Powelson (I had never heard of him, but apparently he used to do international work, and is basically retired now, but he gave me a prepublication copy of his new book, the Moral Economy -- he asked me to share it with the Council members). I also met several representatives of foreign governments (Kuwait, Saudi Arabia, Venezuela); some energy folks (Enron, Western Coal Assn, several oil companies), and a member of the press (a writer with the Oil Daily).

Appreciation expressed by ICEED Director

Dorothea El Mallakh, the ICEED Director, called this afternoon to thank me for my attendance and participation. She apologized for not inviting me to speak on emissions trading, given the comments I made on both the SO2 program and international trading. In addition, she wanted me to pass on her appreciation to the Council for sending a representative, and her hopes that CEA will continue to participate in future conferences.

I would also like to express my appreciation to you for sending me to the conference. I really enjoyed the opportunity to interact with people outside of the beltway on this issue. I made several contacts and I expect our dialogues on this issue will continue. (b)(6) [redacted] (b)(6)

Thanks.

Joe

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:24-APR-1998 12:43:31.00

SUBJECT: Comments by POTUS on Mergers

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: Mark C. Rainey (CN=Mark C. Rainey/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Rebecca M. Blank (CN=Rebecca M. Blank/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:
After the President gave a statement annoucning McClarty's resignation, the President took questions and was asked about mergers. Below is the Q&A.

Q Mr. President, are you concerned about the impact on consumers of the agreements announced between the four major airlines, and will your administration look into possible antitrust violations in those agreements?

THE PRESIDENT: Well, any decision like that, of course, is not one for the White House to be making. But I don't think we've had enough time to analyze it to know whether we have concerns or not, so I don't believe it's appropriate for me to make a comment yet because I don't know enough about it to make a good one.

Q Well, what about the trend in terms of the banks and so forth? I mean, the country is moving in that direction -- is that good?

THE PRESIDENT: Well, if it's being done to compete globally and there's still adequate amount of competition so that consumers are protected in terms of price and quality, but American business becomes more globally competitive, then it's a good thing. If it is a function of there being an awful lot of money around in the economy today and it's just one of those periodic bursts of mergers which may or may not have a good effect on consumers and may or may not lend stability to our economy, then it's much more questionable.

So I think that it requires a level of analysis about what is really going on here and why that I simply haven't had either the opportunity to do or to get advised on by my folks. So I think it's something that should provoke a lot of comment and a lot of thought; experts around the country should be writing op-ed pieces for newspapers; people should be thinking through this, but -- to help the American people understand it, because we've always had a native suspicion of bigness of all kinds in America. It goes all the way back to our beginning. It started with big government, and it's basically extended to all the large institutions in life. And Americans often feel that ordinary people don't have enough control over their lives anyway.

So I think that there is going to be this questioning atmosphere, but I would just say, we need to analyze each one of these on their own merits and ask the questions that I just put out. I'm pretty convinced that I just gave you the right questions to ask; I just haven't had a chance to analyze it and have experts talk to me about it and work it through.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:24-APR-1998 12:14:51.00

SUBJECT:

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

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D63]MAIL413484311.126 to ASCII,
The following is a HEX DUMP:

Questions and Answers Re Climate Change Testimony

[Need info on how large are cuts from projected 2010 emissions.]

Documents - Will have to get back to you on that.

Positions Then and Now: Won't comment on interagency discussions/positions. We have a treaty now and I have come to discuss it. A number of things have changed since our discussions--sinks, six gases, climate policy, extent of trading, CDM.

Don't comment on hypotheticals--focus on analyzing our policy positions--not every possible hypothetical.

Additional analysis - The testimony that I am presenting today is the Administration's economic analysis of the Kyoto agreement. As discussions of particular features of the agreement proceed and domestic implementation I expect that there will be ongoing analysis and discussion. Examples: trading arrangements, developing countries.

ACCOMPLISHMENTS IN KYOTO/THE AGREEMENT

Didn't you just cave in Kyoto?

Kyoto was a great success. The U.S. got:

- 3% emissions reductions below POTUS proposal
- six gases
- sinks
- Clean Development Mechanism, with certified reductions starting in 2000 counting toward compliance in the first budget period. This gives a benefit to early action.
- JI within Annex B
- multi year objective--our desired period
- International Emissions Trading among Annex B
- full flexibility on domestic policies and measures

But we still have work to do:

- need to define rules and procedures for market-based international emissions trading and JI.
- a framework to insure meaningful participation from key developing countries. The CDM is a down payment on participation but more needs to be done.

You said that the Kyoto treaty involves a 3% cutback in GHG emissions for the U.S. while the treaty says that the U.S. has agreed to a 7% cutback. Which is it?

- If we compare what we agreed to in Kyoto with the President's original proposal, we have agreed to no more than a 3% cutback over and above what POTUS proposed. POTUS proposed that the United States lower its net emissions of greenhouse gases--defined as gross emissions less removals due to sequestration in forests--to 1990 levels. The Protocol language, in contrast, says that the United States commits to lower its net emissions to 93% of our baseline gross emissions of GHGs based on combined 1990 and 1995 data. That's where the 7% cut comes in.

- Changing the baseline for the three long lived gases from 1990 to 1995 accounts for about 1% of the 7% reduction. Use of these three gases has grown since 1990, so that permitting a 1995 baseline allows for a higher overall baseline than the Administration assumed last October when POTUS announced his goal of reaching 1990 levels by 2008-2012. Making reductions to meet a higher baseline is easier than a lower baseline. This shift alone would have transformed the President's goal of 1990 levels into a goal equivalent to 1% below 1990 levels.

- Altering the accounting method for carbon-absorbing activities such as planting trees transforms the President's goal of 1990 levels into a goal equivalent to at least 3% below 1990 levels. The President's original goal assumed that carbon absorbing activities would be counted both in the 1990 base year and in the 2008-2012 budget period. However, the method agreed in Kyoto does not count sinks in the baseline (yielding a higher baseline); however certain sinks will count against emission reduction commitments in the budget period. This decision makes the U.S. target less stringent.

How large is the U.S. cut relative to projected total BAU emissions in 2008-2012?

The EIA's forecast of BAU CO_2 emissions in 2010 is 34% above 1990 levels.
BAU in 2010 for all six gases, excluding sinks, is about 40% above specified target.

ECONOMICS/COST TO U.S.

Factors Affecting Our Evaluation of the Economic Impact:

- "What" flexibility (sinks and six gases)
- "When" flexibility (our budget period, average over 5 years; banking till future periods; certified emissions reductions under the CDM beginning in 2000 count toward the 2008-2012 target)

- "Where" flexibility (Annex I trading, possible umbrella, JI in Annex I, Clean Development Mechanism, meaningful LDC participation)
- Efficient Domestic Implementation through permit trading
- Electricity Restructuring
- Possibility of "no-regrets" actions--those that improve economic efficiency while reducing greenhouse gas emissions. These are no-regret because they provide economic benefits without taking into account the benefit of GHG reduction. Examples include improved insulation, refrigeration, lighting control, use of public transportation and telecommuting etc.)
- Voluntary Industry Initiatives
- Technology/$6.3 billion over 5 years for R&D($2.7 billion) and Tax Cuts($3.6 billion)/Federal Energy Efficiency program
- Non-climate benefits (air pollution, traffic congestion, highway accidents)

Reaction to Studies with High Costs

Why are you telling me that the impact on the U.S. is so small whereas the EPI and others find a huge impact?

- It is easy to see how a study can come up with a high cost figure. In the absence of the agreement, total BAU emissions of the six gases are anticipated to be about 40% above the U.S. commitment level in the Kyoto Protocol. Thus, the commitment is very large viewed in those terms. Given current technologies, the fact that our capital stock turns over pretty slowly, pessimism about the possibilities for speeding technology or diffusion of existing technology, ignoring the treatment of sinks, emissions trading and CDM--so that we have to do it all here at home with existing technologies and most of the burden falling on CO2--big price increases are needed to cut energy use and they can have significant macroeconomic impacts.

- But, that is ignoring a lot of things that my testimony show to be important. Sinks alone could matter a lot. Annex I trading, or trading under the bubble, reduces price impacts dramatically and cost impact by 50%-75%. The CDM results in further savings and emissions targets by developing countries makes even more difference. These aren't minor offsets--these lower the cost by a huge factor. Recall, in the IAT report, the DRI estimate of $100 to attain 1990 by 2010 without trading turned into $9 under the trading conditions I just listed. Also, electricity restructuring will make a difference. And we know that there are "no regrets" policies that can save energy and save money if we make people aware of them.

- EPI, WEFA and other studies ignore many things we think are critical to mitigating the impact--particularly international trading and the CDM, but also six gases, sinks, electricity restructuring, the Climate Change Technology Initiative and industry partnerships. Ignoring upside potential on the technology side.

- There are process safeguards in place and periodic reviews. No country would sign this agreement in order to shoot itself in the foot economically and it's hard to believe that a future President or Congress would consider that reasonable. We think it can be done based on our analysis and judgement. We need to act--it is too risky not to act given the scientific findings. There are risks from waiting.

Do your simulations assume cutbacks by the developing countries? Shouldn't they have to cut back like we do?

- Since the economies of developing countries are likely to grow faster than developed countries in coming decades, these countries will contribute an increasing proportion of GHG emissions. An agreement among only Annex I countries to limit emissions will not ultimately succeed, therefore, in stabilizing global emissions. Eventually non Annex I countries must cut back too.

- *Nevertheless, we have assumed that developing countries included in the agreement would not be expected to cut back emissions at this time.* Our simulations provide them with permits equal to their likely baseline emissions. *Even so, they will choose to cutback because it is in their interest to do so.* They have the opportunity of earning income whenever they can cut emissions at less than the going permit price--and their are lots of opportunities for them because they are so energy inefficient. Their inclusion in a trading regime, even if they are not required to do anything, is a win-win situation. It's a win for us because we can abate CO2 at low cost and put them on a much better energy path than the one we traveled along when we industrialized. It's a win for American businesses because they have a chance to develop industries that will cut emissions around the world. It's a win for them because they earn income and help improve the global environment as well as their own. The important thing about emissions trading and JI is that these schemes create the right incentives to economize on greenhouse gas emissions everywhere they are in place--even in countries that are not required to cut their own emissions. That's critical it fostering energy efficient investments and in avoiding concerns about competitiveness. Even if a LDC isn't expected to cut back its own emissions, it will have the incentive to avoid attracting industries that produce GHGs, because higher emissions of GHGs by industries that are energy intensive will use up that country's emissions rights and result in revenue losses to a country or its firms that could otherwise have sold unused permits.

- The ability to trade permits would be a big incentive to *eliminate subsidies for energy and gas.* In developing countries, it is estimated that electricity prices were, on average, 30% below long-run marginal cost. Reforms in Russia, central Europe and China have contributed to closing that gap. But there are still probably hundreds of millions of tons of CO2 that could be reduced by elimination of coal subsidies and price supports. Article 2 also recognizes the importance in all countries of removing taxes and subsidies.

As we go forward, we will have to decide what is meant by meaningful participation, but identical targets for developing countries and developed ones would not seem fair given our higher income, and much higher per capita production of greenhouse gases.

COMPETITIVENESS

If developing countries don't cut emissions won't that damage U.S. competitiveness and cause energy intensive industries to flea?

- The inclusion of key developing countries in a trading scheme, even if they are not required to cut back their own emissions, mitigates the concern about competitiveness. This is true because for any country in that scheme, it is costly to emit carbon--costly for the LDCs in the sense that they are foregoing the chance to earn extra income by conserving carbon emissions. Any member of the trading scheme will want to insure than industries operating in their borders use energy efficiently, because if they use it inefficiently, they impose a revenue loss either on themselves or on the government, that could gain from selling permits.

- We do not, in an event, expect a substantial impact on energy prices. Remember that, on average, energy accounts for only 2.2% of total costs to U.S. industry.

- With respect to our developed country competitors, they will be making the same cuts we are.

- We shouldn't exaggerate the impact of energy prices on location decisions. Today, energy prices already differ significantly around the world. For example, in 1996, premium gas cost $1.28 in the U.S., $0.08 in Venezuela, $3.71 in Switzerland and $4.41 in France. Yet U.S. industry is not moving en masse to Venezuela nor is European industry fleeing to the U.S. Similarly, with respect to wages; a good share of our imports come from countries with higher wages than ours and over half of our foreign direct investment is in countries with comparable or higher wages. The impact of variable cost factors on location decisions is easily exaggerated.

- We have a sector that is already highly competitive and will become more so as a consequence of this agreement--the energy efficiency/alternative energy sector. As countries expand their own domestic climate change action plans, significant export opportunities will open up for U.S. manufacturers in these fields.

You agree that energy prices will rise. Isn't that just a tax?

The President has not proposed a tax increase. Quite the contrary, he has proposed tax cuts to stimulate energy efficiency and to jumpstart technologies that can provide lead to big cutbacks in energy use. This plan relies on win-win strategies and carrots, not sticks. He has also proposed voluntary emissions reductions, spending on R&D, working with industry. And he will propose energy restructuring that will lower energy prices for all households. There will be periodic reviews to see how effective these initiatives are. Only in 2008, has the President proposed an emissions trading system that would determine a market-determined price, not a tax, on carbon emissions.

- We expect gas prices, under the conditions I have specified to rise less than $.05. You have to put this in perspective. An increase of this amount is less than the normal year to year or seasonal variation in gas prices. On average, gas prices have changed since 1983 by about 8 cents per year in absolute terms--equivalent to a $31/ton price of carbon.

COAL

What will happen to the coal industry in the United States under your scenario?

- Remember we don't have a binding agreement at this point and won't until the Senate ratifies a treaty. A permit system would not be put into place for a decade under POTUS proposal, so we are talking about impacts a decade away.

- Coal has the highest carbon content per unit of energy among fossil fuels and is a major source of greenhouse gas emissions and any strategy to reduce greenhouse gas emissions is very likely to impact the coal industry. It is the industry in the United States that is most likely to see an impact from the policy. Indeed, coal prices will be most sensitive to pricing of carbon emissions permits once such a system is in place.

- The coal industry begins from a situation in which, due to rapid productivity growth, employment has been declining notwithstanding output growth. Even without a GHG emissions plan, national coal employment was projected to fall substantially.

- Even so, we should not exaggerate the impact of this policy on coal. For example, using the SGM model to gauge possible impacts of a carbon permit price in the $14-$23 range suggests a possible reduction in coal use of 7% to 13% below BAU in 2010. The price of coal would rise by $7 - $13 per ton. However, coal use would be expected to grow by about the larger amount between now and 2010. So the impact could be to reduce, even substantially, growth in coal output, but not to lower coal use absolutely in the United States. Recall, that the U.S. will be expected to attain a fraction of its commitment through international emissions reductions.

- The President is fully committed to helping workers adversely affected by climate change policies.

- It would be wrong to write coal out of our energy future because there is the possibility of increasing the energy efficiency of coal and also, ultimately, of developing techniques to sequester the CO2 emissions from coal. The President's climate change initiative seeks to develop lower-carbon coal combustion technology that offers the possibility of much lower carbon emissions than existing technologies and sequestration techniques. The DOE Office of Fossil Energy's program, Vision 21, has the goal of developing a power system that is highly efficient, produces no appreciable air pollutants and has no net carbon dioxide emissions (due to sequestration). (Technologies for CO2 capture and sequestration are being deployed today. In Norway, for example, Statoil is using state of the art technology to sequester CO2 from production of natural gas in saline aquifers under the North Sea. These and more economical methods could be applied to coal systems. In addition, the goal is a system that produces power at a cost that is competitive with natural gas. The PCAST report indicates that this is very ambitious but has some chance of being realized and is an appropriate target for DOE.

- Even in the absence of any policy it is projected that natural gas will account for a growing proportion of electricity generation. In 1990, coal accounted for 53% of total generation. By 2020, the share of coal is projected to decline to about 44%. This is due to the use of highly efficient and low-cost natural gas combined cycle power plants, which makes natural gas the choice fuel for electricity generation. Substitution away from coal in electricity generation toward natural gas and renewables is an important source of conservation in the U.S., along with increased energy efficiency.

NUCLEAR

Could nuclear have a role?

Yes. With respect to nuclear power plant life extension, DOE will initiate an R&D effort addressing the critical technology needs to allow currently operating nuclear power plants to safely extend their operating lifetimes by 10 to 20 years.

In its November 1997 report, the PCAST Panel on Federal Energy R&D determined that establishing nuclear energy as a viable and expandable option was important and that a properly focused R&D effort to address the problems of nuclear waste, proliferation, safety and economics was appropriate.

AUTOMOBILES

What about automobiles?

- There is no question that the automobile industry has the potential to find the innovative solutions necessary to address global warming concerns. This has already been clearly recognized by the industry. John Smith has stated flatly that "no car company will be able to thrive in the 21st century if it relies solely on internal combustion engines." Harry Pearce, GM's Vice Chairman noted recently that "effort to reduce emissions levels is more likely to succeed when driven by innovation, not regulation, but that the government can and should play a significant role in enabling the framework for the market to succeed.

- Pearce said: "Government can serve as a catalyst providing leadership and incentives, educating the public, creating rational tax and regulatory policies and supporting long-term research efforts." That is what the PNGV, the fuel-efficient car tax program and the DOE research and development initiatives are designed to do.

- We have been very heartened by the recent announcements of all of the major auto producers that they are nearing production of marketable cars that rely less on gas burning engines and more on more fuel efficient alternative power sources like fuel cells.

Well what would the cost to households and the impact of permit prices be in the United States if none of this trading works out at all?

- It depends on a wide variety of things--how successful our climate change initiative is; the pace of technological change, electricity restructuring, the role of sinks, six gases and so forth. It's very hard to say.

- Big numbers can come about under sufficiently strict assumptions, but none of those numbers relate to our policy. Those numbers aren't our policy.

- In a recent paper, the SGM modelers report that in four scenarios they consider, including one that involves a 10% cut off 1990 levels, the economic cost to the U.S. remains below 1% of GDP through at least the year 2020 even in scenarios where the United States meets its mitigation targets without international trading of carbon permits. However, the price of carbon permits would rise, in most models, substantially more than I've estimated. For example, the Five Labs study, which is at the optimistic end of models, envisions a $50/ton carbon price to reduce emissions to 1990 by 2010. [In the SGM simulations, the Kyoto protocol results in a domestic emissions price of $171.]

How have you measured cost? What is that?

Cost refers to the direct additional resource cost required to reduce emissions. It is the approximate sum of the marginal cost of abatement over all abatement units. The first unites of emissions reductions are quite inexpensive; successive units become more and more expensive. These costs include transfers abroad. These do not include any costs of establishing a domestic or international permit trading system or any transactions costs associated with permit trading among firms or regions. The cost is estimated as 1/2 x permit price x required abatement (600 = 2040 BAU emissions - 1440 mmtc)

Aren't the costs you estimate very sensitive to assumed growth rates in the U.S., the world and other features of the Baseline?

Yes, the cost estimates do depend on assumed growth rates worldwide and other features of the baseline. In particular, faster population growth or economic growth could raise the cost.
The assumptions for the U.S. come from the Annual Energy Outlook (97/98?). It is assumed that the U.S. grows at an x% real rate and population grows at 0.85% per year. On average, energy consumption is projected to rise at 1.1% per annum. In the SGM baseline, E/GDP falls at 1.0% per year.
Assumptions for other regions come from the World Energy Outlook 1996. For Eastern Europe and the FSU regions, projected energy consumption was adjusted downward. Population projections were based on World Population Projections 1994-95 of the World Bank. U.S. population and crude oil prices were taken from AEO97.

How much emissions reductions occur in the U.S.?

- It is hard to offer a definitive answer to that question. There is **no cap** on how much we can do at home. **It depends, in particular, on some of the things that are hardest to quantify**, such as the impact of our climate change initiatives. The President has indicated that we are fully committed to tackling the issue of climate change here in the United States in a serious way and the government will lead the way by improving our own energy use. The challenge facing the Administration and the environmental community is to translate this commitment into meaningful action here at home. This means increased attention to energy conservation here and improved diffusion of all of the energy conserving opportunities that already exist that we know can reduce emissions and save money at the same time. We are committed to promoting these win win ideas and that's what the climate change initiative is about. Industry has told us that they see large opportunities to conserve GHGs and we propose to work with them to effect these changes. The Federal government has opportunities to improve its own performance. The more effective these initiatives are, the more mitigation we will end up doing in the United States. On top of that, we have the chance to meet part of our obligation by **planting trees**--which would entail more domestic action. We also expect **electricity restructuring** to make a contribution to reducing emissions.

- I have pointed to the importance of international arrangements, however, and I expect them to be used in meeting our obligation. It is a fact that their exist demonstrable opportunities for efficiency improvements at low cost in so many countries around the world that gives me the confidence to predict that the costs of the agreement will be modest if we obtain strong trading agreements. That does not mean that we will not do our part here at home.

But in the SGM model simulations you reported, how much is done abroad?

In the simulations, 75-80% of the abatement is done abroad, but for the reasons I have given you--sinks, climate change initiatives, electricity restructuring, improved diffusion of existing initiatives--I do not think these simulations provide a good estimate of the U.S. share. I have always said that any single model and even many models alone do not provide a sound basis for judgement. These models should inform our thinking, and they have, but they are not a substitute for good judgement.

JOB LOSS

How can you argue that there will be no job loss?

- In the United States, we rely on market mechanisms and sound monetary and fiscal policy to keep unemployment low and jobs abundant, as they are right now. Opportunities to do business shift all of the time across firms and across sectors for many reasons, whether its mergers and consolidation in banking, health care or telecom, the invention of new technologies that creates demand for new products and reduces demand for existing products or market opening agreements that create opportunities in export industries while shifting them away from import-competing industries. In fact, research shows that in a typical year, about 10% of all jobs in the U.S. economy are destroyed, but a slightly larger proportion are created. It would be wrong to think, for example, that shifts like these affect the total number of jobs available in the U.S. economy overall, rather than just the sectoral and regional allocation of jobs.

- Adjustment is a fact of life that American workers have to adapt to and the role of government is to give workers the tools to make those shifts and to insure that help is there when adjustments are difficult.

- We predict a very small impact on energy prices in the U.S., so I see no reason to assume that significant structural adjustments will be needed to accommodate the Kyoto protocal emissions cuts. I would expect price changes that are so modest in size and so fully anticipated a decade in advance to have no significant impact on inflation or unemployment. The industry that is likely to be most severely affected by the agreement is the coal industry, because domestic emissions reductions are likely to disproportionately affect coal.

- Job loss estimates usually come from short term macro models like the DRI model that are not appropriate for predictions of long term changes. In the EPI study, the model was run with assumptions giving a worst case result--a $200 permit price, increased emissions baseline and no trading. Trade effects were important, which probably reflects weak modeling.

- In the case of the oil shocks, the impacts were large, unanticipated and involved large transfers to the OPEC countries. These supply shocks caused inflation to surge and the Fed tightened monetary policy, raising interest rates. This is not what we will get with Kyoto.

What about revenue recycling?

The SGM runs we have reported assume that any revenue that could be obtained from auctioning permits are redistributed back to the economy through a lump-sum transfer. There are potential efficiency gains that would lower costs if the permits are auctioned and any revenues use for cutting taxes that impede work and saving. On the other hand, the permits can be allocated in ways that generate no revenue whatever. This is what was done in the SO2 case.

Why are you so optimistic about international trading but conservative about technology?

Our conservative approach is to avoid rosy scenarios as in budgeting. I am optimistic about trading because it is in our control to get it and make it work. We know that there are big differences in mitigation costs across countries that can lower overall costs and we will work to insure effective trading arrangements. Technology is out of our control. We can work to promote it, but there is an element of unpredictability.

You emphasized all of the uncertainties in estimating the costs of Kyoto. In light of those uncertainties, doesn't it make sense to wait to tackle climate change?

- The science is clear and compelling and the danger is real. To wait to address it at all would be foolhardy. The most important reason we have to begin is that the costs of inaction are very real and we cannot ignore the environmental consequences of a failure to begin what will be a long journey. America has to show leadership in tackling this task.

- There are real uncertainties about the costs; but we feel, based on a wide range of economic analysis, that they are likely to be modest if we are successful in obtaining a strong treaty, everything considered.

- And we have purposely constructed a process that builds in the uncertainty with period reviews. In the face of uncertainty, it is important to take a step and reevaluate things. With each step we learn more and improve our options. And we can constantly reassess and allow policy to evolve. We do not plan to implement an emissions trading mechanism for a decade and we will learn a great deal between now and then. **We begin with options that are clear wins for the economy**--that provide incentives for early action and opportunities for firms and industries to put in place voluntary plans to reduce emissions that reflect their own knowledge of how they can best proceed. We will work with industry to do our part to eliminate regulations that impede energy efficiency if we can do so without endangering the ultimate goals of those regulations. We will pursue a Federal government program to increase efficiency in our own operations. **These are all win-win options.** Our industries are excited about the possibility of working around the world to lower emissions in countries that are poised for rapid growth and have a real chance to avoid locking themselves into an energy intensive, CO2 intensive path of development. There are real opportunities here for American business that can jumpstart whole new industries and create good, high paying jobs in a dynamic sector.

- Worldwide, countries that adhere to this treaty anticipate that the costs will be modest--otherwise none of them would be willing to sign it. My guess is that no future President of the United States would undertake actions that would bankrupt this country economically in order to meet these obligations.

- If we don't begin now, we won't get the **technological payoffs** we need to get the cost down later. *With respect to technology policy--there are very long lead times.* If we want to make good on stabilizing concentrations--not just emissions--we have a great deal of work to do--emissions will have to fall well below current levels--toward close to zero. Even stabilizing world emissions at 1990 levels requires great changes in the way we use energy. If, as anticipated, the world's population doubles, stabilizing emissions at 1990 levels requires that average global per capita emissions must fall from approximately 1 ton per yr to 0.5 ton per year. Right now, the U.S. per capita emissions are approximately 5 tons/yr. To do this requires enormous changes in technology. It would be foolish not to begin. *Right now, we have a window of opportunity--some breathing space to provide an orderly transition from existing carbon intensive enrgy technologies to non carbon energy technologies. Depending on the suite of technologies available at the end of the first quarter of the next century, the cost of stabilizing the atmosphere can vary by trillions of dollars.* We can waste no time in developing those technologies--it can matter enormously to the cost of the whole project. While technology holds the promise of low cost atmospheric stabilization, recent energy R&D investment levels in the U.S. have been declining. Both public and private sector R&D are declining both as a fraction of GNP and absolutely.

- *Another reason relates to irreversible investments.* We just can't afford to make investments now that lock in carbon inefficiency for decades to come--either here or particularly in the developing world. We need to put in place the right signals now to take emissions into account in long-lived investments.

- If we wait, we will be faced with doing more in a shorter period of time. Adjustment costs are always lower when policies are phased in gradually--avoiding severe sectoral and regional jolts.

- *Another reason is that until we show a credible commitment, the developing countries won't be willing to participate.*

THE BENEFITS

Why didn't you quantify the benefits and do a full cost-benefit analysis?

- Quantification of impacts of climate change is difficult and uncertain. Our knowledge is incomplete.

- Given the long time frame, discount rate is critical and this is deeply ethical question.

- Uncertainty and risk are central--possibility of catastrophe.

- The Kyoto agreement will not, by itself succeed in stabilizing concentrations of GHGs. It will delay but not arrest the increase in concentrations. In this sense, it is phase 1 in the overall process of dealing with climate change. It is difficult to measure the benefits without knowing what will happen after 2012. Stabilizing concentrations requires an eventual stabilization of emissions world wide at a level much below current levels and that cannot be achieved without the involvement of developing countries.

COOPER

In a recent paper in *Foreign Affairs*, Richard Cooper, a predecessor of Stu Eizenstat, said that Kyoto is fundamentally flawed because of its reliance on quantitative targets--that the framework will be unacceptable to developing countries and that we should have common actions. Do you agree?

- The problem of dealing with an externality of the size and scope of climate change has spawned a very interesting academic literature about alternative procedures. Everyone agrees that it is hard to find a way forward, and a number of researchers think that common actions is an approach with promise.

- The U.S. position has been that we do not want to have our tax policy set by an international body--we want the domestic freedom to set our own policies. I don't think such an approach would be politically appealing in the United States. That's why freedom to implement policy as each country wishes has been fundamental to the U.S. position.

- Cooper recognizes, as we do, that it can greatly reduce costs to have international emissions trading. We recognize that such trading results in international transfers, but we think it is quite acceptable to give American businesses the opportunity to go anywhere in the world they want to reduce emissions. We think it should be attractive to developing countries to cap their emissions a bit below BAU levels in order to sell permits and gain from reducing emissions. I don't see this as unacceptable. We all recognize that, given their income level, their low per capita emissions now, and their history of low emissions, it would not be fair to expect effort from the developing countries on the same scale as on the part of the developed countries.

- Cooper estimates that the typical American family of four could be expected to pay $2200 a year to sustain its current level of emissions and total transfers would amount to $130 billion per year. This assumes a very high permit price and we don't agree it will be anywhere near that high. Under our assumptions about permits, we could not envision transfers of much about $10 billion ($100 per household per year) even if we did not domestic emissions cuts.

NORDHAUS

According to Nordaus, the economic optimum has a net benefit over no controls for the global economy (in terms of the PDV of consumption) of $270 billion in $1990. However, stabilizing emissions at 1990 levels imposes major net economic costs--a net PDV loss of $7 trillion. Attempting to stabilize climate would have a net PDV cost of around $41 trillion. It would take a major misestimate of either costs of emissiosn reductions or climate damages to make the stabilization options economically advantageous. Do you agree?

- Like almost all things in economics, the answers one gets depend critically on what one assumes. Nordhaus assumes that future technologies will improve at about the same rate as in the past. He does not vary the trend rate of improvement in technology with the price of carbon permits. However, costs will be lower than he estimates if price effects stimulates new technology.

- These models may not give adequate consideration to the scale of potential damages, even in the absence of catastrophe. They may not account adequately for the costs of a less stable climatic and ecological systems in the face of GHG accumulations. In a survey of experts, Nordhaus found that the median cost prediction for a 3 degree C rise in temperature was 1.9% of output annually--40% higher than his own.

- These calculations depend critically on the discount rate. In the Nordhaus policy, carbon concentrations grow without bound. We compensate our children for an ever deteriorating environment by investing more and leaving them more income to deal with it or to offset the costs on living standards. Many consider this ethically unacceptable. With a 1% discount rate, rather than Nordhaus' 3% rate, the optimal carbon tax rises from $5.3 in 1995 to $23.6.

- They ignore the risk of catastrophic damages and the insurance value of a climate change policy. The optimal decision depends on how uncertainty is handled.

- The lack of early action could signal a lack of political will and retard induced technical progress needed to make mitigation affordable.

- Kyoto should be viewed as a beginning--a first step. It is not a complete plan and there will be ample opportunity to both evaluate how we are doing and debate next steps after this. In the Nordhaus analysis, the mean, as opposed to the median, optimal carbon tax is on the order of $18/ton in 2005. This is in the range of the estimates consistent with the SGM model.

- Kyoto is not stabilizing emissions at 1990 levels worldwide--growth in emissions will be cut, but will not fall absolutely. The permit price that we anticipate for the U.S. is not very much higher than what Nordhaus would consider optimal.

CEA POSITIONS/ANALYSIS

When you last appeared before this committee you said that modelling is futile and now you are telling us about one model. How can that be?

What I actually said was:

- "Both the lessons and the shortcomings [of the IAT project] point to one clear conclusion, which is that the effort to develop a model or a set of models that are going to give us definitive answers as to economic impacts of any given climate change policy is futile. Rather we are left with a set of parameters and relationships that influence estimates of the impacts."

- "We don't believe there can be a single model. I think we are at the end of the road on that exercise."

- "I think if I leave you with any message today at all, it should be that we should not place our reliance on any particular model or even a large range of models and that attempting to find precision with respect to estimates of GDP changes or job changes or price changes is a futile exercise? We are not going to continue in any search for perfection here, but there are a lot of models. ...Each has its strength, each model has weaknesses....So I don't think we should be looking for truth here in the form of a single set of numbers. As we go forward, though, I think the models, the economic analysis, offer us some insights."

- "I think that the committee should expect analysis in support of a policy that we propose. It is our obligation to explain why we think it will be appropriate for dealing with this problem and good for the American economy, but if by forecast what you are saying is what is the impact on the number of jobs in the steel industry in 2020, I think that is something that we shouldn't try to produce. I think that is a hopeless, futile exercise. The kinds of uncertainties that we are dealing with here, I think, preclude being meaningful with attempting to come up with that kind of detailed number."

- "I think we have concluded that when we ultimately develop and propose a policy, we will not rely on this tool kit (solely.) We will bring to bear many pieces of economic analysis done by economists in the government and outside the government and what we are giving you is the staff work as of the end of May, according to your request."

What did CEA do to get the results you reported from the SGM model?

- We first constructed region and country specific cost curves for carbon dioxide abatement from various SGM model runs. We added an EPA-developed analysis for non-CO2 GHGs for the United States and integrated these two sets of data to get marginal cost of emissions reduction for all 6 gases.

- We constructed baselines for all 6 gases for all Annex I countries to estimate the magnitude of necessary cuts required of Annex I countries under the Protocol.

- We identified market clearing prices for various trading blocs using the cost curves.

- We converted permit prices to estimated energy price effects and household impacts using data from Treasury.

What other work did CEA do with respect to Kyoto and when did CEA do it?

CEA has been actively involved both before and after Kyoto in economic analysis. CEA staffers participated in the IAT working group meetings. CEA has reviewed the full literature available on the subject of global climate change. We participated in interagency discussions through the NEC on all aspects of the treaty including domestic implementation, JI, technology initiatives, tax initiatives, developing country participation, targets and timetables. We have had a wide range of contacts with professional economists around the country who are working on these topics and have benefitted from analysis provided to us from a number of sources including the SGM modellers, the G3 modellers, the MERGE modellers, the EMF at Stanford. During Kyoto, CEA staff were in communication with the negotiating team to offer very rough analysis of the likely impact on costs and permit prices of alternative proposals under consideration. This includes the impact of sinks, the inclusion of six gases, the umbrella and other trading arrangements and the impact of alternative targets on U.S. permit prices. We have also been involved in interagency discussions of electricity restructuring.

Wouldn't it have been a lot less costly to stretch out the timetable for reductions? Didn't CEA propose to go to 1990 by 2040?

- The Administration had a thoroughgoing assessment and debate about targets and timetables and it would not be appropriate for me to comment on the positions that we took or that others took in internal discussions.

- With respect to the issue of timetables, there are arguments for and against going slower: the *arguments for going slower* include the argument of waiting for superior technology to lower abatement costs and avoiding premature shutdown of coal fired power plants--avoiding premature depreciation. But there are also *good reasons to move more rapidly.* With effective international trading, many of the arguments for going slow lose force, since the reductions that are likely to be undertaken early on are cheap ones--the low hanging fruit-- and are not likely to entail either premature power plant shutdowns or premature use of technology. Moreover, there is scope for no regrets policy. In addition, credibility requires meaningful immediate action and not just the promise of future action. For investors to take proper action today in long lived investments proper expectations are needed. Moreover, diplomatic issues are also important: we wanted to obtain an international agreement to bring everyone on board. A slower timetable would not have commanded international agreement. A slower timetable would also increase the carbon concentration, all else equal. Early reductions reduce the risk of catastrophe.

By how much will the agreement reduce temperatures?

With or without the agreement, temperatures will rise as a consequence of the increase in CO2 concentration. The agreement will mitigate that increase a bit, and delay the time of doubling of concentrations, but how much depends on what the developing countries agree to and what targets and timetables we agree to after the first budget period. (An aggressive Annex I emissions path that stabilizes emissions at 1990 levels by 2010 and maintains emissions at the 1990 level thereafter would mitigate temperature increase by roughly 0.1 degree by 2050 and 0.2 degrees by 2100.)

How does your work differ from the IAT analysis? You seem to have relied on just one model whereas they relied on three?

- In forming our judgement about economic impact of the Kyoto accord we have relied on a broad range of tools including many energy sector models and reviews of the literature.
- We have also tried to take into account some features of the agreement and the President's climate change initiative that were not included in the IAT report, including sinks, 6 gases, electricity restructuring, and so forth.
- However, our results are broadly consistent with the results of the IAT report, which indicated that with international emissions trading, and joint implementation, the economic costs and impact on energy prices would be extremely modest. We also performed many simulations with the SGM model, which was included in the IAT report.

- In response to critiques of that study, our simulations typically involved less optimistic technological assumptions. We also attempted to perform analysis that was responsive to critiques of the IAT reviewers. In particular, we have consulted with the Stanford Energy Model Forum to encourage broad scrutiny of the Kyoto agreement and to gain insights from a wider array of energy models.

  For example, work by the OECD concluded that requiring proportional cuts by all parties rather than efficient cutbacks through equalization of marginal abatement costs across countries could approximately double the aggregate costs.

PAPER TONS/INTERNATIONAL TRANSFERS

How can you justify giving Russia over 200 (214?)million metric tons of permits in excess of its emissions. It will not need such emissions until 2020.

> The concept behind the international trading scheme adopted at Kyoto is that all countries with targets may trade to effect compliance. Countries can sell emissions permits if they hold their actual emissions below their allocations. Some countries will enjoy excess emissions credits because they are more efficient at domestic reductions, or because they have grown slowly or undergone a major economic transition. Allowing these countries to sell credits lowers the domestic costs of greenhouse gas reductions in the U.S. and provides those countries with the resources to invest in the most climate friendly technologies as their economies recover. Russia could easily need these permits if her growth resumes and Russia can also bank the permits for future periods when she is very likely to require them.

Aren't we transferring huge resources to Russia?

> There will be no taxes on Americans or government transfers to Russia. However U.S.

firms--not the U.S. government--may choose to purchase international emissions credits if they so desire to meet their emissions obligations--from Russia or other countries or through the CDM. As with any market transaction, purchases of these credits will have to comply with all U.S. legal and regulatory requirements. U.S. firms interested in international investment and emissions credits will have an incentive to ensure that other countries meet the international standards for adequately monitoring and reporting their emissions of GHGs. Russia will have a significant incentive to use the revenues to invest in modern, climate-friendly plants and equipments so that as its economy recovers, it continues to produce emissions credits for sale on international markets.

How sensitive is the price to the U.S. to the Russian paper ton gift?

By how much will the total Kyoto agreement cut emissions relative to BAU given the 214 mmtc gift to Russia?

The Kyoto agreement amounts to a 5% cut for A1 relative to 1990 levels and an 18% cut for A1 relative to BAU in 2010.

DEVELOPING COUNTRIES

What are the possible benefits of the CDM?

- Lower costs of reducing emissions: A strong incentive for companies and countries to search the globe for the lowest cost ways of reducing GHG emissions.

- Expanded exports of U.S. technology: enormous potential for JI projects around the world creates major opportunities for the increased sale of U.S. energy efficiency and alternative energy technologies.

- Technology transfer: Increased reliance on more energy efficient technologies and less carbon-intensive energy alternatives will help developing countries meet their growing energy needs with more environmentally sustainable solutions.

How much potential is there for reductions through the CDM?

- Energy Efficiency is low in many parts of the world, so the potential gains are large.

    - A World Bank study suggested that emissions reductions in China before 2020 could save roughly as much in carbon emission as the U.S. would have to reduce to achieve 1990 levels by 2010 through negative cost energy efficiency improvements. Anecdotal evidence describes the untapped potential for efficiency gains in developing and transitional economies and highlights the success of JI pilot projects. Chinese coal fired boilers are only 2/3 as efficient as US boilers. Retro fitting Chinese plants with US boilers saves more money than it costs. Retrofitting Khrushchev era Russian apartments saves 30% of heat use and saves more money than it costs. Many other negative cost efficiency improvements have been identified for Russian industry, including the use of quality insulation around steam piping, improved energy control systems and more efficient motors.

- New Capacity. Due to their high growth rates, developing countries have an advantage over the OECD in their ability to meet targets by installing new, carbon efficient plants rather than by expensive retrofitting of existing plants. In the OECD, we face the prospect of replacing functional coal plants with new natural gas plants. Large changes in coal prices are needed to make that sensible. Developing countries will instead balance the costs of installing new natural gas plants against the costs of new coal. Little coal price adjustment is needed to make natural gas the economic choice.

- Energy subsidies. The World Bank estimates that developing countries could reduce carbon emissions by 7-9% by eliminating energy subsidies.

How have JI Pilot Projects Worked?

Since its foundation in 1993, the US Initiative on JI (formed under the existing climate change convention) has accepted 28 project proposals in 12 countries to help US firms tap potential outside the OECD for low cost carbon reduction. The projects span a range of technologies, including solar, geothermal and wind; fuel switching; biomass; reforestation. Some companies and organizations participating include Commonwealth Edison, AEP, PacificCorp, Wisconsin Electric Power and many others. The projects included one in the Czech Republic that converted a district heating plant from coal to natural gas and built a cogeneration plant to provide steam and electricity. There was one in Costa Rica that replaced fossil fuel burning power sources with a 20 MW wind farm; and a project in Russia planted 506 hectares of trees. There is a large forest management project in progress in Bolivia that combines forest regeneration and protection with the promotion of sustainable forest product enterprises. A project in Russia improves heat efficiency in Zelenograd simply by installing new heat exchangers, pumps and control equipment.

On October 22, a JI project was announced in which 2 U.S. companies (Solar Electric Power and Light of Washington, D.C. and Trexler and Associates, Inc. Of Oak Grove, Illinois) would work with Renewable Energy Services Company of Asia, Ltd. To market and install 812,000 solar home systems in Sri Lanka. These systems would replace the use of kerosene lamps for lighting and the use of diesel-electric charging of lead-acid batteries for powering small home appliances. The result would be a 1.5 million metric ton reduction in GHG emissions and cleaner energy for tens of thousands of people.

JI can, in addition to reducing carbon emissions, open up overseas markets, widen dissemination of advanced technologies and create local health and environmental benefits.

You say you need meaningful participation. What does that include?

- Climate change is a global problem requiring a global solution. By 2030 or sooner, emissions from developing countries will surpass those from industrialized countries. Thus, developing countries must take measures to limit greenhouse gas emissions.

- We will work bilaterally, regionally and multilaterally in the coming months and years to promote active efforts by developing countries to limit emissions. We will concentrate on key countries and approaches that are consistent with economic growth in these countries. We will not submit the Protocol to the Senate for advice and consent to ratification until we believe we have achieved meaningful participation.

- Countries are at very different stages of industrialization and have very different contributions to global emissions. Accordingly, there is no one size fits all approach. Countries with high GDP, or those that emit proportionally larger share of global emissions should be expected to do more than those that are poor or whose emissions are negligible.

- Under the Protocol developing countries can assume binding commitments voluntarily through amendment to the annex of the Protocol that lists countries with targets. (i.e. they can join Annex B.) They could then obtain access to the benefits of international emissions trading. Despite our efforts and the support of some developing countries, the Kyoto Protocol does not include a separate article for developing nations to assume voluntarily targets.

How does the Clean Development Mechanism work? Is it meaningful participation?

The Protocol makes a down payment on meaningful participation. First, they developing countries agreed to the creation of a CDM through which industrialized and developing countries can establish partnerships to cut emissions to the benefit of both parties. Specific projects, like the construction of a high-tech, low-emitting power plant--can include direct participation from the private sector. Industrialized countries and firms in them can use certified emissions reductions earned from such projects to contribute to their compliance while the developing countries get the technology they need for cleaner, more sustainable development. Private sector firms will be able to earn emissions credit either directly, as a consequence of their active collaboration and investment in CDM projects, or indirectly, by purchasing the emissions reductions to offset greenhouse gas reduction at home. The activities will be designed to achieve real, measurable and long-term benefits related to the mitigation of climate change and they will achieve reductions that are additional to any that would occur in the absence of these activities. We will design mechanisms to ensure transparency, efficiency and accountability under the CDM through procedures for independent auditing and verification of project activities. Certified emission reductions obtained from 2000 to 2008 can be used to meet commitments in the first budget period. No government financing is anticipated. As developing countries understand that they can protect the environment without compromising their economies they may be encouraged to assume emission reduction commitments. Assumption of Annex B provides even larger benefits.

At present, it is undefined how much of a country's commitment can be met through the CDM. Our goal is to seek maximum flexibility.

Some of the proceeds will be shared with the most vulnerable nations to climate change. It is intended to benefit small island states with low lying coastal areas--not OPEC countries.

The Clean Development Mechanism will utilize existing institutions and be funded from a small share of the proceeds from each project certified to reduce greenhouse gas emissions. It is an arm of the Parties to the Protocol and not the World Bank. The developing countries also agreed to advance implementation of their existing commitments under the 1992 FCCC. This involves implementing national programs that consider actions in the energy, transportation, industrial and other sectors to mitigate climate change.

What assurance do we have that JI projects under the CDM will actually reduce emissions?

First, at U.S. insistence, states not in compliance with their measurement and reporting requirements (a national reporting and measurement scheme for GHG emissions) cannot receive credit. Second, we will have to set up a mechanism to insure additionality. THE CDM will serve as a clearinghouse for eligible projects. There will be a small executive board and "operational entities to be designated" to certify emission reductions from specific projects.

Now that the developed countries have agreed to reduce emissions, what incentives do the developing countries have to participate?

It is in there long run best interest to do so. There is no solution without them and they are most affected by climate change. If they take on quantitative emissions limitations, they can participate in international trading.

INTERNATIONAL EMISSIONS TRADING

How can we be sure countries that trade emissions permits are actually honoring their emissions obligations?

- We need to establish the rules for the creation of verification and monitoring of emissions trading, JI and the CDM. These will be developed at COP-4 this November and the U.S. will work to ensure an acceptable approach. The U.S. will ensure that compliance with Protocol obligations is a condition for engaging in trading and other mechanisms under the Protocol.

- The Administration will build upon its experience with the SO2 emissions trading program in developing verifiable domestic and international trading regimes. This November, in Buenos Aires, the Parties to the FCCC will continue their work on emissions trading to define the "relevant principles, modalities, rules and guidelines" for verification and monitoring of emissions trading. Leading up to BA we will work hard diplomatically to build support for an appropriate emissions trading verification framework.

How will emissions trading work if only the United States has a domestic program of tradeable permits?

It is premature now to speculate on how foreign governments will design their emissions reduction programs. From our perspective, the private sector will play a critical role in trading; we envision U.S. firms actively participating in our domestic program as buyers, sellers, and intermediaries of emissions trading permits. Our goal will be to structure a similar role for the private sector in the international trading regime. One could envision a U.S. company, for instance, purchasing emissions permits from foreign counterparts, or eventually from private brokers (in the case of a private sector managed program) or dealing directly with a state-run emissions trading office in a foreign country that chooses to maintain more direct government involvement. Of course, if necessary, the USG will be prepared to facilitate trades where foreign governments institute public sector managed programs, but we do not envision the USG funding trades directly.

Aren't the monitoring difficulties so severe that trading isn't workable?

It has worked in the United States and in a few other countries that have tried emissions trading and it can work internationally as well. But we do have a challenge in setting up rules that deal with monitoring and verification. We need to keep the transactions costs low and assure private parties that the asset represented by a permit has value. The rules and procedures for emissions trading are to be defined at the Fourth Conference of the

Parties (COP-4) in Buenos Aires this coming November. Until then, we will work hard to build a consensus on the structure of an emissions trading regime which provides the greatest flexibility for our private sector and domestic implementation.

BENEFITS OF AVERTING CLIMATE CHANGE

Impact on Temperature

You have argued that there are benefits from dealing with climate change, but how much does the Kyoto agreement impact worldwide temperatures?

The Kyoto agreement must be viewed as the first step in a long process to cut emissions. The cutbacks agreed to there are not sufficient to maintain global concentrations at current levels. To maintain global concentrations at current levels, global reduction of approximately 60-70% of CO_2 emissions are needed. Even to stop CO_2 levels from more than doubling, larger cutbacks are needed. Developing country participation will be crucial to that because by 2030 it is predicted that their emissions will eclipse those of the industrialized nations.

SINKS

What role could sinks play?

By including sinks, the Protocol gives proper incentives to avoid deforestation. Annex B Parties would have to reduce other emissions to a greater extent in the budget period to meet their targets to the extent that deforestation occurs--there is a penalty for that.

The Protocol creates incentives through the CDM in developing countries for afforestation and reforestation projects, as well as investments in clean technology. These efforts can partially fulfill the emission reduction commitments of industrialized countries. Annex B countries will see advantages to working with developing countries in these and other areas as a means of achieving cost-effective reductions. Through such projects, developing countries can obtain the financial resources, technology and know-how to promote their own sustainable development.

CLIMATE CHANGE INITIATIVES

Aren't we doing too little over the next decade to prepare for the emissions reductions required in 2008-2012? Isn't it pretty late to introduce emissions trading only in 2008?

It is certainly important that we not wait until 2008 to begin preparing. But we intend to do much over the next decade; and the signing of a treaty and knowledge that a permit system will be set up will provide signals now for taking appropriate action. Early action credit will reward those who take action before it is required. And we are trying to build on the voluntary efforts that industries told us they could achieve. The tax cuts we have proposed for fuel efficient vehicles and equipment have the potential to kickstart new markets. Breakthroughs like the fuel cell technology for tomorrow's cars can lower emissions while also cutting the cost of driving. The Administration believes that there are many energy efficient products and techniques currently available that should be expanded and that doing so would be a win-win. In addition, the knowledge that we have made a binding commitment, that trading will go into effect, and that the commitment is serious, with early action credit, will bring expectations into play now--it provides a credible signal that will generate actions now.

How is the President's plan any different from the unsuccessful Climate Change Action Plan?

- It includes substantially more new technology spending and has the chance to kickstart markets for fuel efficient cars and equipment.
- A plan with binding targets creates expectations which can lead firms and households to begin to adjust their behavior sooner.
- The plan includes early credit to provide appropriate rewards for those who take prompt early action.
- It includes electricity restructuring.

Voluntary Industry Initiatives

What voluntary initiatives does the Administration plan? What are the odds that they will cut emissions noticeably?

- We already have a successful "industries of the Future" initiative run by DOE, which is a strategy creating partnerships between industry, government and supporting laboratories and institutions to accelerate technology, research, development and deployment. The Industries of the Future strategy is being implemented in seven energy and waste intensive industries, using more than 80 percent of the energy consumed in U.S. manufacturing (aluminum, chemicals, forest products, glass, metalcasting, petroleum, steel. There is a new team re agriculture) Two key elements of the strategy include an industry driven document outlining the industry's vision for the future and a technology roadmap to outline the technology needed to reach their goals. Through this process, government funded research is brought to a sharp focus to benefit U.S. industry. Agreements establish voluntary cooperative arrangements for joint R&D with the government and the creation of R&D partnerships, consortia or joint venture with customers, suppliers, academia and government labs.

- The Administration consulted extensively with industries in formulating the climate change policy. The cement industry told us that they saw the opportunity to reduce the volume of CO2 emissions by 5 to 15 million tons per year relatively quickly (months, not years) and relatively painlessly. The industry proposes to reduce the amount of clinker (formed from limestone and other oxides of silica and alumina)--the energy intensive part of the cement manufacture process--with flyash (a waste product from coal fired utilities), granulated blast furnace slag (a waste product from the production of iron) or limestone interground with clinker and gypsum in the finish grinding process. The flyash and slag could replace portland cement or interground with clinker by the manufacturer to produce a composite cement. A five percent replacement of portland cement clinker with flyash, slag, limestone etc. yields about a five million ton reduction in CO2 emissions from the manufacture of clinker. The industry claims that this not only has no detrimental effect but even improves some cement performance characteristics. Many countries all up to 5% limestone in portland cements and some countries up to 35%. In the U/.S. the Standard Specification for Portland Cement, ASTM C 150 does not allow any ingredients in cements except clinker, calcium sulfate and very small amounts of processing additions.

Tax Policies

- **Fuel Efficient Car Tax Credit**

    - Complements the PNGV program to develop a family car capable of getting three times the fuel economy of today's comparable car by 2003-4. This provides strong incentives to purchase these cars: $3000 in 2000 for a vehicle getting 2 x the base fuel economy for its size class. The credit would phase out by 2006. And a $4000 credit for vehicles getting three times the base fuel economy for its class--after 2002 and until 2007.

    - Purpose is to provide an incentive for the auto industry and the American consumer to produce and purchase cars of the future.

Federal Government Energy Initiative

How much scope is there for improved efficiency in the Federal government?

Electricity Restructuring

Won't electricity restructuring lower electricity prices and raise emissions?

- Electricity restructuring will lower prices and that does tend to raise CO2 emissions. But other effects are also at work.
- There will be an improvement in energy efficiency which will lower emissions. Retail competition will provide a financial incentive for generating plant owners to improve their energy efficiency (heat rate=fuel per kwh), reducing the amount of fuel burned to generate each kwh of electricity. In addition, competing retailers will likely increase value of their product to buyers by creating packages of electricity and efficiency services (ESCOs=energy service companies) that take advantage of cost effective efficiency opportunities (i.e. efficient lighting and heating in exchange for a share of the savings)(such as those in the 5 Lab study) or by selling green power derived from renewables. Some of the increased demand for electricity will reduce end-use consumption of primary fuels, reducing emissions outside the electric sector.
- There will be some reductions due to a renewable portfolio standard to required that 5% of electricity sales be generated from non-hydroelectric renewable sources.
- A $1.4 billion public benefits fund will finance energy-efficiency programs, consumer education, demonstration of emerging technologies such as renewables and low-income assistance.
- Green marketing provisions would provide information to consumers to allow them to purchase power from environmentally friendly generators..
- Outside experts predict that in the long run, a small emissions reduction (20-40 MMTC) is the best guess. Current emissions in the electric sector are expected to rise by 39% between 1990 and 2010. With the provisions above, DOE estimates that retail competition will reduce carbon emissions from the utility sector in 2010 EPA feels it would raise carbon emissions modestly. There is uncertainty and NEC and CEQ conclude that utility emissions would fall by roughly 1.5 to 3% relative to the BAU path in 2010 (10 to 20 million metric tons, relative to projected emissions of 663 million metric tons.)

What is the impact of electricity restructuring on electricity prices?

It would reduce electricity prices by 10 -15 percent or 0.5 to 1.1 cents per kw hour. A carbon tax of $30 to $70 has the same impact on electricity prices but raises other fuel prices too. It saves the average 4-person family about $232-$488 per year through direct and indirect effects--about $100 through direct effects. This is the impact of a $15 to $35 carbon tax.

Five Labs Study--Potential for Negative Net Cost Emissions Cuts

- Documents in detail how four key sectors--building, transport, industry and electric utilities--could respond to directed programs and policies to expand adoption of energy efficiency and low carbon technologies, an increase in the relative price of carbon by $25 or $50 and an aggressive program of targeted R&D.

- Uses a technology-by-technology assessment and an engineering-economic modeling approach.

- Looks at such promising low-carbon technologies as advanced gas turbines, transportation biofuels and fuel cells in buildings.

- Conclusions:

  - Energy efficiency alone could reduce carbon emissions by 12- MtC/year by 2010.
  - A $25/ton carbon price and policies to promote energy efficient technology use could lower emissions by 230 MtC.
  - A $50/ton carbon price and aggressive policies could cut 390 MtC by 2010.
  - In all cases the energy savings are roughly equal to or exceed the costs. (There is no analysis of specific policies to achieve the cases, the political feasibility of identified policies or a pathway to achieve the cases.
  - A next generation of energy efficient and low carbon technologies promises to enable the continuation of aggressive abatement over the next quarter century. A wide array of advanced technology options could be cost competitive by the year 2020 assuming a vigorous and sustained program of energy R&D beginning now and extending beyond 2010.
  - Many cost-effective energy-efficient technologies remain underutilized. A host of market barriers account for these lost opportunities. And declining energy R&D expenditures may cause promising technology options to be foregone.
  - The rationale for government support of energy efficiency R&D is strong. Much energy efficiency research is long term and high risk and the rewards are not adequately captured by private firms. There are substantial public benefits. The rate of return is quite high.

CEA critiques of the 5-Labs study:

- No description of the government programs necessary to stimulate the necessary technology adoption of 180 million metric tons. Based on CCAP, we estimate costs of the government programs as $45 billion or $1.1 billion annually into perpetuity. These are costs in addition to existing program costs to improve energy efficiency technology development and adoption.
- Analyses across sectors are not integrated. Penetration rate of energy efficient technologies may be overestimated because separate analyses do not account for declines in fuel prices.

- Ignores costs of accelerating capital retirement, underestimating costs.
- Double counting in utilities sector.

Amory Lovins:

In addition to the 5-Labors study there is a National Academy of Science study and other work suggesting that protecting the climate can be not costly but profitable. There are lucrative business opportunities in making this happen.

> Southwire, the top independent U.S. maker of rod, wire and cable cut its electricity use per pound of product by 40%, gas by 60% during 1981087 and kept on saving even more money and energy, within two year paybacks. Dow Chemical, DuPont, Roche, Kraft and others have also reported saving money and energy. Lovins says "it's far cheaper to save fuel than to burn it."
>
> **Some cost effective technologies which are currently available include:**

- Better insulation of building shells
- Better control systems for regulating the use of energy consuming equipment (time and temperature controls by zone, energy-use optimizers, energy management systems)
- High efficiency heat pumps
- Heat pump water heaters
- Decreased hot water requirements through better designed clothes washers and dishwashers
- High efficiency lighting - fluorescent fixtures, electronic ballasts, control systems
- Cogeneration
- Energy efficient windows
- Whole house design that allows for substantial equipment downsizing.

Payoffs from Technology Initiative

Diffusion:

- It is widely acknowledged (Stavins and Jaffe) that energy use could be significantly reduced through broader adoption of existing technologies, and it is almost as widely accepted that much unadopted technology is cost-effective at current prices.

- Examples of proven technologies that engineering calculations show are cost effective at current prices but not widely used include compact fluorescent light bulbs, improved insulation materials and energy efficient appliances.
- Non-use may reflect a market failure. Possible sources of market failure include:

- lack of information (of the innovation's existence and knowledge of it's profitability); if others' use of a technology is an important source of information, adoption creates positive externalities because it generates information that is valuable to others.

- Principal-agent problems: Energy efficiency decisions may be made by parties other than those who pay the bills. New home builders may not be able to credibly represent its energy conserving features to potential buyers (asymmetric information.) Landlords/tenants: landlord makes investment/tenant pays bill or vice versa.

- Electricity and natural gas prices may be artificially low--not priced on the basis of marginal cost.

What are some of the Benefits of Averting Climate Change:

Temperature is not the most important channel for economic impact given technologies to control temperature. But things that result from temperature changes--precipitation, water levels, extremes of droughts or freezes and thresholds like the freezing point or the level of dikes and levees will drive impacts. Those sectors of the economy that depend heavily on unmanaged ecosystems--that is, are heavily dependent on naturally occurring rainfall, runoff or temperatures--will be most sensitive to climate change. This includes agriculture, forestry, outdoor recreation and coastal activities.

Rise in Sea Levels

Heating and Air Conditioning: Cline $13 billion.

Severe Weather Events

Fresh Water: Cline, $8 billion

Agricultural Impact: Cline, $22 billion

Health Impact

Impact on ecosystems and biodiversity

Possibility of Catastrophes

Arguments over the discount rate

Uncertainty/Insurance

Estimates of economic impact of a doubling of CO_2 concentration: Cline (2.5 degree C=4.5 deg. F): annual damages of more than $70 billion per year (1.1% of GDP); Nordhaus (3 deg C = 5.4 deg F) (1%) Fankhauser(3 deg C) (1.3%). Nordhaus has a much higher estimated impact on coastal areas than Cline and a much lower impact on agriculture. An intensive survey of experts on the economic impact of climate change by Nordhaus found that for a 3 deg C warming in 2090, the median response was an economic loss of 1.8% of world output but with great uncertainty.

According to OECD survey, a doubling of concentrations would produce worldwide costs on the order of 1.5 to 2% of world GDP. Projections with a longer term emphasis point to GDP losses of 6% of world GDP or more for a 10 degree C warming by 2275.

These damage estimates do not correspond to the benefits of reductions in emissions of the sort agreed to in Kyoto. If Annex I countries stabilize their emissions, the projected growth of world emissions would fall only by a ½ to 1% annually, and as a result, the point at which concentrations would reach twice pre industrial levels would be delayed by no more than a decade. The costs of emissions controls described above should be compared with the benefits of delaying, rather than arresting the increase in GHG concentrations. A doubling of CO_2 concentration is impossible to avoid.

Electricity Restructuring Facts

- Under electricity restructuring, competition would replace regulation as the primary mechanism to set electricity generation prices. Consumers would be allowed to choose their own electricity supplier--much as they have been able to choose their own long-distance telephone service provider for over a decade.

- Restructuring has proceeded at a wholesale level under FERC Order 888, which requires investor-owned and some publicly owned utilities to open up transmission lines to qualified sellers. A dozen states, including California and Massachusetts, have taken steps to require their utilities to open up to retail competition as well.

- The economic benefits of restructuring are quite large. Electricity sales amount to over $200 billion per year and DOE estimates that retail competition could save American consumers roughly $20 billion per year in lower electricity costs. (Some of these savings will accrue even without Federal legislation, as some states move to retail competition themselves.

- The Administration proposal would endorse customer choice through a flexible mandate that would require each utility to permit all of its retail consumers to purchase power from other suppliers by January 2003. But it would permit states or non-regulated utilities to opt out of the competition mandate if they find, on the basis of a public proceeding, that consumers in the state would be better served by an alternative policy--including a state-crafted retail competition plan or the current regulated monopoly system.

EPI Study

- Uses DRI model
- 1990 by 2010 would reduce U.S. GDP by 1.8 to 2% in the short run.
- Increase in real energy prices would cause consumption to fall even more.
- Adverse impact on the distribution of income--could cut wage growth in half over the next two decades.
- In the short run 1.5 to 2.6 million jobs fewer could be created.
- Substantial employment shifts between industries and regions over time. Elimination of 400,000 to 500,000 high paying job opportunities in mining transport and public utilities.
- Negative impact on the trade deficit as higher energy prices increase the competitiveness of exporters based in low wage developing countries. Imports become more attractive and exports less competitive due to higher energy prices.
- Predicts shifts in investment to developing countries.
- Border taxes should be considered
- Recommends adjustment assistance involving meaningful retraining and income support. Special programs for hard hit sectors.

IMPACT OF A $100 CARBON EMISSIONS PRICE

Gasoline: + 0.27 per gallon (Now about $1.14 for unleaded)

Coal: + $63 per ton

Petroleum: + $12 per bbl (now about $17/bbl)

Natural gas: + $1.45 per 1000 cf (currently $2.04 at wellhead)

Electricity from coal-fired plants: + .10/kwh (currently $0.03 per kwh)
Electricity from natural gas combined cycle: +$.0035/kwh (currently k$0.04/kwh)

Average price increase for residential electricity: $.03 per kwh

Energy costs of the typical household: +20.2%

Dollars spent by the typical household, taking into account an elasticity effect,: +$514

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:29-APR-1998 18:54:22.00

SUBJECT: Summary of 4/16 G-22 meeting

TO: HOPKINS_M (HOPKINS_M @ A1 @ CD @ VAXGTWY [UNKNOWN]) (CEA)
READ:UNKNOWN

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

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

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

TEXT:
fyi
---------------------- Forwarded by Jeffrey A. Frankel/CEA/EOP on 04/29/98
06:53 PM ---------------------------

"LOEVINGERDA%DOM13.DOPO8" <DAVID.LOEVINGER @ MS01.DO.treas.sprint.com>
04/29/98 10:11:33 AM
Record Type: Record

To: See the distribution list at the bottom of this message
cc: "ATKINSONC%DOM13.DOPO8" <CAROLINE.ATKINSON @ treas.sprint.com>
Subject: Summary of G-22 meeting

Date: 04/29/1998 09:57 am (Wednesday)
From: David Loevinger
To: DOM3.DOPO5.BOORSTINR, DOM3.DOPO5.KAPLANE, IMF, JFrankel, lew,
truman, sherman, MEDISHM, ZELIKOWD, FALLJ, LUNDSAGERM, SchuerchW,
DOM3.DOPO6.SALLADINA, DOM3.DOPO6.MUNKR, DOM3.DOPO6.GELPERNA,
DOM3.DOPO6.JOYD, SHAHS, LOWERYC, DOM3.DOPO5.FROMANM
CC: ATKINSONC
Subject: Summary of G-22 meeting

distribute as you see fit

paper copies will be transmitted to Geithner, Lipton, Summers and Rubin

- att1.unk

Message Sent
To:
"COXB%DOM13.DOPO8" <BRIAN.COX @ MS01.DO.treas.sprint.com>
"FALLJ%DOM13.DOPO8" <"/GQ=III/G=James/S=Fall/" @ MS01.DO.treas.sprint.com>
"LISTERJ%DOM13.DOPO8" <James.Lister @ MS01.DO.treas.sprint.com>
"LOWERYC%DOM13.DOPO8" <CLAY.LOWERY @ treas.sprint.com>
"LUNDSAGERM%DOM13.DOPO8" <Meg.Lundsager @ MS01.DO.treas.sprint.com>
"MEDISHM%DOM13.DOPO8" <MARK.MEDISH @ treas.sprint.com>
"SHAHS%DOM13.DOPO8" <Sonal.Shah @ MS01.DO.treas.sprint.com>
"ZELIKOWD%DOM13.DOPO8" <Daniel.Zelikow @ MS01.DO.treas.sprint.com>
"BOORSTINR%DOM3.DOPO5" <ROBERT.BOORSTIN @ MS01.DO.treas.sprint.com>
"FROMANM%DOM3.DOPO5" <MICHEAL.FROMAN @ MS01.DO.treas.sprint.com>
"KAPLANE%DOM3.DOPO5" <ELLI.KAPLAN @ MS01.DO.treas.sprint.com>
"GELPERNA%DOM3.DOPO6" <Anna.Gelpern @ MS01.DO.treas.sprint.com>
"JOYD%DOM3.DOPO6" <David.Joy @ MS01.DO.treas.sprint.com>
"MUNKR%DOM3.DOPO6" <Russell.Munk @ MS01.DO.treas.sprint.com>

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D15]MAIL47153781U.126 to ASCII,
The following is a HEX DUMP:

Summary of Special Finance Ministers' & Central Bank Governors' Meeting
Madison Hotel, Washington, D.C.
April 16, 1998

Improving Transparency and Disclosure

There was general agreement on the need to improve both the quality and scope of data available to the public. Ortiz (Mexico) noted that investors' perceptions of a country's willingness to be transparent is as important as its actual transparency. He added that the demand for information increases dramatically during a crisis and that providing information boosts credibility. Several speakers suggested what they believed to be particularly important indicators, including: the ratio of net central bank reserves to a country's short-term foreign currency denominated liabilities, Greenspan (US); the yield curve Fernandez (Argentina); and assets and liabilities of the banking sector which George (UK) proposed be required as part of the IMF's Special Data Dissemination Standard (SDDS). Greenspan argued that the first indicator was particularly important because crises occur when buffers meant to handle shocks become to small.

However, Macfarlane (Australia) cautioned against focussing on one or two indicators. He warned this could lead to inordinate market attention on their short-term movements, such as occurred with U.S. monetary aggregates during the early 1980s. Yam (Hong Kong) and Dubinin (Russia) questioned whether more frequent publication of data would really reduce market volatility. George noted the need for central bank reserves depended on a country's exchange rate policy, so that low reserves were not necessarily an indication of vulnerability. He expressed some concern that markets are rewarding "mercantilism," with funds gravitating towards countries holding the most reserves.

Several speakers (Anwar (Malaysia), Dubinin) suggested that stronger data standards are needed to help emerging economies improve transparency. However, Dubinin argued that the International Financial Institutions (IFIs) should not become rating agencies and assess publicly countries' compliance with these, or any other, standards. Yam added that sanctions are needed against countries that do not meet these standards. He added there may be a greater role for the IFIs in organizing and distributing data. Fernandez suggested central banks agree to audits by internationally-known accounting firms. George suggested developing a code of best practices for monetary policy.

Several speakers (Yam, Anwar, Strauss-Kahn (France)) argued for greater symmetry in the provision of information. Getting data from both investors and recipients would make it easier to check the quality of data, and would also provide information on the behavior of different agents. Yam stressed that hedge funds report their activities. Several speakers noted the advanced economies had a role in improving data on capital outflows. To help determine what kind of data are needed a few speakers (Crockett (BIS), Gronkewicz (Poland)) suggested the working group look at how investors use data. Anwar added that ways to reduce the bias in the evaluation of emerging market data by ratings agencies and other analysts in the major financial centers also needed to be examined.

There was a general consensus that simply publishing more raw data does not ensure that it will be used well. Many speakers pointed out that a variety of published data had given ample warnings on the Mexican and Asian economies, but they had been ignored by investors. Many speakers (Brown (UK), Tietmeyer (Germany), Liu (China), Fernandez) stressed that policy making also be transparent. They mentioned the importance of officials explaining to market participants what they are doing, and why. Several speakers also stressed the importance of developing a medium-term framework with transparent rules and instruments against which investors could judge policy makers' actions and performance. A few speakers (Rubin (US), Brown (UK)) proposed the IMF increase its publication of press information notices and other reports and allow countries to publish their own Article IV reports.

Strengthening Financial Systems

Most speakers agreed with Fischer (IMF) that the Asian crisis highlighted the need for strengthened supervision of financial institutions in both emerging market and advanced economies. Rubin called for a more systematic approach to promoting strong financial systems, including regular surveillance of financial sectors and regulators. Speakers had differing views on whether new institutions are needed to do this. Martin (Canada) suggested that peer review would be useful not only to pressure countries to address weaknesses but also to provide a forum for bank examiners to learn from one another.

Rubin called for broader and more effective implementation of the Basle "core principles" for banking supervision, as well as the development and adoption of standards or best practices in other areas including, regulation of securities firms, accounting standards and disclosure practices, loan classification, credit risk assessment, bankruptcy regimes, and corporate governance. Fernandez cautioned that, in some cases, it would be difficult to get agreement on one method of calculating certain prudential indicators.

In addition, Fernandez stressed the danger of policy makers and investors viewing simple compliance with minimum standards, such as the Basle principles, as an indication of a strong banking system. Both he and Gronkiewicz stressed the need for regulators to recognize that because financial sectors in emerging markets are generally less developed, regulations often need to be more stringent than internationally accepted standards. There was a general consensus that qualified regulators and examiners are as important as strong regulations, that building such skills takes considerable time, and that technical assistance to help train supervisors can have a large payoff.

Speakers noted several other important elements of a sound banking system, including, an explicit deposit insurance scheme (Gronkiewicz), independent banking supervisors (Wolfensohn (World Bank)), limited government ownership of financial institutions (Gronkewicz), and liquid bond and equity markets to reduce emerging markets' dependence on bank intermediation (Anwar).

Several speakers noted that opening financial sectors to foreign firms helps establish credit cultures. However, Anwar countered that the IFIs are pressing emerging economies to liberalize their capital account too quickly, and not offering adequate assistance to help governments protect their financial sectors from ensuing sharp swings in capital flows. Anwar stressed that IFIs need to be more sensitive to governments' political concerns about protecting small domestic banks.

Private Sector Burden Sharing (Dinner Discussion)

There was a general consensus that mechanisms needed to be developed so that private investors bore more fully the consequences of their actions. Anwar pointed out that IMF programs tend to place all the burden of adjustment on debtors, while ensuring that short-term creditors get paid, even though, as Malan (Brazil) noted, the latter were just as "liable" for the crisis. There was some concern that large official financing packages contributed to moral hazard. In addition, several speakers (Rubin, George, Malan) stressed that burden sharing mechanisms needed to be developed simply because there were unlikely to be sufficient official resources to finance fully future crises.

There was general agreement that mechanisms to promote private sector burden sharing needed to: 1) minimize the risk of contagion; 2) support the IMF's catalytic role; and 3) support countries' efforts to regain normal access to private capital markets. Tarrin (Thailand) expressed concern that the G-10's recommendations to promote burden sharing would reduce private capital flows to developing countries, and thus raise demands for official finance. Rubin responded that this may be unavoidable.

Several speakers stressed that improving transparency was critical to achieving the three objectives noted above because private investors are more likely to accept those risks about which they are forewarned. For similar reasons, several speakers (Ortiz), Thiessen (Canada), Fischer) stressed the importance of putting in place burdensharing mechanisms before crises. Malan stress the importance of limiting government guarantees, and making them explicit. Ortiz cautioned that even if burden sharing rules are established in advance, creditors will be skeptical of officials' resolve to implement them in a crisis. He also stressed that particular attention needs to be paid to interbank credit lines, which play a central role in transmitting contagion.

Most speakers (George, Trichet (France), Stals (South Africa), Malan) believed that voluntary approaches were also far more likely than unilateral moratoria to reduce moral hazard and achieve the three objectives. Several speakers pointed out that countries which had imposed unilateral moratoria had to wait many years before they could access to private capital markets without special guarantees. Rubin and Fischer added that moratoria also increased the risk of contagion, as investors could be expected to pull back from all emerging markets.

George suggested that greater interaction between the IMF and the private sector could help foster cooperative approaches. At the same time, he and Rubin argued that IMF support must be tailored in a way to put the onus squarely on creditors and debtors to work out liquidity problems. George suggested the IMF condition its support on private creditors agreeing to reschedule short-term debt in certain situations. While noting that this could spark a disorderly run, creditors, and even bondholders, would have a strong incentive to reschedule. Malan added that conditioning IMF actions on creditor actions would still be consistent with a voluntary approach.

George cautioned against the IMF becoming involved directly in rescheduling negotiations. Malan countered that official sector incentives may be needed at times to nudge parties towards an agreement. Lim [?] (Korea) pointed out that intervention by the official community had been instrumental in securing a rollover of Korea's bank debt.

Malan and Nakamurka (Japan) suggested there may be situations where "market-friendly" forward looking (flow rather than asset-based) capital controls could be used to limit the accumulation of short-term foreign currency liabilities. Rubin agreed that this should be studied by one of the working groups. Yam suggested the multilateral development banks consider providing credit enhancements such as giving creditors the option of turning short-term sovereign debt into longer MDB-backed bonds. Rubin asked Yam to submit his proposal to the working group.

There was a general consensus that developing workout procedures would be difficult, particularly for widely disbursed bond holders. Gurria (Mexico) argued that while these problems might seem intractable, there were few issues that had not already arisen during the 1980s debt crisis. He pointed out that then, officials were facing many of the same issues, and expressing many of the same concerns, that officials are facing today. Under the Baker Plan, large IFI financing packages were used essentially to service private bank debt, which many officials believed promoted moral hazard and were not sustainable. Then the IMF proposed that the private sector bear a greater share of financing of countries' adjustment through debt reduction and new money. Though creative banking regulations, the G-7 was able to socialize part of the banks' losses. He argued that similar supervisory creativity in the G-7 could help to address bond liabilities.

Other Issues

Gurria argued that the IFIs need to consider ways to strengthen their surveillance over non-borrowing countries.

Greenspan (U.S.) cautioned against generalizing too much from the Asian crisis, which may have been due to unique factors that are unlikely to be repeated. He suggested that the "once in a generation" increase in stock prices in the U.S. and some other OECD countries in the 1990s led investors to diversify into emerging markets and may have led portfolio managers to be more careless than usual, as they were investing capital gains.

Future Work Plan

Tietmeyer asked about future plans for the "G-22." He asked Ministers to agree that the working groups channel recommendations to the Interim Committee for consideration during this year's Annual Meetings. Rubin agreed that, to the extent there were consensus on issues, these should be channeled to appropriate fora, including the Interim Committee. But both he and Greenspan noted that many of the issues being discussed were complex and cautioned that work may not be completed by then.

Withdrawal/Redaction Marker
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
002. email	Jeffrey A. Frankel to Janet L. Yelln and Blank_R. Subject: reading newsclips in the a.m. WH mtgs. (1 page)	05/04/1998	b(6)

COLLECTION:

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

FOLDER TITLE:

[04/16/1998 - 05/14/1998]

2013-0723-F
ab1277

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: M. Jill Gibbons (CN=M. Jill Gibbons/OU=OMB/O=EOP [OMB])

CREATION DATE/TIME: 5-MAY-1998 09:30:33.00

SUBJECT: LRM MJG224 - HR10 Draft SAP

TO: karen.dorsey (karen.dorsey @ treas.sprint.com @ inet [UNKNOWN])
READ:UNKNOWN

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

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

TO: Robert N. Weiner (CN=Robert N. Weiner/OU=WHO/O=EOP@EOP [WHO])
READ:UNKNOWN

TO: Lisa M. Kountoupes (CN=Lisa M. Kountoupes/OU=OMB/O=EOP@EOP [OMB])
READ:UNKNOWN

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

TO: Raymond P. Kogut (CN=Raymond P. Kogut/OU=OMB/O=EOP@EOP [OMB])
READ:UNKNOWN

TO: Mark A. Weatherly (CN=Mark A. Weatherly/OU=OMB/O=EOP@EOP [OMB])
READ:UNKNOWN

TO: Alice Veenstra (CN=Alice Veenstra/OU=OMB/O=EOP@EOP [OMB])
READ:UNKNOWN

TO: Alan B. Rhinesmith (CN=Alan B. Rhinesmith/OU=OMB/O=EOP@EOP [OMB])
READ:UNKNOWN

TO: Michael Deich (CN=Michael Deich/OU=OMB/O=EOP@EOP [OMB])
READ:UNKNOWN

TO: Roger S. Ballentine (CN=Roger S. Ballentine/OU=WHO/O=EOP@EOP [WHO])
READ:UNKNOWN

TO: US@2=TELEMAIL@5=JMD@7=Deborah@6=CLIFTON@mrx@lngtwy (
1=US@2=TELEMAIL@5=JMD@7=Deborah@6=CLIFTON@mrx@lngtwy [UNKNOWN])
READ:UNKNOWN

TO: Peter O'Keefe (CN=Peter O'Keefe/OU=WHO/O=EOP@EOP [WHO])
READ:UNKNOWN

TO: Ricardo M. Gonzales (CN=Ricardo M. Gonzales/O=OVP@OVP [UNKNOWN])
READ:UNKNOWN

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

TO: James C. Murr (CN=James C. Murr/OU=OMB/O=EOP@EOP [OMB])
READ:UNKNOWN

TO: Kate P. Donovan (CN=Kate P. Donovan/OU=OMB/O=EOP@EOP [OMB])
READ:UNKNOWN

TO: Francis S. Redburn (CN=Francis S. Redburn/OU=OMB/O=EOP@EOP [OMB])
READ:UNKNOWN

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

TO: Michelle A. Enger (CN=Michelle A. Enger/OU=OMB/O=EOP@EOP [OMB])
READ:UNKNOWN

TO: Edward A. Brigham (CN=Edward A. Brigham/OU=OMB/O=EOP@EOP [OMB])
READ:UNKNOWN

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

TO: Paul J. Weinstein Jr. (CN=Paul J. Weinstein Jr./OU=OPD/O=EOP@EOP [OPD])
READ:UNKNOWN

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

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

TEXT:

Total Pages: ____

LRM ID: MJG224
EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
Washington, D.C. 20503-0001

Tuesday, May 5, 1998

LEGISLATIVE REFERRAL MEMORANDUM

TO: Legislative Liaison Officer - See Distribution below

FROM: James J. Jukes (for) Assistant Director for Legislative Reference
OMB CONTACT: M. Jill Gibbons
PHONE: (202)395-7593 FAX: (202)395-3109

SUBJECT: Statement of Administration Policy on HR10 Financial Services Competition Act

DEADLINE: 12:00 Tuesday, May 5, 1998

In accordance with OMB Circular A-19, OMB requests the views of your agency on the above subject before advising on its relationship to the program of the President. Please advise us if this item will affect direct spending or receipts for purposes of the "Pay-As-You-Go" provisions of Title XIII of the Omnibus Budget Reconciliation Act of 1990.

COMMENTS: We understand that HR 10 may be considered by the House Rules Committee on Wed. A summary of the Bliley-Dingell amendment is attached. The text of the amendment can be found at
http://www.house.gov/commerce_democrats/welcome.htm

DISTRIBUTION LIST

AGENCIES:
62-LABOR - Robert A. Shapiro - (202) 219-8201
7-AGRICULTURE - Marvin Shapiro - (202) 720-1516
25-COMMERCE - Michael A. Levitt - (202) 482-3151
54-HUD - Jeff Lischer - (202) 708-1793
61-JUSTICE - Andrew Fois - (202) 514-2141
107-Small Business Administration - Mary Kristine Swedin - (202) 205-6700
114-STATE - Julia C. Norton - (202) 647-4463
118-TREASURY - Richard S. Carro - (202) 622-0650
76-National Economic Council - Sonyia Matthews - (202) 456-6630
128-US Trade Representative - Fred Montgomery - (202) 39/5-3475
35-Farm Credit Administration - Eileen McMahon - (703) 883-4056
86-Office of Consumer Affairs - Sandy Aguilar - (202) 565-0040
92-Office of Personnel Management - James N. Woodruff - (202) 606-1424

EOP:
Sarah Rosen
Roger S. Ballentine
Paul J. Weinstein Jr.
Michael Deich
Steven D. Aitken
Alan B. Rhinesmith
Edward A. Brigham
Alice Veenstra
Michelle A. Enger
Mark A. Weatherly
Alexander T. Hunt
Raymond P. Kogut
Francis S. Redburn
Jeremy B. Rudd
Kate P. Donovan
Lisa M. Kountoupes
James C. Murr
Robert N. Weiner
Sally Katzen
LRM ID: MJG224 SUBJECT: Statement of Administration Policy on HR10

Financial Services Competition Act

RESPONSE TO
LEGISLATIVE REFERRAL
MEMORANDUM

If your response to this request for views is short (e.g., concur/no comment), we prefer that you respond by e-mail or by faxing us this response sheet. If the response is short and you prefer to call, please call the branch-wide line shown below (NOT the analyst's line) to leave a message with a legislative assistant.

You may also respond by:
(1) calling the analyst/attorney's direct line (you will be connected to voice mail if the analyst does not answer); or
(2) sending us a memo or letter
Please include the LRM number shown above, and the subject shown below.

TO: M. Jill Gibbons Phone: 395-7593 Fax: 395-3109
Office of Management and Budget
Branch-Wide Line (to reach legislative assistant): 395-3454

FROM: ____ (Date)

____ (Name)

____ (Agency)

____ (Telephone)

The following is the response of our agency to your request for views on the above-captioned subject:

______ Concur

______ No Objection

______ No Comment

______ See proposed edits on pages __________

______ Other: ______________________________

______ FAX RETURN of _____ pages, attached to this response sheet===================
ATTACHMENT 1 ==================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D28]MAIL433363422.126 to ASCII,
The following is a HEX DUMP:

DRAFT NOT FOR RELEASE

May 5, 1998
(House Rules)

H.R. 10 - Financial Services Act of 1998
(Leach (R) IA and 3 cosponsors)

The Administration strongly opposes the Republican Leadership substitute to H.R. 10, which would: (1) stifle innovation and efficiency in the national banking system; (2) undermine the Community Reinvestment Act by forcing financial innovation to occur in holding company affiliates rather than in bank subsidiaries; (3) diminish the ability of communities and consumers to benefit from the financial system; (4) eliminate advantageous features of the current thrift charter; and (5) impose needless costs on small banks.

In addition, inclusion of the Bliley-Dingell amendment to the manager's amendment would not alter the Administration's position because the Bliley-Dingell amendment fails to meaningfully address the above concerns. **Therefore, if H.R. 10 were presented to the President in its present form or as modified by the Bliley-Dingell amendment, the Secretary of the Treasury would recommend that it be vetoed.**

* * * * * * *

SUMMARY OF
DINGELL CONSUMER PROTECTION AMENDMENT

1. Requires the Federal financial regulatory authorities to revise existing rules or prescribe new rules to provide consumers and investors with accurate, simple, and complete disclosure of all commissions, fees, markups, or other costs incurred in the purchase of financial products.

2. Authorizes the SEC to conduct inspections of the new wholesale financial holding companies to monitor and enforce compliance by such company or any affiliate with the Federal securities laws, after notice to other regulatory authorities and with deference to their reports of examination.

3. Protects the scope and applicability of the Commodity Exchange Act.

4. Protects the applicability of State securities and State insurance laws (including critical insurance solvency requirements) while protecting banks from "significant interference" with their ability to engage in the business of insurance. Requires consultation between the Federal Reserve and the State insurance regulators with respect to coordinated regulation of companies that control both a depository institution and an insurance company.

5. Protects banks and consumers from the confusion associated with conflicting insurance consumer protection regulations by providing that the Federal regulation will preempt the State protection where the Federal banking agencies jointly determine that the Federal provision provides greater protection to consumers.

6. Enhances the functional regulation of securities by underscoring that banks not registered aa broker-dealers may not collect brokerage commissions in excess of costs incurred but may collect a myriad of other types of fees in connection with effecting securities transactions in trust capacities and in connection with certain stock purchase plans.

7. Clarifies the scope of "traditional banking products" by recognizing the SEC's jurisdiction over certain derivative instruments that are securities, and limits the SEC's interpretative reach by spelling out the meaning of "securities" and "government securities" for purposes of the provision.

8. Requires the Secretary of the Treasury, in consultation with the Federal banking agencies and the SEC, to conduct a study of whether adequate services are being provided to low- and moderate-income neighborhoods and persons of moderate means as a result of the changes effected in the financial services industry as a result of enactment of HR 10, and to report to Congress their findings and recommendations within two years of the date of enactment.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME: 5-MAY-1998 16:45:31.00

SUBJECT: FY 98 Surplus update

TO: Rebecca M. Blank (CN=Rebecca M. Blank/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

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

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

TEXT:
Last official surplus estimate
-10 $billion
Final payments on 1997 liabilities higher than expectations
+10
Economy through 1998:Q1 stronger than anticipated as in
Troika
forecast
+15
Stronger GDP in 98:Q1 (4.2%) than in Troika forecast (3.4%) +4
Lower Spending than in official budget
plan +10

---

current surplus estimate
+29

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Mickey Ibarra (CN=Mickey Ibarra/OU=WHO/O=EOP [WHO])

CREATION DATE/TIME: 5-MAY-1998 14:27:14.00

SUBJECT: Report

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

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

TEXT:
I'd sure would like two more Annual Economic Reports for 1998 if you can spare them. I just shared one with Andy Hernandez of San Antonio who is putting together a conference on economic issues confronting Latino children. Several chapters in the report on right on target. He was very excited to discover their inclusion. Thanks.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: William J. Antholis (CN=William J. Antholis/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME: 5-MAY-1998 09:04:33.00

SUBJECT: from the mouths of babes...

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

TO: forrister_d (forrister_d @ btgcinema.com @ INET @ LNGTWY [UNKNOWN])
READ:UNKNOWN

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

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

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

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

TEXT:
from a high school sophmore
---------------------- Forwarded by William J. Antholis/OPD/EOP on
05/05/98 09:02 AM ---------------------------

Scott Flemming <suescott @ pacbell.net>
05/05/98 07:59:45 AM
Please respond to suescott@pacbell.net
Record Type: Record

To: William J. Antholis/OPD/EOP
cc:
Subject: We're Having a Heat Wave...

Good morning, Bill

Here are questions from Diana, with a nice preamble about who she is.
Any insights you might have before you jet off to the G8 would be
great; otherwise, we look forward to hearing from you when you get
back. Have a great trip. You the man!

Best Flembo

Dear Mr. Antholis

My name is Diana Clock and I am a sophomore at University High school. I am a student in Scott Fleming's (sic) class, and he is also my teacher/mentor for an independent study I am writing on global warming. Scott told me that you attended and worked on a governmental committee at the recent Kyoto environmental protocol meeting. I have some questions, and I would greatly appreciate it if you could answer them. Thank you. Diana Clock.

My Questions:

1) Do you think the spokespeople for the US, including Al Gore, will settle for a treaty in which developing countries have more liberties than industrial countries, or will they defend the US and give up the chance for a treaty?

2) China and India are the two largest developing countries in the world, and it is estimated that by the year 2010, the two combined will account for 40% of the world's population and 50% of the world's CO2 emissions. If these countries refuse to participate in a world-wide emissions treaty, what value will the treaty hold? Without China and India, is a treaty still worthwhile?

3) Prior conventions and environmental protocols have been non hyphen-binding, meaning no penalties or sanctions would be brought against a country if it decided not to comply with a treaty. Was the Kyoto protocol non hyphen-binding? If it is not, what penalties and sanctions could a country expect to face if it fails to comply?

4) A main advocate of the protocol is European nations whose populations have been dropping steadily. To what extent should consideration be made for countries such as the US, India, Brazil, and China, whose populations are increasing? Should flexibility be allowed?

5) In the book "A Moment on Earth" by Gregg Easterbrook, there is a mention of a gas called sulfur hexaflouride (SHF) that is reported to neutralize the effects of CO2 in the atmosphere and perhaps cool the earth. To what extent was SHF a factor in the negotiations at Kyoto?

6) Nearly every day, economists predict that a global warming treaty might have a negative effect on the economy. At Kyoto, what were the major economic factors? To what extent were policymakers, then and now, considering that a treaty could decrease economic growth in several countries, including the US?

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME: 8-MAY-1998 18:20:18.00

SUBJECT: a table of contents for your binder

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

TEXT:
Hi Janet,

Welcome back! Hope you had a nice trip.

I've prepared a table of contents for your binder, which appears in the front. In case you'd like to add or subtract from the binder, you may wish to update the table; it is attached for your convenience. I can also prepare a table of contents specifically for the subsection of Q&A's, if that would be helpful.

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D90]MAIL46688582R.126 to ASCII,
The following is a HEX DUMP:

Table of Contents for Janet's Big Black Binder

NYT editorial on low emissions vehicles (1/11/98)
GM Press release on innovative solutions to global warming (1/13/98)

Tab 8: Chart on worker productivity in coal mining industry
PCAST report -- Fossil fuel initiatives
Patricia Godley's (DOE) remarks before the Washington Coal Club (2/11/98)
Nuclear energy initiatives

Tab 9: Lessons from SO2 program -- 1 pager
SO2 discussion in ERP 1998

Tab 10: Electricity restructuring and climate change -- 1 pager
Gruenspecht memo on Paul Joskow's remarks on electricity restructuring (2/4/98)
Pena speech on restructuring (11/7/98)
Comparison of AEO 97 and AEO 98 (11/18/98)

Tab 11: EPI study -- 1 pager
WEFA study -- 1 pager
WEFA study (9/24/97)
5 labs study -- Scenarios of US Carbon Reductions (9/22/97)
Roadmap for stabilizing carbon emissions in 2010 at low cost (10/20/97)

Tab 12: Chart of projected GHG emissions
Table of emissions by country and region, 1990-2015
Chart of world emissions without Kyoto
Chart of cumulative world emissions, 1950-95

Tab 13: IAT draft report, June 1997
IAT Report talking points, July 1997
IAT Q&A, 7/15/97
Schaefer Q&A's on IAT from Tim Wirth (7/15/97)

Back Flap: Modelling Global Change (Ch. 9 by Edmonds, et.al.)
Calibration of the SGM -- PNNL (June 1993)
Return to 1990 -- Edmonds et.al. (October 1997)

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:11-MAY-1998 15:02:17.00

SUBJECT: Report

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

TEXT:
Can you take care of sending some copies of the ERP to Mickey?
---------------------- Forwarded by Janet L. Yellen/CEA/EOP on 05/11/98 03:01 PM ---------------------------

Mickey Ibarra
05/05/98 02:24:46 PM
Record Type: Record

To: Janet L. Yellen/CEA/EOP
cc: Suzanne Dale/WHO/EOP
Subject: Report

I'd sure would like two more Annual Economic Reports for 1998 if you can spare them. I just shared one with Andy Hernandez of San Antonio who is putting together a conference on economic issues confronting Latino children. Several chapters in the report on right on target. He was very excited to discover their inclusion. Thanks.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Sandra F. Daigle (CN=Sandra F. Daigle/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:11-MAY-1998 15:28:54.00

SUBJECT: Re: Report

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

TEXT:
Janet,
Alice was cc'd on an e-mail message about getting ERPs to Mickey Ibarra,
and I sent them over last week. I just called his office and confirmed
that he had received them.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Christopher D. Carroll (CN=Christopher D. Carroll/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:11-MAY-1998 11:29:19.00

SUBJECT: China Op-Ed.

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

TEXT:
Janet:

Here's my first stab at an Op-Ed. Let me know what you think.

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D26]MAIL40596403K.126 to ASCII,
The following is a HEX DUMP:

Opening Up the Chinese Box

China is engaged in a momentus transformation. The drive toward a free market economy that began twenty years ago has lifted over 200 million people out of abject poverty and thrust China to the forefront of world attention with head-spinning rapidity. By some measures, the absolute size of China's economy is now second only to the US, and if recent growth rates continue, sometime [in the next twenty years] China's economy will outweigh even the US.

Some observers have found China's rapid growth ominous, because of China's troubling record on human rights, problematic past foreign policy stances, and disregard for intellectual property rights and other rules of international trade. But my meetings with Chinese leaders last week convinced me that China understands that it must accept the responsibilities that go with membership in the community of leading nations. Those discussions also convinced me that dialogue and engagement are the best ways to speed China along the path toward the policies the West would like to see.

In the long run, economic progress is not sustainable unless citizens are given the rights and responsibility to make their own decisions and choices. It is not an accident that the richest countries in the world are those that accord their citizens the most freedom. Long-run progress on human rights may therefore hinge on continued economic advances. And China cannot hope to achieve a world-class standard of living for its people without becoming a responsible partner in both international trade and foreign affairs.

There are many signs that China is beginning to accept its new responsibilities. One that stands out clearly is China's determination to join the World Trade Organization. Membership in the WTO will require major changes in Chinese trade practices to bring it into compliance with the established rules for international trade, but the Chinese leadership recognizes the inevitability, and ultimately, the desirability of those changes in the long run, and is committed to making them.

China also played a constructive role in the recent East Asian crisis. China resisted the temptation to devalue its currency in response to devaluations by most of its competitors; because a Chinese devaluation could have further destabilized the already-shaky economies in the region, China's restraint was very helpful. Furthermore, China contributed significantly to the IMF rescue package for Indonesia, a clear sign that China recognizes the value and importance of multilateral international institutions like the IMF. The East Asian crisis has provided salutary lessons for China's own internal economic policies as well. The crisis illustrated the paramount importance of an open, transparent, and honest financial system in which information is freely and widely available. The crisis has given new urgency and direction to efforts that were already underway to clean up China's troubled banking industry, where in the past loans were often made more on the basis of political connections than economic prospects. And the woes of Korea's *chaebols* have illustrated the importance of sound corporate governance principles, a lesson that the Chinese will need to take to heart as they prizvatize hundreds of thousands of state owned enterprises in the next few years. Finally, and perhaps most critically, the crisis illustrates the profound importance of the rule of law in building a long-term healthy economy. Until both businesses and private citizens can count on impartial enforcement of contracts and laws, investment and economic progress remain perpetually in jeopardy.

One of the most important upcoming tests of China's commitment to fulfilling its international responsibilities will be the stand it takes on participating in efforts to curb global climate change. This should be an easy ...[Something about how everybody benefits if they participate].

Both China and the world stand to gain immeasurably if China fulfills its promise and recognizes its responsibilities as a leading nation of the world. ... [Something about how dialogue and engagement are the best way to make sure that things turn out as we wish rather than as some fear].

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:11-MAY-1998 11:17:22.00

SUBJECT: possible GCC insert to possible JY op-ed on China

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

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

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

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

TEXT:
(revised draft.)
For this to be inserted into the op-ed that Chris has drafted for Janet,
it would have to be condensed. One alternative possibility is to do two
separate op-eds on the subject ("My trip to China") , one focused on Kyoto
and one not, and submit to two different newspapers.=================== ATTACHMENT 1
===================

ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D81]MAIL462954031.126 to ASCII,
The following is a HEX DUMP:

POSSIBLE CONTRIBUTION ON CLIMATE CHANGE TO OP-ED ON CHINA
[Passages in square brackets are among those that could be cut to save space.]

One area where China should participate alongside other leading countries is the global environment. The Kyoto Protocol negotiated in December calls for specific reductions in emissions among industrialized countries of the greenhouse gases that lead to global warming [including Russia and other Eastern European countries]. So far, China and other developing countries have not adopted commitments to emission targets.

We cannot solve the problem without participation by developing countries. The Senate voted 95-0 for the Byrd-Hagel resolution, making their commitment to emission targets a pre-requisite for ratifying the Kyoto treaty. There was a logic to this resolution. The whole effort to address climate change will not succeed without the developing countries, as they are the fastest-growing source of emissions, and will surpass the industrialized countries early in the century (probably by 2020, according to the International Energy Outlook 1998 released recently by the Energy Information Agency). China is the largest emitter among them.

Most of the manmade greenhouse gases that have already accumulated in the upper atmosphere were put there by the rich countries. *It is understandable that poorer countries feel that they should not have to sacrifice their economic well-being to deal with the problem. But we are not asking them to do so.* The Chinese need to be aware that their participation in the global system of targets and trading of emissions carries both environmental and economic benefits for them. The economic and environmental rationale for their participation includes

- **Economic benefits to China:** With targets at (or only slightly below) the estimated Business-as-Usual (BAU) path that they would have followed anyway, China and other developing countries would enjoy net gains of many billions of dollars through the international sale of emission reductions achieved at lower cost than the world price.

- **Environmental benefits for all:** Targets slightly below BAU would lower global emissions. (A ton of carbon has the same effect regardless where emitted.) Even targets *at* BAU would prevent emission cutbacks in the rich countries from "leaking" out to poor countries. [Further, being paid to reduce carbon dioxide emissions generates ancillary air quality benefits for China, through lower particulate matter, sulfur dioxide, and nitrogen oxides emissions.]

- **Cost savings to the U.S.:** Participation by developing countries in international permit markets would greatly lower the costs to the U.S. and other advanced countries of meeting their Kyoto targets. [It is far cheaper for China to reduce emissions, e.g., by switching from dirty coal-fired power plants to cleaner forms of energy, than it is to do so in countries that have already industrialized.]

To persuade China and other developing countries *voluntarily* to adopt targets, international agreements can be structured to reduce the risk of inadvertent stringency [and in particular to reduce the possibility of a target so stringent as to cause large economic losses to the developing country.]
Thus participation in the target-and-trade system is not only a responsibility of China as a

leading power, but is in its economic interests as well.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:11-MAY-1998 15:19:14.00

SUBJECT: Oral version of testimony

TO: Adele C. Morris (CN=Adele C. Morris/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

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

TO: Randall W. Lutter (CN=Randall W. Lutter/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: Sandra F. Daigle (CN=Sandra F. Daigle/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Attached is the latest version of the oral testimony.=================== ATTACHMENT 1
===================

ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D12]MAIL43066603O.126 to ASCII,
The following is a HEX DUMP:

ORAL TESTIMONY OF DR. JANET YELLEN
CHAIR, COUNCIL OF ECONOMIC ADVISERS
BEFORE THE HOUSE INTERNATIONAL RELATIONS COMMITTEE
ON THE ECONOMICS OF THE KYOTO PROTOCOL
MAY 13, 1998

Thank you, Mr. Chairman. The President has said that we can work to avert the grave dangers of climate change, while at the same time maintaining the strength of our economy. I agree and am pleased to have this opportunity to appear before the Committee to elaborate on the Administration's views on these issues.

The international agreement that was reached in Kyoto this past December is a crucial step forward in addressing global climate change. But it is only one step in a long journey. Since the international effort to reduce greenhouse gas emissions is still in some respects a work-in-progress, it is not yet possible to provide a full authoritative analysis of it. In my testimony today, I will attempt to identify key elements of the agreement and the Administration's policy, such as international emissions permit trading, meaningful developing country participation, the inclusion of land-use activities that absorb carbon ("sinks") and six categories of gases, as well as domestic initiatives, that can ensure that reductions in global greenhouse gas emissions are consistent with continued strong economic growth.

Effects of Climate Change

The Intergovernmental Panel on Climate Change (IPCC), jointly established by the World Meteorological Organization and the United Nations Environment Programme, concluded in 1995 that "the balance of evidence suggests that there is a discernible human influence on global climate." Current concentrations of carbon dioxide, methane, nitrous oxide, and the other so-called greenhouse gases have reached levels well above those of preindustrial times. As a result of the increased concentration of greenhouse gases, the IPCC estimates that global temperatures will increase by between 2 to 6 degrees Fahrenheit in the next 100 years, with a best guess of about 3.5 degrees Fahrenheit. The IPCC reports that a doubling of carbon dioxide levels would lead to approximately 10,000 additional deaths per year for the current U.S. population from higher summer temperatures, even after netting out the effects of warmer winters and acclimatization. The IPCC also predicts sea level increases of about 20 inches by 2100, with greater increases in subsequent years. Despite the difficulties of deriving quantitative assessments of the damages from climate change, researchers have nonetheless developed monetary estimates of damages that prompt substantial concern, and range in the tens of billions of dollars per year for temperature changes projected to occur in the next century. If left uncontrolled, disruption of the Earth's climate may thus pose substantial costs in terms of harm to commerce and the environment alike. These costs--and they are significant--provide the primary motivation for actions to reduce greenhouse gas emissions.

These estimates do not, and cannot, accurately reflect the value of reducing the unknown risk of large-scale and potentially irreversible events with potentially catastrophic consequences, such as warming of the Northern tundra sufficient to release very large amounts of methane from the permafrost and thereby leading to accelerated warming. There is thus a strong argument for the Kyoto Protocol as a form of insurance against a serious environmental threat.

Kyoto Protocol

To address climate change, the United States and approximately 160 other nations agreed in negotiations held in Kyoto, Japan, last December, to reduce emissions of greenhouse gases. The Kyoto Protocol, which requires the advice and consent of the Senate, would place binding limits on each industrial country's combined emissions of the six principal categories of greenhouse gases. These limits apply to the 38 so-called Annex I countries, which are the industrialized countries, defined to include Russia, Ukraine, and most Eastern European countries.

In taking action to reduce emissions, economic analysis suggests that two elements are absolutely essential: the effort must be flexible and market-based, to ensure that we reduce emissions in the most efficient way; and the effort must be global, for without global emissions reductions the effort would be ineffective. The nature of the climate change problem--that greenhouse gas emissions have the same effect on the climate regardless of how, where, and, within limits, when they occur--suggests three basic approaches to lower the cost of achieving given levels of environmental protection. We term these "when", "what", and "where" flexibility.

As a result of U.S. diplomatic efforts, all three forms of flexibility are broadly reflected in the Kyoto Protocol. The choice of a multi-year budget period, ending later than many countries proposed, with allowance for "banking" of emissions reductions, constitute key elements of "when flexibility." These provisions mitigate costs by permitting reductions at times when they are less rather than more costly. The inclusion of all six greenhouse gases and certain sink activities that promote removal of carbon from the atmosphere provide substantial "what flexibility". The U.S. succeeded in having the Kyoto Protocol stipulate that countries with binding targets are to reduce total greenhouse gas emissions by certain percentages, but the Protocol does not require specific reductions for specific gases. Moreover, sinks can be used to offset emissions targets. The inclusion of international emissions trading among countries that take on binding targets, coupled with an agreement allowing industrial countries to receive emissions reduction credit for certified investments in "clean development" projects in the developing world, are the critical forms of "where" flexibility incorporated in the Kyoto Protocol. Although details of these provisions need to be finalized in negotiations in Buenos Aires later this year, we believe that these mechanisms can produce substantial reductions in the costs of attaining our environmental objectives.

The problem of climate change is global and so requires a global solution. Around 2030, under a continuation of business as usual, a majority of world emissions are projected to come from developing countries. Without developing country participation we cannot achieve adequate climate protection. In addition, developing country participation would permit relatively low-cost emissions reductions to be internationally recognized as a substitute for more expensive reductions in many industrial countries. The President has made clear that he will not submit the Kyoto Protocol to the Senate without meaningful participation from key developing countries (who are not included in Annex I).

Economic Effects

An economic analysis of climate change faces three broad categories of difficulties. First are the uncertainties that still remain over the terms of the ultimate treaty. Second are the inherent limitations of available models to analyze even short-term costs and benefits. And finally is the impossibility of putting a single monetary figure on the long-term benefits of climate change mitigation.

Mindful of the limitations of any single model as a tool for evaluating the economic impact of the Kyoto Protocol, we have employed a broad array of techniques to assess the various possible costs and non-climate benefits of the Administration's emissions reduction policy. Ignoring the benefits of mitigating climate change itself, our conclusion is that the net costs of our policies to reduce emissions are likely to be small if those reductions are undertaken in an efficient manner and we are successful in securing meaningful developing country participation as well as effective international trading and clean-development mechanisms in future negotiations. As I explain in my written testimony, this conclusion is not entirely dependent on, but is fully consistent with, formal model results. For example, given the factors, such as trading, just delineated, but excluding the benefits of acting and the impact of electricity restructuring, estimates derived using Battelle's Second Generation Model suggest that the resource costs of attaining the Kyoto targets for emission reductions might amount to just $7 to $12 billion per year in 2008 to 2012 -- or just 0.1 percent of projected GDP. That small net premium, in effect, purchases a partial insurance policy against a serious environmental threat.

A comprehensive economic evaluation of the Administration's climate change policies must also take into account the potential payoffs from the full package of proposed Administration climate change initiatives. As you know, the President's FY 1999 budget includes a $6.3 billion package of tax cuts and R&D over the next 5 years; this package makes good sense in terms of energy policy and will jumpstart our efforts. A second responsible step entails industry-by-industry consultations to prepare emission reduction plans in key industrial sectors. A final component of the President's climate change policy is his support for electricity restructuring in a manner that will offer approximately $20 billion in cost savings to electricity consumers, while offering modest reductions in greenhouse gas emissions.

I look forward to continuing to work with members of this Committee, as well as other interested parties, in further analyzing the Kyoto Protocol and evaluating the effects of reducing greenhouse gas emissions.

I welcome your questions.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:11-MAY-1998 20:03:32.00

SUBJECT: draft Qs and As based on recent Congressional testimonies

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: Randall W. Lutter (CN=Randall W. Lutter/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:
Attached is a WP6.1 file that provides a first draft of Qs and As based on economic testimonies before McIntosh's subcommittee a couple of weeks ago. (Janet -- this is the same as the hard copy I left on your chair.)

Joe

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D31]MAIL47374113O.126 to ASCII,
The following is a HEX DUMP:

Q1. Recent research by the respected economics firm WEFA indicates that implementing the Kyoto Protocol would result in higher U.S. energy costs, reduce U.S. living standards, and give developing countries -- such as Mexico, China, India, Korea, Brazil, and others -- a competitive advantage over the U.S. Why shouldn't we believe these results from the WEFA economic analysis?

A1. The WEFA analysis does not incorporate many of the Kyoto agreement's flexibility mechanisms. For example, the WEFA analysis excludes cost-effective opportunities to reduce emissions through international trading, the Clean Development Mechanism, and non-carbon dioxide greenhouse gas reductions. Further, the analysis does not account for the Administration's position on developing country participation. These flexibility measures were included in the Administration's analysis. As I have said before, we can do it dumb, or we can do it smart. Doing it dumb means that we would ignore many of these cost-effective opportunities to reduce emissions. Doing it smart implies that we would take advantage of cost-effective options, and that is why the Administration was a strong advocate in Kyoto for flexibility measures, and we will continue to serve as an advocate in subsequent negotiations.

I should add that no one model result should serve as the "right" answer on the costs of complying with our commitment under the Kyoto Protocol. The Administration analysis serves as a powerful illustration of the virtues of flexibility measures. The cost-effectiveness of increasing flexibility in achieving environmental goals is robust across models. Indeed, the high costs associated the WEFA analysis -- in contrast with the Administration analysis, modeling results from Energy Modeling Forum exercises, the IPCC Working Group III 1995 assessment, OECD climate modeling results, and the Interagency Analytic Team report -- illustrate the importance of flexible, cost-effective implementation that is the cornerstone of the Administration's policy.

Q2. The Administration claims that the Kyoto Protocol will cost the U.S. $7 - $12 billion per year by 2010, while the WEFA economic analysis indicates that economic losses will be $300 billion per year. Why is the WEFA estimate 30 times greater than the Administration estimate?

A2. The WEFA analysis found very high costs because it does not account for the many flexibility measures in the Kyoto Protocol (see A1).

Q3. WEFA estimates more than 2.4 million job losses because of the Kyoto Protocol. The Administration claims very modest job losses, but neither you nor Dr. Ed Montgomery of the Department of Labor has presented an estimate. Do you consider 2.4 million "very modest"? What is the Administration's estimate? Why does your estimate differ so much from the WEFA estimate?

A3. 2.4 million jobs is not a modest decline. However, the WEFA analysis assumes that we achieve our emissions target without the benefit of many flexibility mechanisms that are a part of the Kyoto Protocol (see A1). Accounting for these flexibility mechanisms significantly decreases the costs of achieving our target, and the effect on employment -- just like the effect on energy prices -- would be quite modest. Although there may be job gains in some sectors and job losses in others, we do not anticipate any significant aggregate employment effect if we achieve the conditions we have discussed. The effects on energy prices do not occur over night -- they occur only 10 to 14 years in the future. Not only are these effects small relative to historical variations in energy prices, they would occur sufficiently far in the future to enable monetary policy to keep the economy operating at its potential. In energy-intensive sectors some employment reduction could occur, although given the very small predicted change in energy prices, impacts in most such sectors are apt to be minimal. Furthermore, a large number of jobs will be created in other sectors -- many of them high-tech jobs paying high wages.

Q4. WEFA estimates $265/ton permit prices by 2010, more than 10 times greater than the Administration estimates of $14 - $23/ton. Why the difference?

A4. The WEFA analysis found very high permit prices because it does not account for the many flexibility measures in the Kyoto Protocol (see A1).

Q5. WEFA estimates that permit prices will increase to $360/ton by 2020. What is the Administration estimate of permit prices for 2020?

A5. The Administration has not estimated permit prices beyond 2012 because of the uncertainty regarding emissions targets for commitment periods after the first period.

Q6. WEFA's analysis indicates that Kyoto would create a prolonged series of mini-shocks to the U.S. economy, similar to the oil shocks of the 1970s and early 1980s. Do you agree with this assessment? If not why not?

A6. First, the WEFA analysis found very high energy prices because it does not account for the many flexibility measures in the Kyoto Protocol (see A1). Further, it should be recalled that the oil shocks of the 1970s were surprises -- businesses did not have an opportunity to plan for the sharp increases in energy prices. However, the Kyoto Protocol provides businesses with a decade-long window to plan before the first commitment period.

Q7. If in subsequent negotiations, the rules for international trading and CDM are cumbersome, and developing countries do not take on targets, would your economic assessment of climate policy change? Would it be more similar to WEFA's analysis?

A7. The Administration's position is to secure rules for effective international trading and for an effective Clean Development Mechanism. Further, it is the Administration's position to secure meaningful participation by key developing countries. I will not speculate on hypotheticals that do not conform to Administration policy.

Q8. WEFA estimates average GDP losses of about $2700 per household by 2010, much greater than the Administration's estimates. Why the large discrepancy?

A8. The WEFA analysis found very high costs because it does not account for the many flexibility measures in the Kyoto Protocol (see A1).

Q9. WEFA estimates that food would be 9% more expensive, medical care costs 11% higher, and housing costs 21% higher under the Kyoto Protocol. What are the Administration estimates for these goods and services?

A9. The WEFA analysis found very high costs because it does not account for the many flexibility measures in the Kyoto Protocol (see A1). The Administration has not conducted an analysis on the effects of specific sectors of the economy because of the substantial uncertainties forecasting that far into the future.

Q10. WEFA claims that U.S. exports would be relatively more expensive on the world market resulting in significantly lower real net exports. What is the Administration estimate of the change in net exports?

A10. The WEFA analysis found a reduction in net exports because it does not account for the many flexibility measures in the Kyoto Protocol (see A1). The Administration has not calculated a number representing the effects on net exports. By achieving broader participation in climate policy through the Administration's position on developing countries and securing effective international trading, the effects on trade should be very modest.

Q11. WEFA indicates that chemicals, paper, textile and apparel, computer and electronic industries would all be significantly hurt by the implementation of the Kyoto Protocol. What are the Administration estimates on the effects of climate policy on these industries?

A11. The WEFA analysis found sector-specific impacts because it does not account for the many flexibility measures in the Kyoto Protocol (see A1). The Administration has not calculated a number to represent the effects of climate policy on specific industries. It is difficult to forecast the economic activity in specific sectors a year, or even a quarter or two, in advance. The task is virtually impossible to predict sector-specific economic effects more than a decade into the future.

Q12. WEFA indicates that it did not assess international trading because it is only "conceptual" and that until the details -- such as principles, rules, verification, reporting, and accountability -- are addressed, it is not possible for trading to take place. Why then did the Administration include trading in its analysis?

A12. Article 17 of the Kyoto Protocol clearly states that Annex B countries have the right to trade emissions allowances. We assessed international trading because it is one of the key components of our flexible approach to implementing climate change policy. Conducting an economic analysis of trading before all the rules have been established is the same as assessing the economic effects of a bill or law before the regulations to implement the law have been drafted.

Q13. WEFA claims that the benefits of international trading could be limited because trading would only occur among Annex I countries. Why does the Administration claim that trading among Annex I could cut costs by more than half?

A13. Expanding a market lowers costs for all the participants in the market. Many of the Eastern European and Former Soviet Union countries in Annex I have higher energy-to-GNP ratios than the United States. For example, Russia is about 5 times less efficient, and Poland about 4 times less efficient than the U.S. Since these countries are less energy efficient than the United States, firms in those countries may find it relatively less expensive than firms in the U.S. to reduce greenhouse gas emissions by improving energy efficiency. In addition, developing countries can adopt targets, join Annex B of the Protocol, and participate in trading, which would further reduce the costs of achieving our emissions target.

Q14. WEFA claims that international trading would require audits of all participating U.S. businesses and the U.S. government. Who would conduct these audits? Would a U.N. bureaucracy be created to audit our country?

A14. The Kyoto Protocol does not require audits for trading, or anything of that nature.

Q15. The Administration claims that climate policy will only cost the economy 1/10 of 1% of GDP, while the respected American Council for Capital Formation (ACCF) has sponsored research that indicates that the less stringent goal of 1990 by 2010 could range between 1% and 4% of GDP, and permit prices could range between $200 - $260/ton. Why the large differences?

A15. These studies found very high costs and permit prices because they do not account for the many flexibility measures in the Kyoto Protocol (see A1).

Q16. ACCF claims that the energy price increases associated with implementing Kyoto will "force" consumers to "make major changes in their lifestyles, including lowering their thermostats in winter, driving less, and reducing their use of air conditioning in summer." Is this true? If not, why not?

A16. This is not true. By accounting for the flexibility measures in the Protocol, the energy price increases will be modest. We expect that consumers will make small changes in response to energy prices, but not major lifestyle changes.

Q17. Research by ACCF indicates that implementing Kyoto would exacerbate income inequality in the U.S. In fact, the increase in income inequality would be twice that experienced between 1968-1978, and about 3/4 of the inequality increase occurring between 1979-1983. How can the Administration support an environmental policy that makes inequality much worse?

A17. The study you are referring to found significant effects on inequality because it does not account for the many flexibility measures in the Kyoto Protocol (see A1). Further, this finding about inequality is very sensitive to the model's "revenue recycling" mechanism. That is, in this study, it is assumed that carbon dioxide permits are auctioned, and the revenues from such an auction would be "recycled" or returned to consumers either through a reduction in personal income taxes or through a lump-sum redistribution. The reduction in income taxes results in inequality effects 5 times larger than the lump-sum redistribution. While this result is beneficial in informing us about the inequality effects of different revenue recycling approaches, it does not substantiate the claim that Kyoto would exacerbate inequality along the lines of what was experienced during the oil shocks.

Q18. ACCF reported a study that indicates that the "single most important factor contributing to the decline in carbon emissions" during 1974-1986 were reductions in per capita GDP. Will implementing the Kyoto Protocol require the U.S. to reduce its per capita GDP and force a decline in our standard of living?

A18. First, the U.S. did not experience a reduction in per capita GDP during these years; the rate of growth slowed. Second, the oil shocks caused energy prices to shoot up causing stagflation and a fall in output. The Administration intends to implement the Kyoto Protocol through a set of flexibility measures that will result in very modest effects on energy prices. By accounting for these measures, the effects on GDP would be negligible, so per capita GDP would not significantly change, and surely would not fall.

Q19. The recent economic analysis by DRI indicates that Eastern Europe and the Former Soviet Union will average 160 million tons of carbon per year below their emissions targets during the commitment period. Some observers have referred to this as "hot air", because the Russians may be able to sell emissions allowances without making any actual reductions in their emissions. What did the Administration assume about the projected magnitude of "hot air" when it conducted its analysis? Do you assume that the Russians can sell their hot air?

A19. The Administration used the estimates of carbon emissions from the Second Generation Model for Eastern Europe and the Former Soviet Union. The Kyoto Protocol does not preclude any country from selling any part of its emissions allowance, and indeed, through the EU bubble, it sanctions implicit exchanges of what has been referred to as hot air by allowing some EU countries to take less stringent targets while Germany reduces below its 1990 - 8% level by taking advantage of the fall in output in the former East Germany. The Administration analysis assumes that all countries trade emissions allowances to minimize the costs of achieving their targets.

Q20. The DRI testimony states that the Administration analysis indicates that the U.S. will be able to purchase permits in an international market that would not include the European Union. Is this true -- will the Europeans actually avoid trading? Does the Administration intend to develop trading rules that excludes the Europeans?

A20. The Administration analysis included a range of permit prices and costs to reflect uncertainty regarding the participation of all Annex B countries in international trading. It is not the Administration's position to exclude any Annex B country or firms from any Annex B country from participating in international trading. The Administration's position to secure rules ensuring cost-effective emissions reductions to achieve our emissions target.

Q21. The DRI analysis claims that U.S. marginal abatement costs "are arguably significantly lower" than Europe's and Japan's. Does this mean the U.S. might not find it cost-effective to purchase emissions allowances abroad?

A21. Many of the Eastern European and Former Soviet Union countries in Annex I likely have lower marginal costs than the U.S. since they have higher energy-to-GNP ratios than the United States. For example, Russia is about 5 times less efficient, and Poland about 4 times less efficient than the U.S. Since these countries are less energy efficient than the United States, firms in those countries may find it relatively less expensive than firms in the U.S. to reduce greenhouse gas emissions by improving energy efficiency. In addition, developing countries can adopt targets, join Annex B of the Protocol, and participate in trading, which would further reduce the costs of achieving our emissions target.

Q22. The DRI testimony claims that the Administration analysis assumes that 85% of our required emissions reductions will be purchased from abroad. Does the Administration intend for the U.S. to buy that much from abroad? What would be the magnitude of wealth transfers to other countries if we buy that much? Do you agree with DRI's statement that "a large revenue stream would be diverted overseas?"

A22. The Administration does not intend for the firms to purchase any specific amount of emissions reductions abroad. Rather, the Administration intends to provide flexibility to the private sector so that emissions reductions can be achieved cost-effectively. If a private firm finds it cost-effective to achieve emissions reductions by purchasing emissions allowances from a firm in another country, we do not believe there should be restrictions on that behavior.

Q23. DRI states that tradable "permits are an implicit tax." Is the Administration's proposed domestic trading program a backdoor approach to tax American businesses? Is the international trading system a backdoor attempt at an international tax on our businesses?

A23. In general, a tradable permit and a tax are not equivalent. A tradable permit system focuses on fixing quantities and leaves prices free to fluctuate, while a tax focuses on prices and allows quantities to adjust. The significant advantage of a tradable permit approach over the tax approach is that it allows for the opportunity to trade across countries and take advantage of low-cost reductions abroad, while a tax approach does not provide this option.

Q24. DRI states that if permits are given, or "grandfathered" to businesses, consumer real incomes would fall while business profits would increase. Do you agree with this conclusion?

A24. It should be noted that the DRI analyses do not fully account for all of the flexibility mechanisms in the Kyoto Protocol. The Administration analysis indicates that the effects of climate policy would be modest. As an illustration, we calculated through a model that annual household energy expenditures would increase by between $70 and $110 by 2010. However, the Administration's electricity restructuring proposal would result in cost-savings roughly equal to this amount, so the total effect on consumer incomes would be very small.

Q25. DRI stated that "the role of developing countries in the Protocol is still undefined. The impact on states producing traded goods could potentially be severe if developing countries would be allowed to use low-cost, high-polluting technologies and sell their products at lower cost in the U.S." Do you agree with this conclusion from DRI?

A25. By accounting for the flexibility mechanisms in the Kyoto Protocol and securing meaningful participation of developing countries, the costs of achieving our emissions target would be modest, and the effects on trade would be minor. The Administration has and continues to advocate for measures that will result in cost-effective emissions reductions and for global participation to address the risks of climate change. The Administration position ensures that trade will not be adversely affected by climate policy.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:12-MAY-1998 10:12:51.00

SUBJECT: report from morning mtg.

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

TEXT:
They say the vote on financial modernization will be very close, down to the wire..

Frank says budget esimtates will be available for release after POTUS returns.
I could tell you more about the budget ex. social security, whenever you want.

Also, regarding the mtg. I went to at Treasury late yesterday, they are going to give the President a memo on what's wrong with the Japanese financial system (a bit like the one I showed you, I think) so that he can share it with Hashimoto at the Summit if the Japanese ask "what exactly do you want us to do?" Let me know if you want to know more.
JF

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:12-MAY-1998 12:26:41.00

SUBJECT: BEA talk

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

TEXT:
Janet -- my suggestion for what to do at the BEA annual all-staff meeting where you've been asked to be the keynoter:

"Using BEA Statistics to Track the Economy"
Give your typical economic outlook talk, but supplement it by highlighting the areas where key statistics are particularly closely watched and important to today's economic news:

For example,
*the productivity numbers (and their various forms) are key to understanding whether wage increases are inflationary or not.

*the industry numbers (production, inventories, exports, etc) in industries that either trade heavily or are heavily competitive with southeast Asian, are telling us something about the impact of the SE Asian crisis on the U.S. economy.

etc.

In general, I guess I think you want to say something that the BEA folks WON"T know...that means doing more than talking about their numbers, which they know better than anybody else. I'd think the easiest way to handle this is to talk about what you know the most about -- namely, overall economic performance -- and talk about how the BEA statistics fit into this. That way they'll get a bit of information on "How's the economy doing?" that they won't know before, and you'll also essentially be telling them how important their work is, which is a good thing to do for all of the statistical agency workers.

Becky

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:12-MAY-1998 17:12:40.00

SUBJECT: current draft of Q&As for McIntosh

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

TEXT:
---------------------- Forwarded by Michele Jolin/CEA/EOP on 05/12/98
05:12 PM ---------------------------

Randall W. Lutter
05/11/98 11:36:51 AM
Record Type: Record

To: Jeffrey A. Frankel/CEA/EOP, Michele Jolin/CEA/EOP
cc: Joseph E. Aldy/CEA/EOP, Adele C. Morris/OMB/EOP, Zachary M.
Candelario/CEA/EOP
Subject: current draft of Q&As for McIntosh

This very rough draft includes Adele's contributions, and mine, but
excludes some tougher answers that we haven't got to yet. More is
pending. Comments are welcome.

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

TEXT:
WPC
q0HAW_?$.&7!r}5P1*Q0
whjH2/7CV^Q=~~.I>'x_de[KBHrXw;6uOyy(zhxXo_ sYMZf&XaVdc8wINp0/7&b!.WNmNsAd,(%K4
Y$%Oj"~I7S
V^cx(G7h.`$ah!&c"6{ sO^
~%Gs4&^k
gwuk@m+mo/R.?
mWn2ZQ?J0xvP2xy&`a#UN %90(?2gw@40DWHnIL\\OA_6\\\CEA_2\32
8_APSWINSPOOL0(9 Z6Times New Roman RegularX($C:\PROGS\WP\STANDARD.WPT
EDEHUIa$3|x(3$
!
M

'May10,1998,Preliminaryandobviouslyincomplete<6X9`(*Courier 12pt10cpiXXx6X@JQX@

?

'Preliminaryandobviouslyincomplete
!FXXDraftAnswerstoMarch13QuestionsToCEA d fromRepresentativeMcIntoshChairoft heHouseSubcommitteeonNationalEconomicGrowth,NaturalResources,andRegulatoryAffai rs#XXF# * A.BudgetInformationandPerformanceMeasures $ Question1.Pleasepro videatablewithFiscalYear(FY)89FY99historicalbudgetauthority `
foryouragencyfor
thevariouscomponentsofthePresidents ClimateChangeTechnologyInitiative,including theprevious ClimateChangeActionProgram/Planandanyotherneworpreviouslyauthorized ResearchandDevelopment(R&D)herein(exceptfortheU.S.GlobalChangeResearchProgramin cludedinQuestion3below).Foreachcomponent,pleaseindicateeachspecificbudgetaccoun t,thespecificlegislativeauthority(includingthespecificstatue,thesectioncitation ,andthelanguageofthesection)fortheprogram,andabriefdescriptionoftheprogram.Resp onse.TheCouncilofEconomicAdvisers(CEA)hasnohistoricalorcurrentbudget H authorit yforanycomponentofthePresidentsClimateChangeTechnologyInitiative,theClimateChan geActionPlan,oranyotherneworpreviouslyauthorizedR&Dprogram.Question2.InSection2 (ProgrammaticDetails)ofOMBsFebruary2,1998handout, \ ClimateChangeTechnologyIn itiative1999BudgetBriefingMaterials,pleaseprovidethefollowinginformationassocia tedwitheachparagraphdescriptioninwhichyouragencyhasbeenfundedorisrequestingfund ing:theassociatedfundinginFY97,FY98,andFY99.Also,foreachparagraph,fortherequest edfundingforFY99,pleaseprovideevidenceofanyaccomplishmentsfromtheFY93FY97fundin g,ifany.Lastly,foreachparagraph,andforeachagency,pleaseindicateanyprogramperfor mancemeasuresfortherequestedfundingand,foreachsuchmeasure,pleaseprovideannualda taforthe1990baseyearandannualdataformostrecentthreeyearperiodforwhichdataareava ilable.Response.TheCEAhasnotbeenfundedorrequestedfundingforprogramsassociatedwi ththe "0 ClimateChangeTechnologyInitiative.Question3.PleaseprovideatablewithFY8 9FY99historicalbudgetauthorityforyouragency X%! forthevariouscomponentsofthe U. S.GlobalChangeResearchProgramwhichwereoraredevotedexclusivelytoclimatechangeR&D .Foreachcomponent,pleaseindicateeachspecificbudgetaccount,thespecificlegislativ eauthority(includingthespecificstatue,thesectioncitation,andthelanguageofthesec tion),andabriefdescriptionoftheprogram."0IffundedinanyofFY93FY97pleaseprovide evidenceofanyaccomplishmentsfrom *|$' thesedollars.Also,forrequestedfundinginFY 99,pleaseindicateanyprogramperformancemeasuresfortherequestedfunding,and,foreac hsuchmeasure,pleaseprovidedataforthe1990baseyearandannualdataforthemostrecentth reeyearperiod -@'* forwhichdataareavailable.
(#(# Response.TheCouncilofEconomic
Advisers(CEA)hasnohistoricalorcurrentbudget < authorityforanycomponentoftheU.S. GlobalChangeResearchProgram.Question4.PleaseprovideatablewithFY89FY99historical budgetauthorityforyouragency foranyothercomponentsoftheAdministrationsclimatec hangeprogram(i.e.,inadditiontothoseincludedinanswerstoquestions1and2).Foreachco mponent,pleaseindicateeachspecificbudgetaccount,thespecificlegislativeauthority (includingthespecificstatue,thesectioncitation,andthelanguageofthesection),anda briefdescriptionoftheprogram.Response.TheCEAhasnothadhistoricalbudgetauthorityf oranyspecificcomponentsofthe $
Administrationsclimatechangeprogram.Wedo,however,devotenormalstafftimetopartic ipatingintheAdministrationsclimatechangepolicydevelopmentprocess.Question5.Fort heFY99request,pleaseprovideatableshowingwhatpartisfundingto 8
continueinitiati
vesfundedinFY98orprioryearsandwhatpartisbrandnewactivity.Foreachcomponent,pleas eindicateeachspecificbudgetaccount,thespecificlegislativeauthority(includingthe specificstatue,thesectioncitation,andthelanguageofthesection),andabriefdescript ionoftheprogram.Foreachbrandnewactivity,pleaseindicateexpectedrequestedfundinga

nnuallythroughFY03.Response.TheCEAdidnotmakeaclimatechangeprogramrelatedFY99request,hasnoprior H andnewinitiatives,andanticipatesnonethroughFY03.Question6.Pleaseidentifythefullsetofyouragencyspecificperformancemeasuresforthe p AdministrationsClimateChangeproposal(besidesthoseindicatedinresponsetoquestions2and3),includingdataforatleastthe1990baseyear,FY97,FY98,andFY99.Also,pleaseidentifyhowanyofyouragencyspecificmeasures(includingthoseinresponsetoquestions2and3)relatetothoseforanyotherFederalagency.Lastly,pleasedescribeanyinteragencyeffortstoidentifyandrelatetheentiresetofclimatechangeperformancemeasures,includingwhichagenciesareinvolvedandthenamesoftheagencyrepresentatives.Response.TheCEAhasnoagencyspecificclimatechangeperformancemeasures,norarewe $I! awareofspecificinteragencyeffortstoidentifyandrelatesuchperformancemeasures.Question7.PleaseprovideatableforFY93FY97identifyingallassistance(includinggrants, '0!$ cooperativeagreements, andothertransactions)andcontractawardstononprofitandforprofitorganizationsforanyclimatechangeactivity,includingthedate,amountoftheaward,nameoftheorganization, purposeoftheaward,andasummaryofanyresult(s)fromtheaward.Pleaseprovideacopyofanyfinalreportfromtheseawards.Response.TheCEAhasmadenograntsorawardsforFY93FY97anyclimatechange -&* activity.[Q:WhataboutconsultingbyMikeToman?]B.Economic,PolicyandLegalAnalyses < Answerspending.C.Dr.YellensTestimonybeforetheHouseCommerceCommitteeonMarch4,1998 15.PleaseprovideanyandallanalysesthatsupporttheAdministrationsconclusionthatimpactsontheU.S.economyofcomplyingwiththetermsoftheKyotoProtocolarelikelytobe modest.0Ourtestimonyconcludedthatthenetcostsofourpoliciestoreduceemissionsarelikelytobesmall,assumingthosereductionsareundertakeninanefficientmannerandwearesuccessfulinsecuringmeaningfuldevelopingcountryparticipationaswellaseffectiveinternationaltrading,andtheCleanDevelopmentMechanisminfuturenegotiations.InaTechnicalSupportDocument[tobe]releasedon______,theanalysessupportingthisconclusionarepresented.

(#(# 15.Continued.Also,explainfullyhowtheAdministrationcanmakesuchaforecastresponsiblywhenasDr.Yellenstated, itisnotyetpossibletoprovideafullauthoritativeanalysisoftheKyotoProtocol.Amongotherthings,Dr.Yellennotedthattheseisstill muchthatwedonotknowbecausemuchhasbeenleftunresolvedbythistreaty(forexample,implementationissues,therulesandproceduresgoverninginternationalemissionstrading,jointimplementationprojects,andtheCleanDevelopmentMechanism,andfutureemissionsreductionobligations).Moreover,Dr.Yellenassertedthattoherknowledge, no[economic]modelwhetherusedinsidethegovernmentornothasyetbeensetuptoanalyzetheimplicationsoftheKyotoProtocol,sincethisagreementisonlyafewmonthsold..0Aspreviouslystatedintestimony,theKyotoProtocolisaworkinprogress;itisincomplete.ThereremainsuncertaintyabouttheultimateregulationofinternationalpermittradingpursuanttotheKyotoProtocol,andthetimingandnatureofdevelopingcountryparticipation.However,thereshouldbenouncertaintyabouttheAdministrationsfirmcommitmenttoachieveeffectiveinternationalpermittrading,andmeaningfulparticipationbykeydevelopingcountries.TheAdministrationsconclusion,andthesupportingbutillustrativenumericalestimates,arebasedonourpoliciestoimplementtheKyotoProtocolcosteffectivelyaswellasontheProtocolitself.

(#(# 16.Pleaseprovideanyandallanalysesthatsupportthefollowingestimates:a.U.S.electricityrestructuring willofferapproximately$20billionincostsavings.0InparttorespondtotheseandotherquestionswehavepreparedaTechnicalSupport -&* Documentthatdetailsthederivationstothenumericalestimatesincludedinearliertestimony.PleaseseepagesxxtoyyoftheTechnicalSupportDocument.

(#(# b.
EmissionstradingamongtheAnnexIcountries canreducethecosttotheUnitedStatesofachievingitstargetsfor20082012emissionsbyabouthalf.PleaseseepagesxxtoyyintheattachedTechnicalSupportDocument.c.EmissionstradingamongasubsetofAnnexIcountries(forexample,theUnitedStates,Australia,Canada,NewZealand,andRussia) canreducecostsbyanestimated6070percent.0Thisstatementisbasedonouranalysisdescribedinpagesxxto

yyoftheTechnicalSupportDocument.
(#(# Also,basedontheestimatespresentedinJane
tYellenstestimony,pleaseexplainandfullydocumenthowmorelimitedtradingamongthissu
bsetofcountrieswouldproducegreatercostreductionsthanfromeithertradingamongallAn
nexIcountriesortradingwiththefullparticipationofNonAnnexIcountries0Undermanyi
nternationaltradingscenariostheUnitedStatesisexpectedtobuyemissionspermitsonint
ernationalmarkets.Asabuyer,theUnitedStateswouldenjoylowerpermitprices,andlowerc
osts,thegreateristhesupplyofpermitsthatitstradingpartnersarewillingtosellforagi
venprice.However,,ifsomeofthetradingpartnershaverelativelyhighabatementcosts,an
dsowouldpurchasepermitsoninternationalmarkets,thenthesepurchaseswouldreducethen
etsupplyavailabletobesoldtotheU.S.byitstradingpartnersasagroup.Reductionsinthes
upplyofpermitswouldraisethepriceandhencethecosttotheU.S.Inparticular,limitedtra
dingamongthissubsetofcountrieswouldproducegreatercostreductionsthaneithertradin
gamongallAnnexIcountriesortradingwiththefullparticipationofNonAnnexIcountriesbe
causethissubsetexcludessomepotentialtradingpartnerswithrelativelyhighabatementc
oststhatwouldotherwisebuypermitsoninternationalmarkets.
(#(# d.TheCleanDevelopm
entMechanism mightshavecostsbyroughlyanother20to25percent.0AftertheCleanDevel
opmentMechanismisincludedintheKyotoProtocol,althoughthedetailsabouthowitwouldwo
rkhavestilltobenegotiatedwithpartiestotheProtocol.TheAdministrationspolicyistha
tthedetailsoftheCDMshouldensurethatitbecomesanefficientmechanismtoallowdevelope
dcountryfirmstogivefinancingandtechnicalassistanceforprojectstoloweremissionsan
dtoreceivecreditforthereductions.Ourbestprofessionaljudgment,basedondiscussions
withavarietyofinformedanalysts,isthatthecostswouldfallbyroughlyanother20to25per
cent.
(#(# -&* e.Overallcosts wouldreachroughlyonetenthofonepercentofprojected
GDPin2010"(resourcecostsofachievingKyototargetsforemissionsreductionswereestima
tedtobe$7to$12billionperyearin2008to2012).0PleaseseepagesxxtoyyoftheattachedT
echnicalSupportDocument.
(#(# Also,pleaseexplainhowitispossiblethatcompliance
withtheKyotoProtocol,whichhasbeenprojectedbyindependenteconomiststobethemostexp
ensiveenvironmentalundertakingever,couldcostlessthancompliancewiththerecentlyis
suedU.S.airqualityrulesforparticulatematterandozone(thefinalRegulatoryImpactAna
lysisforthoserulesestimatedcostsof$46billion).0Asmentionedinthetestimony,inde
pendenteconomistshavegenerallynotestimatedthecostsoftheKyotoagreementandtheAdmi
nistrationspolicytoimplementit.Inparticulartheyhaveneglectedthecostsavingslikel
ytoresultfrominternationalpermittrading,fromtheCleanDevelopmentMechanismandmean
ingfulparticipationbykeydevelopingcountries.Thisneglectraisestheircostestimates
.
(#(# 0ThereisnoparticularreasonwhythecostsoftheKyotoProtocolshouldhaveanypa
rticularrelationtothecostsoftherecentlypromulgatedairqualitystandards.Webelieve
however,thatcarefulestimatesofthecostsoftheKyotoProtocolandtheAdministrationsIm
plementationpolicywillbesubstantiallylessthan$46billionperyear,andindeedcloseto
theillustrativenumberswehavepresentedearlier.
(#(# f.Theassumptionthattherateof
improvementinenergyefficiency(AEEI)willbe1.0percentperyear(whichisgreaterthanth
atassumedbytheEIA).0[AdddefenseofAEEI=1.00.]
(#(# Inparticular,pleasereconc
ilethisassumptionwiththestatementoftheCEAinits1998AnnualReportthat [u]ntilanemi
ssionscapandtradingsystemareinplace,however,theeconomicincentivetouse[technolog
iessupportedbytheAdministrationsbudget]maybelow.0Noreconciliationisneeded.The
commentfromthe1998ERPimpliessimplythatintheabsenceofacapandtradesystemthatwould
lowerthepriceofusingcarbonleantechnologiesrelativetocarbonrichtechnologies,thei
ncentivestoadoptsuchcarbonleantechnologieswillbetoolowrelativetoaworldwiththeca

pandtradesysteminplace.Moreover,theAEElrepresentstheautonomousrateoftechnologic alimprovement,i.e.,theratethatwouldoccurintheabsenceofpricechangesthatthecapand tradesystemmightleadto,duemerelytothegreateravailabilityofnewtechnologies.Thusi tsvalueisacommentontheextentofonestechnologicaloptimism,andnotaboutoptimismofpr ivatepartiestorespondtopriceincentives.
(#(# -&* IstheAdministrationassumingth atsuchasystemwillbeputintoplaceintheshortrun?0No,theAdministrationspositionon thetimingofacapandtradesystemhasnotchangedsincelastfall.TheAdministrationthenma intainedthatthesystemwouldbeestablishedwiththebenefitof10yearsofadditionalexper iencewithsimilarmarketbasedmechanism.
(#(# g.Theestimatedeffectonenergypriceswi llrangefrom$14to$23pertonofcarbonequivalent.0PleaseseepagesxxtoyyintheTechnic alSupportDocument.
(#(# h. Inenergyintensivesectorssomeemploymentreductioncould occur,althoughgiventheverysmallpredictedchangeinenergyprices,impactsinmostsuchs ectorsareapttobeminimalFurthermore,alargenumberofjobswillbecreatedinothersector smanyofthemhightechjobspayinghighwages.0AsexplainedintestimonyandintheTechnic alSupportDocument,theenergypricechangesexpectedtoresultfromtheKyotoprotocolandt heAdministrationsimplementationpoliciesaremodest.Inparticular,thesepricechanges overthenextdecadearelessthantheaverageofyeartoyearabsolutepricechangesobserveds ince1960.Thusthereislittlereasontobelievetherewillbelargechangesinemploymentinm ostsectors.Moreover,mosteconomicmodelshavenoabilitytoestimateemploymentchangesi nspecificsectorsthatmightresultfromsuchsmallpricechanges10yearsinthefuture.
(#(
0TheU.S.hasastrongcompetitiveadvantageinavarietyofhightechsectors.Recentinn ovationsinbatterytechnology,andinfuelcellswereannouncedbyU.S.companies.Theseinn ovations,andfutureonesexpectedfromU.S.companies,willbeindemandworldwide.Thegrow thinassociatedproductionislikelytoleadtogrowthinhighwagejobsinthiscountry.
(#(#
I.Astoeachanalysis,pleaseindicatewhopreparedtheanalysisandproviderecordsofcomm entsfromotherfederalagencies.0Alloftheanalysisforourtestimonyonclimatechangew aspreparedbyCEAstaffunderthedirectionoftheMembersoftheCouncil,withthecollaborat ionofstaffatseveralothergovernmentagencies.CEAstaffwhohaveworkedonclimatechange

(#(# ` JoeAldy` ZachCandelario` DanielChang` KeithFuglie` RandallLutter` AdeleMorris -&* Wearepreparingthelistofcommentsreceivedfro motherfederalagencies.17.PleaseprovideanyandallanalysesthatsupporttheAdministra tionsestimatethatbenefitsrelatingtotrafficcongestion,highwayaccidents,andairpol lutionunrelatedtoclimatechange couldoffsetapproximatelyaquarteroftheresourcecos tofthеclimatechangepolicy.0PleaseseepagexxtoyyoftheTechnicalSupportDocument.
(#(# Astoeachanalysis,pleaseindicatewhopreparedtheanalysisandprovideallrecordso fcommentsfromotherfederalagencies.0RandallLutteronourstaff,withtheassistanceo fTreasurysOfficeofEconomicPolicy,andEPAsOfficeofPolicyPlanningandEvaluationprep aredtheanalysis.Wearecompilingallrecordsofcommentsfromotherfederalagencies.
(#(
18a.Inhertestimony,Dr.Yellenstatedthat,inevaluatingthe likelyneteconomicimpac toftheKyotoProtocol,theAdministrationhas drawnuponabroadarrayofanalyticaltools, anda widerangeofmodelsoftheenergysectorandeconomyoverthenext25yearstoassessthev ariouspossiblecostsandnonclimatebenefitsoftheAdministrationsemissionsreductionp olicy.PleasespecifyallofthemodelsandanalyticaltoolsthattheAdministrationhasused anddescribeindetailtheirstrengthsandweaknesses.18.bAccordingtothetestimony,theA dministrationhasreliedparticularlyontheSecondGenerationModelofBattelleLaborator iesformanyofitsestimates.However,theIATreportindicatedthattheSGMmodel"focusseso nlongtermtransitionsandmeasurestheeconomyin5yearintervals,"sothatitrisksracingp

astshorttermtransitionissues,suchasGDPlossandimpactsonspecificindustries.Spec ifyalloftheAdministration'sestimatesthatwerederivedfromthismodel.0TheAdminist rationusedthismodel'sestimatesasoneofseveralinputsinitscalculationsoflikelyperm itpricesandresourcecostsforthedifferenttradingscenarios.(SeepagexxtoyyintheTech nicalSupportDocument.)Informationofthemarginalabatementcostcurvesofnoncarbongre enhousegaseswasmissingfromtheSGMoutputandaddedtoreflectprovisionsintheProtocol. Numericalestimatesofexpenditurechangesandancillarybenefitsusedestimatesoflikely permitpricesoremissionsreductionsasinputs.

(#(# Also,indicatewhymanyoftheAdmi nistration'skeyestimateswerederivedfromthismodel.0TheSGMmodel,unlikemanyecono micmodelsofclimatechangehasanexplicitmodelsofemissionsreductionsinothercountrie s,andsoisexceptionallywellsuitedfor -&* estimatingemissionspermitpricesgivenint ernationaltradeinpermits.Inaddition,ithasmodulesreflectingseveralmajordevelopin gcountriesanddataonallotherdevelopingcountriesasagroup.Thusitiswellsuitedtoaddr esstheeffectsofdevelopingcountryparticipationonpermitprices.Finally,thetimelyav ailabilityofsufficientinformationaboutavarietyofSGMmodelrunsmadeitsusepractical betweenthetimetheKyotoprotocolwasdevelopedandourfirsttestimony.

(#(# Finally, pleaseidentifythecorrespondingestimatesderivedfromeachmodelthattheAdministratio nhasusedinassessingtheimpactsoftheKyotoProtocol.0Thedevelopmentofcorrespondin gestimatesisacomplicatedtechnicaltaskthatisbeyondtheabilitiesofourstafftocomple teintimelymanner.WeexpectthattheEnergyModelingForumwillsoonproducecomparisonsof variousclimatechangemodels'forecastsoftheeffectsoftheKyotoProtocol.Althoughmany ofthesemodelswillnotyetincorporatethe5noncarbongasesdirectlyintotheirmodels,the secomparisonsshouldprovideafullcomparisonoftheSGMpredictionswiththoseofothermod els.

(#(# 19Whatarethe1990baseline,theFiscalYear1997,1998and1999,data,andtheann ualoutyearestimatesuntil2012forthefollowingoutcomeperformancemeasuresmentionedi nDr.Yellen'stestimony:morbidityratesforsomediseases,mortalityratesforsomecauses ,monetarydamagesfromtemperatureincrease,consequencesfromsomecatastrophes,traffi ccongestion,highwayaccidents,andairpollutionunrelatedtoclimatechange.0TheTech nicalSupportDocumentprovidesbaselinedatafortrafficcongestion,highwayaccidents,a ndairpollutionunrelatedtoclimatechange.Thesedataarefor2010,orfor1995,ifmorerece ntdatadonotexist,andnopublished2010forecastswereavailable.Forthesedatawehavenoi nformationofoutcomeperformancemeasuresfortheFiscalYearsrequested,orforyearbyyea restimatesthrough2012.

(#(# 20WhydoestheAdministrationmaintainthattheU.S.acidra inprogramexperience"clearlydemonstrateshowprogramslikeinternationalpermittradin g,jointimplementationandtheCleanDevelopmentMechanismwillleadfirmstofindcheaperw aysofreducingemissionsthatcanleadtounexpectedlylowcosts"?0

(#(# 0Emissionst radingprograms,byprovidingcontinuouseconomicincentivestoreduceemissionsfurther, generallyleadscoststobemuchlowerthanwouldbethecaseunderavarietyofmoreprescripti veregulatoryapproached.

(#(# WhydoestheAdministrationbelievethatitisappropriate toextrapolatefromthatexperiencetotheglobalarena.0Generallyeconomicincentivesh avesimilareffectsindifferentcountriesandcultures:peopleeverywhereareinterestedi nhigherincomes.Internationalpermitmarketswill -&* lowercompliancecostsinallpart icipatingcountries,becausetheyprovidefinancialincentivesforsomesourcestoreducee missionsfurtherthanmandated.Theseincentiveswillhavetheeffectofloweringthecostso femissionscutsrelativetowhatwouldbethecasewithoutanytradingofemissionspermits.

(#(# Won'ttheeffectivenessoftheinternationalsystem,jointimplementation,andtheCl eanDevelopmentMechanismdependondifferentfactors,suchastherulesandproceduresgove rningthesemechanisms,theextentofparticipationbyothercountries,includingdevelopi

ngcountries?0Yes.Theimportanceofeffectivetradingrules,andrulesonjointimplemen tationandtheCDMisthereasontheAdministrationisaskingotherpartiestotheProtocoltha ttheysupportregulationsthatwillleadtoeffectiveandsuccessfultrading,JIandCDM.
(#
(# 21aInhertestimony,Dr.YellenstatedthatpartofdoingitsmartI(i.e.,loweringthecost sofreducinggreenhousegasemissions)undertheKyotoProtocolmeans takingseriousandre sponsiblestepsintheshortruntoprepareustomeetourobligationsinthelongerterm.Shein dicatedthatthesestepsincludea$6.3billionprogramoftaxcutsandR&Dinvestments,indus trybyindustryconsultationstoprepareemissionreductionplansinkeyindustrialsectors ,andlegislationtorestructuretheelectricalindustry.UnderwhatauthorityistheAdmini strationpursuingthisunilateralexecutivebranchcourseofactioninfurtheranceofthetr eatysemissionsreductionstargetsandwithoutSenateRatification?0The$6.3billionin taxcutsandR&DinvestmentsisaproposalmadetoCongressaspartoftheannualAdministratio nbudgetpreparedundertheauthorityofthe_____.Theindustrybyindustryconsultationsdo notrequireexpresslegislativeauthoritybecausetheyarediscussingonlyvoluntaryemiss ionscutsthatindustriesmightmake.Theindustriesinquestionaresufficientlyconcerned abouttheirrolesinfosteringclimatechangethattheybelievetheyshouldtakevoluntaryme asures.
(#(# 21b.IftheAdministrationisdelayingthesubmissionofthetreatytotheSena teuntilitobtainsmeaningfulparticipationbydevelopingcountries,doesn'tthatdecisio nalsorequiretheAdministrationtodelayanyunilateralexecutivebranchactiontoaddress globalwarminguntilthatcooperationisforthcoming.0TheAdministrationisnotembarki ngonunilateralExecutiveBranchactiontoimplementtheKyotoProtocolwithoutratificati on.Tothecontrary,stepstoensurecompliancewiththeProtocol'srequirements,willbeund ertakenonlywiththefulladviceandconsentoftheSenate.However,theAdministrationispu rsuingavarietyofpoliciesthatmakegoodsenseindependentofconcernsaboutclimatechang eandthathavetheadditionaldesirablepropertyofreducinggreenhousegasconcentrations .ExamplesofsuchpoliciesincludetheCCTI,muchofwhichisanexpansionofexistingprogram s,aswellas -&* ongoingeffortstoassessefficiencystandardsforhomeappliances.These policesallreduceenergyconsumption,andtherebyreducedependenceonforeignoil,anemis sionsofairpollutantsunrelatedtoclimatechange,policygoalsthathaveenjoyedbipartis ansupportformanyyears.Thefactthatthesepoliciesreducecarbonemissionsshouldalsobe asharedpolicygoal,becausein1992theRioTreatyadoptedbytheBushAdministrationandrat ifiedbytheSenaterequiredtheU.S.totakeunilateralvoluntarystepstoreturnitsemissio nslevelsto1990levels.
(#(# c.GiventhattheKyotoProtocolseekstoaddressaglobalissu e,isn't[it]harmfultoU.S.intereststoproceedwithoutthefullparticipationofdevelopi ngcountries.0No.Aswehavetestified,thecostsofmeetingtheKyotocommitmentwillbemo destfortheUnitedStates.TheKyotoagreementrepresentsthebestinternationalagreement totakecollectiveactionthatcouldhavebeennegotiated:itsprovisionsforinternational permittrading,jointimplementationandtheCleanDevelopmentMechanismensureflexibili tyandcosteffectiveness.Giventhisflexibilityandthehistoriccommitmentstoreduceemi ssionsamongdevelopedcountries,itisareasonablepolicytotakeprudentcutsinemissions thatareimportantinavertinggreaterdamagefromclimatechange.
(#(# d.Besidesbeingun constitutional,isn'titalsoprematureandharmfultoU.S.intereststotakesuchunilatera lactions,withoutratification,whentheAdministrationhascharacterizedtheProtocolas a"workinprogress"aProtocolthatisnotyetfullycompletenorreadyforthePresident'ssub missiontotheSenate?0No.First,asexplainedabove,theseactionshaveindependentpoli cymeritapartfromtheirimplicationsforgreenhousegasemissions.TheAdministrationiss ubjecttoavarietyofpressuresfromothercountries.Oneconcernoftenexpressediswethert heU.S.isseriousaboutreducingemissions.
(#(# D.Cost/BenefitAnalysisoftheKyotoTre aty[sic]22aPleaseprovideanyandallanalysesthattheAdministrationoranyfederalagenc

ypreprepared(orhadprepared)orispreparing(orishavingprepared)ofthecostsandbenefitso fimposingontheU.S.thebindingtargetsandtimetablessetforthintheKyotoProtocolforre ducinggreenhousegasemissions,takingintoaccounttheglobalimplicationsofthewayinwh ichthisagreementisstructured.0TheTechnicalSupportDocumentprovidesadditionalde tailedinformationabouttheeconomicsoftheKyotoProtocol.Akeyareathatwehavenotpursu edinouranalysis,however,isthebenefitsoftheProtocol.Thesebenefitsareexceptionall ydifficulttoquantifybecauseclimatechangeraisestheriskoflargescaleirreversibleca tastrophiceventslikedisplacementofimportantoceancurrentsthatwarmmidlatitudearea s.Inaddition,thequantificationofclimatechangebenefitsisquitedependentonthechoic eof -&* discountrate,whichforperiodsaslongasacenturyisthesubjectofongoingprofes sionaldebate.Moreimportantly,however,theKyotoProtocolisjustafirststepinaddressi ngclimatechange.Furtherstepswillentailadditionalcutsinemissionsinyearsbeyond201 2,anduncertaintyaboutthemagnitudeofthesetprecludesmeaningfulanalysisabouttheeffe ctsoftheKyotoagreementitselfonclimate.

(#(# Alsopleaseanalyzeanddocumentthefoll owing:22b.WhetherthebenefitsofimplementingthisProtocolarejustifiedbythecosts.22 c.Evaluatetheeffectivenessofthisagreementbycomparingthemarginalabatementcostsof themostplausiblealternativescenariosformeetingtheKyototargets,giventhewayinwhic hthisagreementisstructured,withthemarginalcostsofotherreasonablealternativecomp lianceschemes.22d.Withrespecttoeachscenariothatisanalyzed,identifytheassumption sused,explainanyuncertaintiesconcerningtheassumptions,andexaminethesensitivityo fneteffectstothedifferentcompliancestrategies,usingarangeofplausibleassumptions aboutfutureeconomicdevelopmentandaboutfundamentalclimateprocesses.22e.Evaluatet heopportunitycostsofpursuingtheAdministrationsstrategyfortheabatementofgreenhou segasemissionsunderthetermsofthetreaty;0AstheProtocolisaworkinprogressitmakes nosensetoevaluateitsopportunitycostswithoutconsideringalsotheadditionalflexibil ityinitsimplementationthatwillbeachievedastheresultofcontinuedU.S.effortsinongo ingdiplomaticdiscussions.TheopportunitycostsoftheProtocolandtheAdministrationsp oliciestoimplementareextensivelydiscussedinpriortTestimonybyJaDr.JanetYellen,an dintheTechniclaalSupportDocument.byassoc

(#(# and22f.Evaluatehowthebenefitsandb urdensofcomplyingwiththistreatywouldbedistributedonthenationalandhouseholdlevel s,describing,amongotherthings,thedisparateregionalandindustrialimpacts,andtheef fectsondifferentincomelevels.0Asmentionedinmyearlierverbaltestimony,althought hedistributionaleffectsofapolicyareimportantinevaluatingitsmerit,theenergyprice changesassociatedwiththeKyotoProtocolandtheAdministrationsimplementationofitare likelytobemodest,andsmallerthantypicalyeartoyearabsolutechangesinenergypricesob servedsince1960.Thereforestimatingsectoralimpactsofsuchsmallenergypricechangesf oraperiod10yearsinthefutureisveryunlikelytobesuccessful.Suchanexercisewouldsugg estthatparticularindustrieswouldbearburdenshigherorlowerthanonaverage.However,s uch -&* results,becauseofhowfartheyareinthefuture,andbecausetheunderlyingaverag eexpectedfuelpriceissosmallarequiteunlikelytobeinformativeaboutthemeritofadopti ngtheKyotoProtocolatall.

(#(# 23a.Inevaluatingalternativescenarios,pleaseexamin ethefollowing.23b.Comparetheeconomicandenvironmentaleffectsofnotincludingdeve lopingcountriesintheefforttoreduceglobalemissions(withthepotentialforbindingdev elopedcountriestoevengreaterobligations,withoutlimitingdevelopingcountriesatall)againsttheeffectsofaddressinggreenhousegasmitigationonaglobalscalebytheinterna tionalcommunity.0Althoughclimatechangeisaglobalproblem,letusnotpretendthatitn eedsliterallya t globalsolution,althoughpoliciesapproachesencompassingmorecoun trieswilllikelybebothmoreeffectiveandmorecosteffectivethanapproachesinvolvingon lyafewcountries.Verypoorcountries,orthosethataresmallcontributorstoglobalgreenh ousegasemissions,areunlikelytohavemucheffectontheclimatewhetherornottheypartici pate.ByparticipatingintheCDM,orinanappropriatelydesignedcapandtradesystem,suchc

ountriescouldofferimportantcostsavingstotheU.S.andotherindustrializedcountries; suchopportunitiesarealegitimateandimportantreasonforustocontinuetoseekgreaterin volvementbydevelopingcountries.However,ifsuchparticipationisnotforthcominginama nnerconsistentwithoutaspirations,theKyotoProtocolmaystillofferauniqueopportunit ytopurchaseaninsurancepolicyatmodestcostsagainstthemoresevereclimatechangerisks
.
(#(# 23c.Comparetheeconomicandenvironmental================== END ATTACHMENT 1
==================

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:13-MAY-1998 11:56:37.00

SUBJECT: request from Todd re case for int. emissions trading

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

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

TEXT:
Janet,

See (below) Todd's request re the NYT and the morality of international permit trading.

I have written out some thoughts by way of a possible reply to Clapp's anti-trading view. (The file is called "protrade.") Someone will have to judge whether it is appropriate in tone.

This line of argument does not address the other approach -- "limitations on trading would in any case be unworkable" that Todd discussed at the meeting three weeks ago But we can do more; Randy was going to give this some thought. (One could invoke black-market images of what happens in response to artificial price differentials when national markets are separated by law.)

JF

PS I attach also the reply that Sarah drafted to the "trading is immoral" op-ed in the NYT, by Michael Sandel 5 months ago. (We deleted one paragraph.)

---------------------- Forwarded by Jeffrey A. Frankel/CEA/EOP on 05/13/98 11:51 AM ---------------------------

Todd Stern
05/12/98 09:28:57 AM
Record Type: Record

To: Joseph E. Aldy/CEA/EOP
cc: Jeffrey A. Frankel/CEA/EOP
Subject: emissions trading

I spent some time in NY yesterday with Bob Sempel, the NYT editorial writer who covers the environment. When I got back, I had a message on my voice mail from him saying he had received a mailing from Phil Clapp, a well-known enviro, criticizing the Administration because of our support for international trading. I haven't seen the mailing yet, but he evidently does the standard European/enviro attack about how most of our reductions should be done at home, etc.

I have been saying lately that we support unrestricted trading not because we're trying to evade action at home -- the President is clearly committed to taking action -- but because building constraints into a trading system (e.g., at least 50% of reductions have to be done at home) will reduce its efficiency and consequently cause world permit prices to be higher than they otherwise would be. Is this argument correct? If so, can you write a few points to make this economic argument in a more serious way than I have stated it? If not, do you have any other bright idea about how to answer the argument? The Times is explicitly looking to us to answer Clapp's attack.

If I get a hold of the mailing, I will send you a copy. tds

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D41]MAIL434195231.126 to ASCII,
The following is a HEX DUMP:

"The Virtues of Emissions Trading"

In evaluating the desirability of trading, one must begin by considering what one is trying to accomplish. Is the goal to accomplish the maximum environmental improvement for the minimum cost? Or is the goal to strike a picturesque pose, to feel good about one's environmentalist stance, e.g., by maximizing the economic cost inflicted on one's own country? Let us [for the moment] stipulate that the goal is the former.

Once countries' targets for emissions of greenhouse gases are set, as they were among industrialized countries at Kyoto, the impact on atmospheric concentrations is determined and therefore the impact on the global environment is determined. The environmental impact is the same, regardless whether or not trading is used to lower the economic costs of meeting those targets. The reason is that a ton of carbon emitted into the atmosphere has the same effect on global warming regardless where it is emitted. (There is of course the distinct -- and admittedly difficult -- issue of enforcement. But a plan that achieves targets at low economic costs is, if anything, less likely to be violated than a plan that does so while inflicting high economic costs.)

Estimates are that emissions trading, even just among the Annex I countries, reduces the costs of attaining the Kyoto targets by about half. Conversely, a quota that limited trading sharply, as some are proposing, would approximately double the economic costs of attaining those same targets.

Why are economists so sure that trading raises economic welfare? It is far cheaper to reduce emissions in some countries than others. Russia and Ukraine, for example, use about six times more energy as a share of GDP than we do, and the energy tends to be of a more polluting type. So it is far cheaper for Russia to cut back emissions of greenhouse gases than for us to cut back. The Russians are unlikely to cut back sufficiently if they are not given an incentive to do so. But if we pay them to undertake energy-saving investments (e.g., by replacing dirty coal-fired power plants with gas-fired ones), then everyone is better off. There is a simple "proof" that countries/firms/people are better off, or at the least no worse off, with the opportunity to buy or sell emissions than without that opportunity: consenting adults can always choose not to exercise the right to buy or sell, if it turns out that the transaction does not in their estimation benefit them.

The argument for trading emissions is similar to the argument for trading other things. It is more efficient to let each country do what it can do most cheaply, just as it is more efficient for people to specialize in what they do best. This is why we no longer each grow our own food and skin our own animals for fur. Under our (quite successful) economic system, food, clothing, and other goods and services are produced by whoever can do so most efficiently, each of us earning the money in one endeavor to buy what is produced in others.

Those who are opposed to trading seldom try to refute the logic regarding the efficient achievement of environmental goals. Rather, they tend to express a visceral negative reaction to trading -- sometimes a feeling that it is immoral. It is certainly true that one would not want to sanction an immoral act, aside from its environmental and economic benefits. But it is very important to recognize that a pronouncement that trading is immoral constitutes a declaration that one is seeking to accomplish something other than just environmental goals. Opponents must believe that non-trading is a goal in itself -- they must assume directly, outside the realm of science or rational policy analysis, that trading is immoral. There might be some to whom demonstrating environmental passion by inflicting costs is genuinely more important than improving the environment. But most Americans would probably describe themselves as more interested in improving the environment than in proving their environmentalist fervor.

That international trading of emissions permits reduces the economic costs of achieving our environmental goals should be considered a virtue, not a point against it. Minimizing the costs per given environmental achievement can also be viewed as maximizing the magnitude of environmental achievement that is possible per given costs. Again, a virtue. In this light, trading -- rather than being immoral -- is virtuous.

Washington, DC

Michael J. Sandel, in his Op-Ed "It's Immoral to Buy the Right to Pollute" (NYT 12/15/97), complains that establishing international permits to emit greenhouse gases would remove "the moral stigma that is properly associated with [pollution]." Since Sandel's sentiment is a common one, a response is in order.

Sandel argues that emissions trading "creates loopholes that let wealthy countries evade their obligations" by purchasing credits from countries who can reduce emissions more cheaply. Certainly, he does not mean that trading allows wealthy countries to evade *legal* obligations since the Protocol specifically calls for trading. Trading does not compromise obligations to the *environment* because, as Sandel rightly points out, in reducing the risk of climate change, it makes no difference where emissions reductions occur. The concern about Russia's having a target that is above projected emissions for the target compliance date of 2008 to 2012 is a concern about targets, not trading. Presumably, Sandel refers to a *moral* obligation to cease polluting.

Sandel is essentially objecting to the "commodification" of pollution, arguing that it "removes the moral stigma that is properly associated with it." And he draws a distinction between a fine, a punitive measure with a moral stigma, and a fee, which is simply another cost of doing business. Fines are appropriate in some cases including littering in the Grand Canyon and parking in a handicapped space, to which he compares emitting greenhouse gases. These are false analogies, however. Whereas the activities to which Sandel refers are "asocial," greenhouse gas emissions are *byproducts* of socially and economically productive activity. The logical extension of Sandel's analogies would lead us to believe that the only morally defensible course is to emit zero pollution, and he surely could not have meant that Americans are immoral every time they turn on the lights (or emit carbon dioxide by breathing out).

This does not mean that pollution should be ignored. The Kyoto agreement and a slew of domestic environmental regulations demonstrate that the United States and other nations have recognized the need to control, but not necessarily eliminate, these pollutants. Sandel's analogies more appropriately apply to the violation of permits under these regulations. Firms that violate their permits are rightly fined (and in some cases criminal penalties might also apply) because they have violated the law. Sandel also misses a major advantage of a fee over a fine: *it imposes disincentives to pollute at all levels of emissions.* A fine presumably only kicks in at a certain unacceptable threshold level, under which no disincentive operates.

In order to make meaningful progress in mitigating climate change, the developed world must work with the developing countries to facilitate reduction in greenhouse gases without undermining economic development. Indeed, developing countries' primary and justifiable concern about international climate change policy is that they will be asked to pollute less as they strain for the economic growth that will give their untold millions a reasonable standard of living.

Finally, Sandel objects to emissions trading on the grounds that it will undermine a sense of shared responsibility that increased global cooperation requires. An international system to establish emissions limits, monitor participants, verify reductions, and transfer technology requires an enormous and unprecedented amount of cooperation and institution-building -- certainly more than each country turning inward for pollution reductions with command-and-control regulation. And make no mistake, the U.S. will fully bear its share of the responsibility for emissions reductions by accepting binding targets and paying for emissions reductions accordingly, even if some share of the emissions reductions occur in other countries.

The President's climate change proposal includes important policies to promote cost-effective emissions reductions. A system of tradable emissions permits among developed countries, along with opportunities for developed countries to invest in climate-friendly technologies in developing countries, could reduce the total cost of achieving our greenhouse gas goals by as much as 80 percent. The Administration believes that finding low cost, efficient, and clean technological solutions are key to addressing climate disruption risks.

While paying less than we might for a better environment may not appear righteous to Sandel, paying more for the exact same environmental achievement has its own problems. Every dollar society spends unnecessarily to meet our greenhouse gas objective is a dollar we cannot spend on other worthy environmental and social goals. Dismal as we economists may sound, we think that voluntary and mutually beneficial exchanges between cooperating nations for the betterment of the planet makes perfect sense.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:13-MAY-1998 14:44:42.00

SUBJECT: Re: report from morning mtg.

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

TEXT:
I would like to see a copy of the memo going to POTUS on Japan or know if there are any changes of significance in Treasury's views concerning what Japan should do.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:13-MAY-1998 09:12:42.00

SUBJECT: "Admin. to Study Business Concentration"

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

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

TEXT:
In today's WSJ, in case you didn't see it. "The first meeting next week.." (Nice to find out our schedule from the papers.)
Aaron, we have to intensify our efforts along the lines that you and I have discussed, and that Janet and you discussed before that.

Apparently Henry Kaufman has been arguing that these mergers are in danger of leading to a damaging degree of concentration. One of several possible contrary arguments is that globalization is redefining the market to be global, so that the mergers have not raised monopoloy power. Let's look into Kaufman.

Let's try to meet on this, perhaps this afternoon.

Big Questions:
Is concentration going up? (Kaufman...) How direct is link between mergers and measures of overall concentration?
What is the tradeoff between efficiencies from scale economies and inefficiencies from monopoly power?
How does current merger mania compare to past (80s and 60s; see attached file)?
Role of technology (network externalities, etc.)
Role of globalization.
Administration anti-trust policy (effect on consumers..., e.g. 98 ERP)
Financing of mergers (debt vs. equity; does merger mania signal a bubble? a la Economist)
Effect of mergers on workers.
Firm size and job creation (Haltiwanger...)

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D11]MAIL49556323H.126 to ASCII,
The following is a HEX DUMP:

	Current merger boom	vs. 1980s merger boom
Stock market	Very high	Undervalued
Financing of takeovers	Stock swaps	Debt
Effect on firm size	Consolidation; economies of scale	Spinning off; Downsizing
Geographic scope	Partly international	Primarily domestic
Implications for management		
Implications for workers		
Implications for consumers		
Implication for investors		

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Dorothy Robyn (CN=Dorothy Robyn/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME:13-MAY-1998 19:03:17.00

SUBJECT: Mergers

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: Charles F. Stone (CN=Charles F. Stone/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:
---------------------- Forwarded by Dorothy Robyn/OPD/EOP on 05/13/98
07:02 PM ---------------------------

Thomas A. Kalil
05/13/98 06:38:12 PM
Record Type: Record

To: Dorothy Robyn/OPD/EOP
cc:
Subject: Mergers

Did you see this?

White House to look at wave of mergers

By Steve Holland

WASHINGTON (Reuters) - The White House is establishing a high-level group
to review a
wave of corporate mergers and determine whether competition will suffer as
a result, aides to
President Clinton said Wednesday.

Driven by a soaring stock market, some $114 billion in mergers have been
announced involving
U.S. companies in May alone, coming after a record $260 billion in mergers
in April.

A White House official, who spoke on condition of anonymity, said the group would be headed
by Gene Sperling, chairman of the White House National Economic Council.

It will include Treasury Secretary Robert Rubin and his deputy Lawrence Summers, Council of
Economic Advisers chair Janet Yellen and Commerce Secretary William Daley, among others.

The White House official said the group, formed at Clinton's request, would not necessary
recommend legislative action.

"When there is a major trend like this in American business, there is a presumption that you
need to take a look at it," the official said. "There is not a presumption that you need to act."

He said the group would ultimately report to the president on its findings.

"They will take a look and see whether we're increasing competition and improving American
industry. It's not meant to look at individual mergers. We'll leave that to the regulatory agencies,"
the official said.

The group is expected to have its first meeting during the week of May 25.

Clinton said last week that the wave of mergers was probably inevitable and that the
government must make sure consumers are protected.

The mergers have raised questions in some corners of Washington that competition will suffer,
driving up prices for consumers.

The White Houses official said no single merger prompted Clinton to ask for a study, but the
trend caught his attention in the past month or so and that he has written a variety of notes about
it to Sperling.

Federal regulators filed suit Tuesday to block plans by MCI Communications Corp. and Rupert
Murdoch's News Corp. to merge their satellite TV company with one owned by major cable
TV companies. The Justice Department alleged violations of antitrust laws.

Just this week there have been some big deals.

On Monday, SBC Communications Inc. and Ameritech Corp. announced a $61 billion stock
transaction that would create the country's largest telephone company with

control over an
estimated 57 million phone lines.

That deal is expected to generate intense scrutiny from regulators, competitors, politicians and consumer groups.

Energy service company Baker Hughes Inc. agreed to buy Western Atlas Inc. for about $5.5 billion in stock; Monsanto Co. announced plans to acquire seed companies DeKalb Genetics Corp. and Delta & Pine Land Co. for a combined $4.4 billion; and New York utility Consolidated Edison Inc. said it would buy Orange & Rockland Utilities Inc. for about $790 million.

Last week, German carmaker Daimler-Benz AG announced plans to buy U.S. auto icon Chrysler Corp. for more than $40 billion in the largest-ever cross border transaction.

And last month there was the giant $70 billion-plus union of financial services titans Travelers Group Inc. and Citicorp.

The merger spree actually began about three years ago but has accelerated in the past year due to soaring stock prices, confidence in the state of the economy and the notion that companies need mass to compete in a global marketplace.

So far in 1998, $614 billion worth of corporate transactions have been announced compared with a record $908 billion for all of 1997. ^REUTERS@

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: "Tim Brennan, Policy Sciences" <BRENNAN@UMBC2.UMBC.EDU> ("Tim Brennan, Policy Sciences" <BRENNAN@UMBC2.UMBC.EDU> [UNKNOWN])

CREATION DATE/TIME:13-MAY-1998 14:50:12.00

SUBJECT: mergers

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

TEXT:
Janet,

Saw the story about the "high-level" group on the WEB. If I can be of any help, let me know. I tried to hint at some possible issues, particularly in the "deregulating" industries of telephones and electricity, in a box in the '97 ERP. I tried to float when I was there the idea of a "moratorium"
for mergers in those industries, until relevant policies that determine the extent of the relevant markets had been put in place in an operational way. Don Gips thought it was an interesting idea, but it probably appropriately didn't go anywhere. Joel Klein has floated the idea from time to time as well. One noteworthy thing about it is that it is one area where a legislative initiative, rather than a change in enforcement practice, would be necessary.

Regarding enforcement, I have to say that for the most part, the quality of the analysis and judgment in the Antitrust Division at the highest levels
is as high as I've known it in my (God!!) 20 years of affiliation with it. I've seen some of it fairly close hand in my work with them on Microsoft. There are a few things I'd tweak, but by and large I don't think the problem is that the powers that be aren't disposed to get it right.

They probably could use a bigger budget, with all that's going down, but I'm sure they can and will make that case in the appropriate venues.

Hope all's well,

Tim

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:14-MAY-1998 22:11:50.00

SUBJECT: News story on Janet's Wednesday Testimony

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

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

TEXT:
Please see the THIRD of the files attached to Ray's e-mail.

---------------------- Forwarded by Randall W. Lutter/CEA/EOP on 05/14/98
10:06 PM ---------------------------

Ray.R.S.Squitieri @ MS01.DO.treas.sprint.com
05/14/98 06:00:00 PM
Record Type: Record

To: Randall W. Lutter, Adele C. Morris
cc:
Subject: Environment & Energy Email Update for May 14, 1998 -Forwarded

Date: 05/14/1998 05:49 pm (Thursday)
From: Ray Squitieri
To: randy,joe,adele
Subject: Environment & Energy Email Update for May 14, 1998
-Forwarded

See story on Janet's testimony.

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

TEXT:
Subject: Environment & Energy Email Update for May 14, 1998

================== END ATTACHMENT 1 ==================

==================== ATTACHMENT 2 ====================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Subject: Environment & Energy Email Update for May 14, 1998
================== END ATTACHMENT 2 ==================

==================== ATTACHMENT 3 ====================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Dear Reader,

Here is the Environment & Energy Email Update.

Each Email Update provides you the highlights from our twice-weekly and monthly publications as well as special announcements. You can also access complete stories online by clicking on the listed links. This is the easiest way to track the issues that concern you the most.

Online access is password protected. If you know your subscriber codes, simply type them in upon request. If you are a subscriber and need codes assigned, please call or email us. If you aren't a subscriber and want to test this online service, call or email us and we will give you a free trial.

If you don't wish to receive any further Email Updates, please reply by writing "cancel email" in the message field.

Thank you.

EESI Publishing
http://www.eesi.org/
Email: (mailto:pubs@eesi.org)
Phone: (202)628-6500 -- Toll Free: (888)884-3374
Fax: (202)628-1825

LEADING THE NEWS....

Climate Change

Yellen criticizes "pessimistic" economic models of Kyoto
http://www.eesi.org/subscriber/search/search.cgi?op=pdf&file=mwu.htm#1

Characterizing her own economic analysis of the Kyoto Protocol to reduce greenhouse gas emissions as conservative, Janet Yellen, chairwoman of the White House Council of Economic Advisors, on Wednesday criticized many of the competing, negative analyses - particularly a prominent one by WEFA, Inc.

The studies which show the protocol will result in dire consequences for the U.S. economy are formed under "the most pessimistic assumptions," Yellen told the House International Relations Committee. They fail to take into account not only the economic benefits of cleaner air but also the agreement's emissions limit on six greenhouse gases and provisions for international emissions trading, the proposed clean development mechanism to broaden energy efficiency technologies, and the expected emissions reductions from carbon sequestration by forests, or sinks, she said. While many of these factors still need to be worked out by negotiators, Yellen said they are an essential part to the administration's analysis, which concluded total U.S.-Kyoto related expenses will be modest ($7 billion to $12 billion per year, or 0.1 percent of gross national product).

Yellen said the council's economic report, released in early April, does include a number of "reasonable assumptions," such as a projected U.S. savings of about $20 billion from a federally deregulated electric utility industry and savings produced by the enactment of President Clinton's $6.3 billion budget proposal to boost energy efficiency. She said any analysis involves a large amount of uncertainty in measuring the short-term costs, and it is impossible to predict the long-term costs of having to mitigate global warming. But Yellen also said the administration's analysis uses conservative estimates and does not take into account "substantial" projected savings from further technological advances and the full utilization of carbon sinks.

Mary Novak, senior vice president of WEFA, Inc. (Wharton Econometrics), said emissions trading among developed nations is unworkable and some countries would view the clean development mechanism as threatening to their national sovereignty. WEFA's analysis, also released in April, sets total U.S.-Kyoto related costs at over $250 billion, or a loss of 3.2 percent of GNP. Plus, Novak said, about 2.5 million jobs would be lost and the annual expense per family would exceed $2,700.

Again defending her report, Yellen acknowledged the production of coal in the United States would likely be affected by the Kyoto Protocol, but that would be a "tapering off, rather than a sharp decline."

The hearing was sparingly attended, and the administration was provided with a marked reprieve from congressional criticism of the protocol. Reps. Tom Campbell (R-Calif.) and Pat Danner (D-Mo.) were, though, skeptical of Yellen's estimates. Under Secretary of the Department of State Stuart Eizenstadt again defended Clinton's budget proposal against recent charges of "de facto" implementation, and he reassured Chairman Benjamin Gilman (R-N.Y.) that the agreement will not be submitted to the Senate until there is "meaningful participation" from key developing nations.

Convincing those developing countries to sign on and agree to cut their own greenhouse gas emissions involves a vast educational effort of the benefits of international emissions trading and the clean development mechanism, Eizenstadt said, which "will take months and perhaps years."
- Neil Franz

Budget

Kasich ready with plan, other issues muddy budget picture
http://www.eesi.org/subscriber/search/search.cgi?op=pdf&file=mwu.htm#2

Agriculture/Water Pollution

Witnesses call for greater financial support of CAFO strategy
http://www.eesi.org/subscriber/search/search.cgi?op=pdf&file=mwu.htm#3

Defense/Hazardous Waste

Senate defense bill holds on to PCB provision
http://www.eesi.org/subscriber/search/search.cgi?op=pdf&file=mwu.htm#4

Transportation

Leadership meets; negotiations over ISTEA spending drag on
http://www.eesi.org/subscriber/search/search.cgi?op=pdf&file=mwu.htm#5

Forests

House easily passes watershed management, forest land exchange bills
http://www.eesi.org/subscriber/search/search.cgi?op=pdf&file=mwu.htm#6

Questions or Comments? (mailto:pubs@eesi.org)
EESI Publishing
http://www.eesi.org/

If you would like to reach us by phone, please call (202)628-6500 or
(888)884-3374.

================== END ATTACHMENT 3 ==================

==================== ATTACHMENT 4 ====================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
RFC-822-headers:
Received: from conversion.pmdf.eop.gov by PMDF.EOP.GOV (PMDF V5.1-9 #29131)
 id <01IX16PH2WWG0072KG@PMDF.EOP.GOV>; Thu, 14 May 1998 18:02:08 EDT
Received: from Storm.EOP.GOV by PMDF.EOP.GOV (PMDF V5.1-9 #29131)
 with ESMTP id <01IX16PB0K68006QSI@PMDF.EOP.GOV>; Thu,
 14 May 1998 18:01:59 -0400 (EDT)
Received: from reston-mx1.telemail.net ([206.229.206.20])
 by STORM.EOP.GOV (PMDF V5.1-10 #22921)
 with ESMTP id <01IX16O9WU660019AT@STORM.EOP.GOV>; Thu,

14 May 1998 18:01:12 -0400 (EDT)
X400-Received: by /PRMD=GOV+TREAS/ADMD=TELEMAIL/C=US/; converted (ia5-text)
; Relayed; Thu, 14 May 1998 18:00:31 -0400
X400-Received: by /PRMD=GOV+TREAS/ADMD=TELEMAIL/C=US/; converted (ia5-text)
; Relayed; Thu, 14 May 1998 18:00:31 -0400
X400-Received: by /PRMD=GOV+TREAS/ADMD=TELEMAIL/C=US/; converted (ia5-text)
; Relayed; Thu, 14 May 1998 18:00:31 -0400
X400-Content-type: P2-1984 (2)
X400-MTS-identifier:
[/PRMD=GOV+TREAS/ADMD=TELEMAIL/C=US/;939571415089911/1827291@TREAS]
X400-Originator: Ray.R.S.Squitieri@MS01.DO.treas.sprint.com
X400-Recipients: Joseph_E._Aldy@oa.eop.gov, lutter_r@a1.eop.gov,
morris_a@a1.eop.gov
================= END ATTACHMENT 4 =================

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:14-MAY-1998 15:30:42.00

SUBJECT: Bus Econ Speech

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.D20]MAIL40602143W.126 to ASCII,
The following is a HEX DUMP:

Asia's Challenges

It is a pleasure to be here today. I debated a little over what to speak to you about this morning. Discussing the booming U.S. economy and the extraordinary change in the budget outlook was pretty high on the list, but I decided that after 5 consecutive years of good news that must be getting a little tedious. That said, I do feel the need to briefly comment on the budget outlook.

[budget outlook comments]

That said, I decided not to talk explicitly about the domestic economic situation. Instead, I would like to talk about significant developments in Asia that have important consequences for the U.S. economy. In particular, last Saturday I returned from a week long trip during which I met with many senior officials in the Chinese government. This trip was a continuation of an ongoing dialogue between the CEA and the Chinese State Development and Planning Commission. This dialogue was initiated two years ago by the CEA as a reflection of our firm belief in the importance of actively engaging the Chinese in a dialogue of economic issues as they pursue their ambitious reforms. Given recent accomplishments in pulling 200 million people out of poverty and generating a decade of unprecedented growth, it is clear that over the long term, China will serve as an important strategic partner for the United States. Accordingly, it is in our mutual interest to help and prod China into the world economy. [relate to POTUS trip?]

I had the pleasure of leading a delegation consisting of Robert Shapiro, the Undersecretary for Economic Affairs at the Department of Commerce and Roger Ferguson, a former student of mine and a Governor at the Federal Reserve Board, my old stomping grounds. Our trip began in Beijing and subsequently took us through Shanghai to Hong Kong. This was my first trip to East Asia and I found it to be an incredible experience in contrasts. As I'm sure many of you know, or can well imagine, the difference in atmosphere between Beijing and Hong Kong is nearly as extreme as can be found anywhere in the world. Beijing, although growing rapidly, still maintains an old world feel to it, where the old world took place less than 20 years ago and was rather grey and drab. On the other hand, Hong Kong is well established and one might even say glamorous, save for the myriad of rusty ships inhabiting the harbor.

During this visit, the challenges facing China over the course of the next few years were made abundantly clear. These challenges stem from a major restructuring of both the Chinese government bureaucracy and of the primary economic system. These reforms are further complicated by four millennia of history in which the Chinese population has placed a heavy reliance on the government for guidance, direction and support.

In March of this year, China's new Premier, Zhu Rongji, presented concrete plans for the development of a new economic system in China involving significant reform of the current system. These reforms are on a relatively tight timeline and include dramatic reorganizations in the banking sector, the industrial sector, the provision of social services and the structure of the government bureaucracy. In the banking sector, reforms include a transition from government directed lending to lending based on conventional commercial practices comparable to those of banks in the west. The industrial sector, generally characterized by state owned enterprises will see a great deal of change involving reduced government ownership and increased corporatization. Social services, including housing, unemployment insurance and pension plans, previously provided by employers, will now be provided by the market or directly by the government. Much of this reform is to be implemented within three years time.

The magnitude and ambitiousness of these economic reforms is staggering. Begun in 1978, the process of reform has served to encourage competitive, capitalistic behavior. The vast majority of the Chinese economic system has, however, remained largely centrally planned. The new round of reforms is designed to do away with central planning and to institute what is often referred to as a "socialist market economy". Alternatively referred to as a "market economy with Chinese features". My current read of this definition is that it implies a relatively free market system in which the government maintains a significant ownership role in much of the productive capacity. The heavy government regulation of the economy will be gradually, in the Chinese tradition, but significantly reduced.

Reform of the beleaguered banking system might be considered the top layer of these reforms and perhaps the most technically challenging. For the last 50 years, a system of directed lending has made the banking sector the primary conduit through which government funds have been provided to the thousands of state owned enterprises. As a result, the banking sector is, from a western perspective, overloaded with non-performing loans -- the extent of non-performing loans is generally thought to be 20-25 percent of total bank lending -- and is illequipped to carry out its current mandate to make lending decisions based on conventional commercial banking principles.

In January of this year, the extent of lending directed by the government was significantly reduced and banks were given wide discretion to lend on a commercial basis. Although many feared that the bank managers would dramatically increase the volume of lending, quite the opposite occurred. During the first three months of this year, lending was much reduced relative to past levels. One hypothesis that I find fairly compelling, is that the loan officers had great difficulty in discerning good loans from bad loans and have taken a relatively conservative approach. This inability may arise from a lack of expertise -- as these banks not generally been engaged in commercial banking as we know it, and hence may simply not have known what criterion to employ, or how to employ them -- or it may be because the information provided by potential borrowers was simply insufficient for evaluating the risks associated with a particular loan -- as I will discuss next, many of the businesses applying for loans may not until recently have had profit maximization as their raison d'etre (sp?).

The manufacturing sector may well present the most ambitious layer of reform. As the recipient of significant government funds, the 300,000 state owned enterprises, some 100,000 of which are classified as industrial enterprises, have been operating in a system that has until recently failed to reward production above a prespecified level and fails to detect and hence punish corrupt behavior such as asset stripping. This system, a system in which firms were never expected to make a profit, plays a role in explaining the current losses generated by many enterprises. The provision of social services by these firms also plays a major role. The provision of implicit unemployment insurance with lifetime employment, housing, health care and pension services have all placed a burden on Chinese manufacturing enterprises that is unparalleled in the west. It is no wonder many reports indicate that as many of half of the Chinese State Owned Enterprises are not covering costs.

It is believed by some that the government will maintain full ownership of some 3,000 SOEs, while the remainder will merge, sell stock to employees, be offered on the stock market or in some cases go bankrupt. Some set of SOEs have also been put on the auction block for direct transfer of ownership to both domestic and foreign buyers. This process has met with limited success because of the significant baggage the enterprises carry. Although the terms of the sale are generally negotiable, some obligation to care for the current employees is often sought or imposed on the buyer. The implicit unemployment insurance that I mentioned earlier, for instance, is in fact a system in which the employee is not formally unemployed, but does not report to work and receives a reduced paycheck. The government is not interested in having these workers suddenly thrown into the throngs of the already growing pool of unemployed workers. This explains in part why a sale price of 1 Yuan has been rejected by some potential foreign investors.

The separation of the housing and social security services from the business sector is also being undertaken. Much of this reform has circular implications for the banking sector. Most obviously, as home ownership becomes more common, the need for a functioning mortgage market arises. The kernel of such a market is in place, but has not yet become an important factor for the banks. The converse will also hold true, as some will be borrowing to finance the purchase of a home to replace that provided by their employers, others will draw down on savings, potentially reducing the base upon which the banks rely to carry out their lending activities.

The interconnected nature of the Chinese system makes reform extraordinarily difficult. Reforming any single piece of system is nearly impossible because of the links between them. The task faced by the Chinese government, and indeed actively and aggressively pursued, is therefore formidable. Although much has been accomplished in the past 20 years since Deng

Xiaoping initiated wide scale reform, much remains to be done. The challenge of coping with widespread unemployment and maintaining control over the reforms is significant. Current reports indicate an urban unemployment rate of 8-10 percent and growing. Chinese government estimates indicate that enterprise reform will yield at least 10 million layoffs and the government streamlining announced in March will cut at least another 4 million jobs. In order to cope with this disruption, and increasing migration from rural to urban areas, Premier Zhu Rongji has stressed that anything less than 8 percent growth in 1998 will be less than acceptable.

The Asian Financial Crisis has played a significant role in the pace of China's economic reforms and will increase the difficulty with which China maintains its current growth targets. The crisis has in some ways had a positive influence on the nature of reforms in China. From the Asian crisis, the Chinese have learned to be skeptical of the Korean Chaebol system, a system of close links and long-term relationships between the banking community and the industrial sector. There remains an element of this in the reform plans, however, that leaves one a bit uneasy. The government has selected 512 large state owned enterprises for special treatment and attention. The special treatment comes about by permitting these enterprises to engage in similar long-term relationships with banks, much as is done in Japan, Korea and elsewhere. As economies thus characterized are currently suffering hardship, this practice is coming into question among Chinese policy makers. The contrasting success of the U.S. system is consequently drawing greater attention as a model for the Chinese.

At the same time, there is the possibility that the Chinese will slow the pace of reform in their external sectors because of the Asian Crisis. During our visit, we explained the importance of openness as a complement to their ongoing structural reforms and they were receptive to the notion. We also stressed the importance of Hong Kong as a model for China. Although the relatively restrictive nature of China's external sector has arguably shielded it from the crisis, we expressed the view that Hong Kong has been successfully protected by its open trade and investment position. China is at a critical juncture in the reform process. At a fundamental level, the reforms being undertaken embrace the notion that competition is an important driving force behind growth and economic progress. As I argued before this same group last fall, it is just such competition that results from opening markets to international trade and investment. In fact, Beijing need not look as far away as Hong Kong to see the validity of this argument. Since 1978, it has been coastal regions that have participated in international trade and coastal regions that have experienced the most significant growth.

The Asian crisis has also caused the Chinese to resort to relatively strong, but sensible, measures to ensure 8 percent growth for 1998. The primary impact of the crisis on the Chinese economy has been to appreciate the Renminbi relative to other currencies in the region. This reduces the competitive position of Chinese goods in foreign markets relative to those of other Asian countries. The measures designed to promote growth are much needed plans for infrastructure and housing development. Sustaining growth through technological progress is also a major theme repeatedly expressed by President Jiang Zemin. It is reassuring that China has chosen this route and maintaining a strong Renminbi rather than pursuing a competitive devaluation of its currency.

I would like to speak more generally about the ongoing Asian crisis. In particular, the impact on the U.S. economy and our response to that impact. Concern is often expressed over the potential impact of the crisis on our trade deficit. The fear is that it will grow significantly in 1998. Through February, our deficit with Asian countries other than Japan and China widened by only $3.0 billion relative to the same period in 1997. Although it is still early and the impact of the crisis may well increase in severity, this hardly seems consistent with a $300 billion trade deficit this year, as some predict. Nonetheless, the trade deficit will likely rise significantly relative to 1997. Given our strong position economically, it is terribly important that we as a country not use this as an opportunity to turn inward. The United States must show leadership in times of crisis and particularly in times as prosperous as we are currently enjoying. It is important that the region have an engine of economic growth. The United States is currently in a unique position to provide this engine. In order to show leadership, we must embrace the open regime that we have developed with such great expense of energy and not turn back. It is more important now than ever to wield tools such as fast-track to promote transparent and open trade and investment flows as a source of growth and prosperity.

While in Asia, the clear sentiment was expressed that the crisis is not over and many feel that the region may well go through another round of speculative attacks. Indeed, recent statistics suggest that after a brief period of recovery, several stock markets in the region have resumed their decline. The sentiment expressed to me that we have seen the bottom of the Asian crisis and will see it again appears to be quite accurate. Many of these troubled economies are looking to the United States for leadership and support. Along with embracing open markets, the United States can provide this support by meeting its obligations to the IMF. Meeting these obligations is important not only because the IMF plays a vital role in protecting the world from the spread of financial contagion, but also because the United States has an interest in reshaping the IMF. Our ability to do so will be strengthened by our continued support of the institution rather than shirking on our obligations. Shirking on our obligations at this point is a little like canceling not only our, but our neighbors home-owners insurance when the house across the street catches fire. It may not be a costly decision, but it may well result in catastrophe.

In partial defense of the IMF and its current policies, the countries now in crisis are clearly better off for having the IMF there to provide support. As evidence is the fact that Thailand, Indonesia and South Korea have all voluntarily accepted the support of the IMF and the conditions that apply.

By turning away from the IMF, the United States would be denying the importance and inevitability of significant and stable global financial flows. It is clear that financial flows were crucial in generating the prosperity in Asia and it is equally true that impediments and inefficiencies in financial flows were responsible for the crisis. Our efforts must begin with this fundamental linkage between strong growth and capital flows. Our goal must be the promotion of sound and effective capital markets so that capital flows can be a source of opportunity rather than instability. The IMF is the most potent weapon in our arsenal.

In my comments today, I have focused on two important opportunities to further our international strategy. First, the benefits and importance of a comprehensive dialogue with the

Chinese were made apparent to our delegation. This importance stems largely from the degree of misunderstanding that exists between policy-makers in our two countries. It is clear that disagreements on issues such as the mutually beneficial nature of action on global climate change and liberalization of international transactions are often due to differences in understanding rather than differences of opinion. As such, a senior level dialogue is crucial to forwarding our common agenda of promoting mutual economic growth and prosperity. Second, the expressed desire for continued U.S. international leadership more generally was made equally clear. For our own purposes, the need for the United States to participate in the recovery and development of troubled Asian economies is crucial if we are going to help shape the future of the inevitable global economy.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:14-MAY-1998 17:46:09.00

SUBJECT: mergers outline: current draft

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

CC: STONE_CF (STONE_CF @ A1 @ CD @ VAXGTWY [UNKNOWN]) (WHO)
READ:UNKNOWN

CC: Aaron S. Edlin (CN=Aaron S. Edlin/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.D57]MAIL433923438.126 to ASCII,
The following is a HEX DUMP:

Preliminary draft; close hold. JF 5/14/98

Proposed 2-page mini-papers on current mergers and anti-trust

1. Facts and trends in recent mergers (CS)

- Magnitudes
- List of major recent mergers, with magnitudes
- How does current merger mania compare to past (80s and 60s)?
  - Relationship to stock market and financing of takeovers (stock swaps vs. Debt)
  - Effect on firm size
  - Geographic scope
- Measures of concentration

2. Recent history of anti-trust philosophy/schools of thought (Aaron E.: ERP 98; Economist)

- Old-fashioned anti-trust policy: "big is bad"
- Chicago-school: laissez-faire
- Post-Chicago (imperfect competition)

3. Causes/motivations of mergers (AE)

- Synergies
- High corporate profits/cash
- Improve management
- Empire building
- Eliminating competition

4. Consequences of mergers (AE)

- Are mergers associated with increased concentration? Not necessarily:
  - Non-competing regions
  - Global competition
  - Entry
  - Vertical mergers.
- If concentration rises anyway, this may:
  - increase prices
  - lower service
  - decrease variety
  - slow innovation
  - speed innovation
  - raise regulatory issues, such as:
    - benchmarking
    - cross-subsidization (e.g., telephony)
    - safety and soundness (banking)
- Efficiencies: Mergers may lead to economic savings
  - reduce excess capacity
  - take advantage of economies of scale/network externalities
  - synergies/economies of scope
  - improve management
  - eliminate double markups
- Studies of effects of mergers on subsequent firm performance

5. Defining the size of the market *(may be omitted)*

Non-competing regions (Bell-Nynex; Nationsbank-B of A)
Global competition (Boeing-McDonnell Douglas; Daimler-Chrysler)
Industries broken into detailed segments
(e.g., discount/wholesale vs. retail: Staples-Office Depot))

6. Implications of technological change (*will probably be omitted*)

Things happen quickly; court cases can get left behind (IBM)
Network externalities: efficiency gains from setting a standard, vs. suppressing competition
Technology dynamics:
dominance at one stage or in one area allegedly can create advantage at next stage or in another area (Microsoft?...)
Difficulty of merging different standards (SP-Union Pacific)
Use of Electronic commerce to increase competition by consumers shopping around
(cars on the Web), vs. Use of IT by sellers to collude (NASDAQ)
Use of econometrics and scanner data by experts to test price competition statistically

7. Specific industry cases (*perhaps just defense*)

Defense: need for consolidation <= smaller industry post Cold War
Banking: natural consolidation as past prohibitions are removed
Computers
Telecomm
Airlines
Autos

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Charles F. Stone (CN=Charles F. Stone/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:14-MAY-1998 19:17:09.00

SUBJECT:

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

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D47]MAIL44077343Y.126 to ASCII,
The following is a HEX DUMP:

ARTICLE

China's Challenges

In March of this year, Premier Zhu Rongji detailed Beijing's reform plans for the Chinese economy. These involve substantial modernization of state enterprises, an overhaul of the banking system, and a reorganization of the government. Premier Zhu's objective is to maintain growth at 8 percent per year.

Modernization of state-owned enterprises. State-owned enterprises suffer from poor management, bloated payrolls, old technology, and the burden of providing all social services—health care, housing, and pensions—for their employees. These enterprises now account for just 40 percent of industrial output, but they are still the most important provider of better paying urban jobs. However, over 40 percent of these enterprises reported losses in 1997. The reform strategy is often described as "grasping the large and letting go of the small." In this approach, the central government focuses its support and supervision on a limited number, 512, of the largest enterprises. The remaining 90,000 smaller industrial enterprises will be reformed through a variety of means including mergers, bankruptcies, conversion into share-holding firms, leases, and sales. A crucial goal of the reforms is to create a system in which managers are held responsible for the success of their firms.

Overhaul of the banking system. For the last 50 years, a system of directed lending has made the banking sector the primary conduit through which household savings have been provided to the thousands of state-owned enterprises. With collapsing profits at these enterprises, the banking sector is, from a western perspective, overloaded with non-performing loans—reportedly in excess of 20 percent of total bank lending. This January, China's banks were given a mandate to make lending decisions based on conventional commercial banking principles. This transition may occur with great difficulty because bankers lack expertise and accounting systems are too primitive to provide adequate evidence of the risks associated with individual loans.

Reorganization of the government. The central government reorganization announced in March trims the number of central government ministries and state commissions from 40 to 29. Media reports indicate that several million workers, including white-collar workers, are likely to lose their jobs. These reforms are intended to create an institutional structure appropriate for a "socialist" market economy, reduce government interference into enterprise management, minimize opportunities for corruption, and lower government costs.

Unemployment and growth. Maintaining a minimum growth rate of 8 percent is thought necessary in order for China's economy to create jobs for workers who become unemployed as a consequence of the reforms. The 8 percent target represents a decline from last year's 8.8 percent growth and a continuation of steadily falling growth rates since the peak of 14.2 percent in 1992. Official sources report unemployment at less than 4 percent but growing. According to unofficial sources, however, the unemployment rate in urban areas exceeds 10 percent. Much of the differential is accounted for by redundant workers in the state-owned enterprises. These workers—who would be unemployed in other systems—are kept on the payroll at reduced wages but perform no work. As the reforms of government and state-owned enterprise are carried out, the unemployment problem will likely increase. During the next 3 years, enterprise reforms could yield up to 10 million layoffs, and government streamlining will cut at least another 4 million jobs. The Chinese are planning significant investment in infrastructure—transportation, communications, and the environment—and housing to help achieve the target 8 percent annual growth rate.

Impact of the Asian crisis. Although a heavily restricted international trade and portfolio investment regime has largely shielded the Chinese economy from the Asian crisis, it may nonetheless have had a visible impact on exports and the reform process.

- The relative appreciation of the Renminbi is consistent with the drop off in export growth through the first 2 months of 1998. Export growth in the first quarter of 1997 exceeded 25 percent.

- The crisis has weakened China's interest in the Korean chaebol system as a model conducive to long term growth.

- The crisis may have heightened China's apprehensions about the risks of opening up its economy to financial capital flows. However, foreign direct investment is viewed as a key contributor to market reform.

Conclusion. The nature of the Chinese system makes reform extraordinarily difficult. Reforming any single piece of the system is nearly impossible because of the links among them. Although many observers are skeptical that the ambitious reform program can be completed in the near term, during a recent trip to Beijing, the CEA was impressed with the determination of top policymakers to see these reforms succeed.