Withdrawal/Redaction Sheet
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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	Joseph E. Aldy to Janet L. Yellen at 18:21:23.00. Subject: Sunday of trip. (partial) (1 page)	06/11/1998	b(6)
002. email	Joseph E. Aldy to Janet L. Yellen at 10:04:40.00. Subject: CIA briefing on China and Korea. (partial) [50 U.S.C. § 403g (Central Intelligence Agency Act of 1949)] (1 page)	06/22/1998	P3/b(3)

COLLECTION:

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

FOLDER TITLE:

[06/19/1998 - 07/21/1998]

2013-0723-F
ab1281

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]
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001. email	Joseph E. Aldy to Janet L. Yellen at 18:21:23.00. Subject: Sunday of trip. (partial) (1 page)	06/11/1998	b(6)

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RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:19-JUN-1998 18:21:23.00

SUBJECT: Sunday of trip

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

TEXT:
Janet,

On today's conference call, I was asked what you intend on doing Sunday. I said that we would do the tour of the Great Wall and the Forbidden City. [redacted] [001] Also, the American Chamber of Commerce dinner for that night is open to cabinet members, and all cab inet members present will have the opportunity for brief remarks. You will also host your own table.

Joe

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:19-JUN-1998 14:17:43.00

SUBJECT: talking points on ancillary benefits

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

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

CC: 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:
Here are some thoughts on how to respond to possible inquiries about
ancillary benefits. =================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D64]MAIL46261027H.126 to ASCII,
The following is a HEX DUMP:

Concerns About the Ancillary Benefits
Response to EPA

David Gardiner's memo requests that we delete reference in the Technical Support Document to the lower bound of the health benefits of ancillary air quality improvements. (He would substitute a cost savings estimate as an estimate of the lower bound for total ancillary benefits, which in principle could be either cost savings or the value of health improvements.) The method we use to estimate this lower bound was accepted by EPA during interagency deliberations on the Regulatory Impact Analyses (RIA) of the recently promulgated revisions to the national ambient air quality standards. Failure to include this lower bound would mean that the only estimate of health benefits would be based on methods used for upper-bound estimates.

The specific concerns raised by EPA may also merit a response. EPA alleges:

1) We ignore two thirds of all mortality associated with fine particulate matter.

Following EPA's RIA, we assume for the lower-bound that two thirds of the mortality associated in epidemiological studies with fine particulate matter is premature by only days or weeks. In the absence of an accepted causal mechanism for particulate-related mortality, it is plausible that many statistical deaths estimated in epi studies to be associated with particulate matter are premature by days or weeks. Under a valuation approach based on the gain to longevity (e.g., life-years), the value of days or weeks is negligible relative to other uncertainty.

The two-thirds assumption is no more arbitrary than an assumption that **no** mortality is premature by only days or weeks.

2) We use $120,000 per life-year, an "inappropriately" low valuation for small longevity gains.

In fact this figure was used in EPA's RIA for the lower bound. It is greater than the estimate of $100,000 / life year used by Cutler and Richardson (1997), who were featured in this week's WEB. Finally, it is consistent with or greater than central tendency estimates published by Garber and Phelps (1997).

3) We "arbitrarily" assume that there is no mortality effect of particulate matter below a threshold of 15 micrograms per cubic meter.

Such a threshold was reflected in EPA's RIA for the lower-bound. In addition, as noted in the preamble to that rule, the evidence for the possibility of effects at lower annual concentrations is highly uncertain and the likelihood of significant health risk, if any, becomes smaller as concentrations approach background. Finally, according to EPA staff, EPA's Scientific Advisory Board has requested orally that EPA continue to conduct analyses of effects of particulate matter that reflect a threshold at 15 micrograms.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:22-JUN-1998 08:48:00.00

SUBJECT: Latest on IPCC process, mtg. Thursday

TO: Joseph E. Aldy (CN=Joseph E. Aldy/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:
At our last climate cluster, we agreed to send a message to the IPCC about the process of selecting authors and topics for the Third Assessment Report (TAR). I talked with Rosina and they also have some concerns about process, as well as some of the next steps on sinks. Her recommendation was that we speak directly to Bob Watson rather than send a note to Rob Swart, who only heads the technical support division for Working Group 3 of the TAR. (By the way, he's with RIVM in the Netherlands.)

We have set up a meeting with Bob Watson, Rosina and me, and any of you who wish to join us, in my office (328 1/2) on Thursday morning at 11 am. We'll talk about the TAR process and content and next steps on sinks.

Depending on how the meeting goes, I haven't ruled out the desirability of sending a note to Rob Swart. I agree with Rosina, though, that talking to Bob is probably likely to be a lot more effective.
Finally, Jae Edmonds, Rich Richels, and John Weyant among others head off later this week to Europe for the Scoping Meeting for the TAR. This meeting will produce an outline of the chapters and narrow in on the set of authors. I'll be talking with them today or tomorrow about what we agreed at the cluster that we thought should be covered by the economists:

(1) ways Parties can meet the targets
(2) participation by developing countries
(3) design of the trading system
(4) domestic implementation and domestic trading

Please let me know if you have any other suggestions you'd like me to pass along.

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COLLECTION:

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RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:22-JUN-1998 10:04:40.00

SUBJECT: CIA briefing on China and Korea

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

CC: Michael A. Egner (CN=Michael A. Egner/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

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

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

TEXT:
We will meet at 3pm today in Janet's office for a CIA briefing on energy and environment issues in China and Korea. The briefing will last about 1 1/2 hours. Unfortunately, because of the content, interns will not be able to attend. [redacted] (b)(3) [002]
[redacted] (b)(3)

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:23-JUN-1998 00:23:23.00

SUBJECT: China trip update: conference call and conversation with control officer

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

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

TEXT:
Janet,

We had a conference call today on the trip and I spoke with David Bleyle in Beijing again tonight. Here is the latest news:

Lodging: We are in villa 14 at Diaoyutai. Your room number is 1425; mine is 1404. For Monday night, David had already put in for a request for either the China World or the new Sheraton (about 6 months old; very nice apparently).

Transportation: We have a car, and David will meet us when we land. For Monday, we will likely have 2 cars, since we need space for both an interpreter and a note-taker.

Meetings: On Monday afternoon, several of the people we would like to meet with will be attending a signing ceremony for commercial contracts that Daley is doing. Reps of the Chinese government in attendance will be Zeng Apeiyan (SDPC head) and Wu Yi (State Counselor on Zhu's staff) who we would probably want to meet with. The Chinese have asked if we could have our meeting before or after the ceremony. I suggested after the ceremony, because several of the contracts are for GCC-related goodies (e.g., power plant technology, air sampling equipment). It might be beneficial to talk climate change and ancillary benefits right after a ceremony on tech transfer. Would you like to attend the ceremony? If so, I'll contact Daley's folks (in today's conference call, all cabinet members were invited to the ceremony).

Given the possible conflict, we went over possible fallback times for meetings: Sunday morning (e.g., between 9am-11am, since we are not attending church), Saturday afternoon (after the working lunch with Zhu), Friday afternoon (if we are getting in late Thursday night). I pushed for the meetings to occur after the President meets Jiang and Zhu, so we could at least get a sense of where they may be coming from on climate change. However, David understands that Monday afternoon is still clearly our first choice.

Sunday: We are set to leave at 12:15pm for the Great Wall and Forbidden City. Glickman, Bowles, Barshefsky, and Guerin (sp?) will likely be on the tour with us.

The AmCham dinner is all set as well. It will be held at the Great Wall Sheraton. Daley, Glickman, and Barshefsky will be there as well. They expect at least 150 in attendance. It will likely run from 7-9pm. You will have 3-5 minutes for remarks, however, cabinet affairs had little guidance on substance.

Me: Apparently, the rule about my participation in meetings and events is that if the President is there, I am not. This applies to the expanded bi-lat, the working lunch with Zhu, and the state dinner. Any meeting where you are the lead, I obviously attend.

Incidentals: David asked me about the following incidentals that we might want,

water in car (I said yes)
umbrellas in car (yes)
VIP room at airport on Tuesday morning (no)
special support (security, secretary, etc.) (no)

If you would like me to change any of these, let me know, and I will call David.

In addition, let me know if you have any questions for either cabinet affairs or David Bleyle -- I will probably call him at home early Tuesday morning.

Joe

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:23-JUN-1998 00:33:07.00

SUBJECT: ancillary benefits and EPA

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

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

TEXT:
I spoke with Todd on the document after the early action credit meeting. He raised a couple of issues with me, including EPA's comments on our report. Apparently, Gardiner has not called Todd, but Todd wanted to know how I was addressing their comments. We discussed ancillary benefits for a while. He asked if I could explain in lay terms what the issues were. I told him that it is not a fight over numbers but over methodology, since both methodologies yield similar estimates. He found this peculiar, so I explained to him the NAAQS RIA vs. 812 report methodology, and why it would hurt our credibility to use the 812 methodology after we fought it so hard. I stipulated that I think EPA wants us to use this methodology so they can use it later (e.g., for the RIA for the domestic cap and trade program), and that seemed like the only plausible reason to Todd.

I also told him that Gardiner's comments misrepresented what we had done, and that it is a methodology that has been agreed to in an interagency process and used by EPA last summer. He asked me if anyone at CEQ is familiar with this issue -- I told him that I wasn't sure (Randy -- Linda Lance???), but that I knew Sally was very familiar with it. He said he does not want to relitigate anything, but that if EPA considers elevating this (e.g., Gardiner goes to Carol), then he would like to know how NEC and CEQ stand on this. Further, he suggests that we meet with Gardiner (even though, as I told him, we would not change our mind on this issue). Jeff (and Lisa) -- should we arrange a meeting sometime on Tuesday?

Joe

Joe

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:23-JUN-1998 18:22:38.00

SUBJECT: latest version of sinks background paper

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

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

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

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

TEXT:
I'd like to send this out to the friendly interagency group of sinkophiles before our next ag outreach (WHCCTF) meeting on Thursday. I've tried to pitch it as an internal background piece on the agricultural and forestry sectors, but by all means let me know if you think it smacks too much of domestic implementation or if you have other recommendations. Again, other agencies have repeatedly expressed interest in having such a paper.

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D5]MAIL48959647Y.126 to ASCII,
The following is a HEX DUMP:

Climate Change and the Agricultural and Forestry Sectors

I. BACKGROUND ISSUES

Agricultural and forestry activities (the land use sectors) contribute directly to emissions and sequestrations of greenhouse gases (GHG) through a variety of processes. In 1996, agriculture accounted for 6% of gross U.S. GHG emissions; forestry activities sequestered some 117 million metric tons of carbon equivalent (MMTCE). Agricultural soils constitute a major reservoir of the global carbon pool and this pool can be a principal source or potential sink, depending on the net flux of carbon in organic matter in the soil. Some of these land use-related GHG contributions will be included in the calculation of net U.S. emissions that will be compared to our Kyoto Protocol target, but others will not. By addressing the contributions that do count and extending the Protocol to cover other important land use activities, these sectors could play an important role in the ability of the U.S. to meet its treaty obligations at reasonable cost.

How do the agriculture and forestry sectors contribute to mitigating the risk of climate change by sequestering carbon dioxide?

Various forestry activities sequester carbon dioxide and thereby offset some emissions associated with industrial activity. Trees, other vegetation, and organic matter in soils take-up carbon dioxide through photosynthesis and transform the carbon dioxide and store it in vegetative tissue, also called biomass. These carbon sinks can serve as opportunities to mitigate the emissions of carbon dioxide from fossil fuel combustion. For example, the Climate Action Report (1997) reported that gross anthropogenic greenhouse gas emissions in the United States in 1990 were 1,583 MMTCE. However, by including certain carbon sinks, *net* greenhouse gas emissions totaled 1,458 MMTCE, or 8% lower.

The Kyoto Protocol includes the opportunities to reduce net emissions through certain carbon sinks. For countries such as the United States, where acres of tree-planting exceed acres of tree-cutting annually, this is an opportunity for the United States to reduce net emissions at low cost. Although the IPCC greenhouse gas inventory guidelines provide methodologies for estimating anthropogenic terrestrial sinks, the guidelines produce comprehensive measures of changes in carbon stock rather than the changes in stock due to the limited set of activities recognized in the Protocol's Article 3.3. The Protocol recognizes sinks that:

> "[result] from direct human-induced land-use change and forestry activities, limited to afforestation, reforestation, and deforestation since 1990, measured as verifiable changes in stocks in each commitment period."

The Parties to the Protocol could interpret the activity list (afforestation, reforestation, and deforestation) several different ways with potentially with very different contributions of sinks in the baseline, as well as different opportunities to credit increases in sinks with targeted forest polices. The language does make clear that to qualify carbon must be sequestered on land that has experienced one of the three forestry activities since 1990, meaning that the continued sequestration in forests established before 1990 does not count under Article 3.3.

Other important sequestration opportunities, including agricultural soils and sustainable forest management, may be added to the Protocol under Article 3.4 pending methodological work by the IPCC and further negotiations among the Parties to the Protocol.

Complementing the offset of emissions through business as usual forestry activities, targeted policies could stimulate the creation of additional carbon sinks at low costs. Economic studies have provided some indication of the cost-effective potential of these policies. For example, Stavins (1996) derived a marginal cost curve for carbon sequestration for the United States based on his analysis of land use decisions between 1935 and 1984 for a set of counties in Mississippi, Arkansas, and Louisiana. He found that more than 150 MMTCE could be sequestered at $25/ton. Adams et al. (1993) assessed several different scenarios of tree planting on agricultural land and found that about 250 MMTCE could be sequestered at approximately $25/ton.[1] Studies based on engineering/costing models indicate that even more carbon could be sequestered at low costs (Moulton and Richards 1990).

Sinks are best thought of as a cushion for the transition to a more emissions-efficient economy, not as a permanent fix to the problem of climate change because, while the cost-effective sink potential of U.S. land is likely very significant, it is not unbounded. As sequestration in forests, vegetative cover, and soils increases, the marginal cost of additional sequestration rises and other land uses become more competitive. Investing in sinks in the near term can allow slower capital stock turnover in the emissions side, lowering the cost of reducing emissions but not eliminating it.

Does the Kyoto accounting system for sinks create perverse incentives for landowners?

Some climate watchers are concerned that by only counting post-1990 forests, the Kyoto Protocol could lead to perverse incentives to cut down older forests to receive sequestration credit for newer forests on replanted lands. The Protocol also does not penalize Parties for the emissions from harvest, sustainable or otherwise. It is important to recognize the distinction between national incentives and incentives for individual landowners. By making sure our domestic policies for sinks do not create a perverse incentive, we probably can largely mitigate this concern -- at least for U.S. forests. Nonetheless, a comprehensive carbon accounting system, either through a broader interpretation of the current Protocol language or an expansion of that language under Article 3.4, is the surest way to avoid perverse incentives in the land use sectors.

How do the agriculture and forestry sectors contribute to the risk of global climate change by emitting greenhouse gases?

[1] Adams et al. (1993) provide their estimate in short tons, and for purposes of comparison, we have converted this estimate to metric tons.

Agricultural and forestry activities release three kinds of greenhouse gases, presented in Table 1. The IPCC GHG inventory guidelines explain in detail how emissions of CO_2, methane, and N_2O from agricultural and forestry activities are calculated. Those emissions are totaled with emissions from other sectors to form our gross GHG emissions under the Protocol. The inclusion of multiple greenhouse gases under the Protocol allows more flexible and cost-saving emissions reductions, and more opportunity for the agricultural sector to participate in efforts to slow global climate change.

Table 1. Greenhouse gases from Land Use Sectors

Greenhouse gas	Symbol	Global warming potential in carbon equivalent
Carbon dioxide	CO_2	1
Methane	CH_4	6
Nitrous Oxide	N_2O	85

Although agriculture accounts for a small share of total U.S. energy use, it is energy intensive. Energy-related expenditures account for about 20 percent of total production expenditures, and form many economically important crops and livestock operations, energy accounts for more than 40 percent of variable production costs. Since 1975, energy efficiency in the agricultural sector has increased more that 50 percent. Farmers now use less fuel than they did 20 years ago.

Although it is tempting to lump agricultural activities together, the sector is actually extremely diverse. Undoubtedly, a variety of flexible and tailored approaches will be needed to address the numerous ways agriculture affects GHG concentrations. Table 2 below outlines some of the most pertinent aspects of agricultural operations and their 1995 GHG levels.

Table 2. 1995 Gross Emissions from Agriculture (MMTCE)

Activity	Description	CO_2	CH_4	N_2O
Fossil fuel consumption	Emissions from operation of farm equipment and production of fertilizer.	~ 300		
Enteric fermentation in domestic livestock	Methane is a product of digestion in beef and dairy cattle. Emissions depend on number of animals as well as feed quantity and quality.		34.9	
Manure	Emissions are higher when manure is stored		17.1	

management	as a liquid, as in some confined livestock facilities.			
Rice cultivation	Soil's organic matter decomposes in flooded conditions, releasing methane through plants.		2.8	
Soil Management and Fertilizer Use	Improved production practices can lower N2O emissions and increase carbon sequestration.	N/A		18.4
Field burning and agricultural wastes	Burned carbon was previously sequestered, so net carbon is zero. Methane is a net source.	net zero	.04	
Total			**54.5**	**18.4**
% of U.S. total for each gas			**31%**	**46%**

II. POLICY ISSUES FOR EMISSIONS

How can emissions from land use sectors be addressed?

One of the main policy challenges to controlling emissions from the land use sectors is their non-point source nature. Utility plants, industrial facilities, and other big emitters are easy to identify and their emissions are relatively straightforward to monitor. In contrast, in 1997 the U.S. had 2.06 million individual farms, over a million operations with cattle, and over 968 million acres of land in farming, all of which contribute in some way to GHG activity. Although the number of head of cattle -- about 99.5 million head in 1998 -- can provide a basis for rough estimates of methane emissions from enteric fermentation, other GHG emissions such as from manure management and soils are harder to calculate and come from widespread sources. In addition to land use activities on commercial operations, countless other landowners affect the carbon cycle by clearing, burning, and otherwise managing their property.

There are two main approaches to control emissions from these sectors, cap-and-trade and policies-and-measures.

- Cap and Trade

  Emissions from land use activities could be covered under the cap and trade system shared by other industries. To the extent that their emissions can be monitored, land use sector firms could be part of the initial allocation system (grandfathering or auctions), international emissions trading, and the early action credit program. Just as for other industries, an upstream/downstream level of production would be designated as the level at which permits must be used for compliance.

Pros:

- Allows trading and abatement across more sectors and gases, which helps lower the total cost of attaining the target.
- Doesn't create inequities across different industries because all sectors face the same marginal abatement cost.
- As a performance-based approach, cap and trade doesn't require picking individual technologies or practices.

Cons:

- Not all land use emissions are easily monitored, so ascribing emissions levels to specific landowners or firms could be difficult and costly, if not impossible.
- May enormously expand the number of actors in the trading system, depending on the choice of upstream/downstream level of participation, which could raise coordination costs.

- Policies and Measures

In this approach, emissions from a land use sector would not be placed under a cap and trade system. Instead, a variety of policies could reward emissions reductions, discourage emissions, and encourage development and adoption of climate-friendly technology. Examples of possible policies and measures include:

➢ Programs that acquire partial interests in land, such as easements or rental agreements, to promote sequestering activities (similar to the Conservation Reserve Program or the Farmland Protection Program).
➢ Project-by-project activities that generate JI-like credits. The participant alters production practices or adopts climate-friendly technology and receives payment or tradable carbon credits (similar to the Environmental Quality Incentives Program).
➢ R&D and deployment programs targeted to agricultural and forestry technologies (similar to the Climate Change Technology Initiative). Deployment programs service to adjust the anticipated costs and benefits of the relevant production practices by providing information, technical assistance, and price signals.
➢ Make participation in other attractive government programs contingent on adopting best management practices that reduce emissions or sequester carbon (similar to Conservation Compliance for highly erodible land).
➢ Regulatory approaches, including requiring plans for soil, nutrient, and manure management (similar to some State programs).
➢ Elimination of preferential pricing for farm-related fuel consumption.

Pros:

- Doesn't necessarily require accurately measuring the emissions from individual sites and activities.

- May be the only practical way to deal with some non-point sources.
- Government and farmers have experience with similar programs.

Cons:

- Doesn't cap emissions.
- Doesn't equalize marginal abatement costs across sectors, so increases total costs.
- Voluntary measures won't affect all emitters, and regulatory measures are politically problematic.
- Would require budget expenditures to reward emissions reductions and encourage technology changes.
- Would require numerous programs and policies to cover the huge variety of agricultural and forestry activities, with high administrative overhead.
- Technology and practice-based approaches are indirectly linked to emissions and present the familiar problem of picking technology winners and losers and establishing baselines against which reductions are measured.

What approach make sense for each source?

Whether a cap-and-trade or policies-and-measures approach is more appropriate for a given emitting sector or activity depends on the cost of monitoring and reporting, the uncertainty of the measures, and the number of emitters and their individual shares of total emissions. The appropriate approach also depends on the level of production at which the emissions occur and the analogous treatment in other industries. For example, it may make sense to treat emissions from fossil fuel consumption by farm equipment much the same way as trucks and construction equipment. Otherwise, a possibly unworkable distinction would be drawn between emissions from farm equipment and non-farm equipment.

Large and identifiable emitters are more likely candidates for a cap and trade approach, but as with other emissions in the economy, the trading system would need to identify the upstream/downstream level of production at which the trades would take place. Very small emitters may too numerous and diffuse to be likely participants in the trading system but may benefit, however, from technical assistance programs that help identify appropriate production practices for their operations.

Addressing GHG activity is one of a number of environmental initiatives underway that affect the land use sectors, and many climate-friendly practices have co-control benefits for other pollutants. The climate change policy development process should include consideration of potential complementarities and tradeoffs across environmental objectives, and coordinate with other programs affecting the same constituencies. To the extent that emissions reductions from certain activities are too costly, too uncertain, or too unpalatable, there is also the option to encourage sufficient emissions reductions and sequestrations elsewhere to make up the difference.

If some emissions are not included in the cap and trade system, how can the U.S. be assured of achieving its target?

Each Annex B Party starts the commitment period with a pool of internationally tradable emissions permits equal to our assigned amount (the target), about 1500 MMTCE per year for the U.S.. Parties can also "print" new permits with eligible sink activities during the commitment period. Parties can also cover their emissions by purchasing permits from other Parties, either through international trading or Clean Development Mechanism projects.

The domestic trading system will initially allocate a share of the permit pool to U.S. firms for domestic and international trading. The remaining reserved share will cover emissions from all sectors not included in the trading system, including non-point sources that are too diffuse or uncertain to cap and trade. If we don't retain enough permits to cover these sources, some means to acquire additional permits will be required for the U.S. to comply with the treaty.

III. POLICY ISSUES FOR SINKS

How could carbon sequestration by the land use sectors be encouraged?

Carbon sequestration from land use activities could play an important cost-lowering role in offsetting emissions. As with emissions, there are two main ways of approaching sequestrations: cap-and-trade, and policies-and-measures. Also as with non-point source emissions, there is the option of not implementing policies that encourage additional sinks, but the U.S. would receive credit under the Protocol for business as usual sequestrations.

One possible performance measure is the amount of carbon sequestered that would have otherwise been emitted into the atmosphere. With growing trees, the sequestered carbon is relatively straightforward to measure or calculate. Agricultural soils, however, lose carbon both to the atmosphere and through eroded sediments that are sequestered elsewhere. More research is needed to improve the certainty of sequestration measures for agricultural soils, and to better understand the carbon flux process.

Sink activities face the same policy challenges inherent in any project-oriented approach in that whatever the level of carbon sequestered and credited in a particular project, what matters for the U.S. inventory is the GHG activity across all relevant land use. If offsetting or unaddressed emissions are ignored, the net sequestration could be less than anticipated. For example, a policy that rewards designated forest projects and encourages the conversion of marginal farmland to tree coverage but ignores deforestation would likely produce less improvement in overall carbon stocks than a comprehensive approach. Similarly, if a policy increases forest sinks but also increases the projected supply of commercial timber, the lower projected prices will work simultaneously to reduce private replanting on other lands. Sinks policy development should carefully anticipate the full long-term emissions inventory effects of the options.

Sinks provide the only way to "print" new tradable credits. Those credits could be generated either from private activities at a project level, or by more general reductions attributable to policies and measures. In the first approach, for example, a forest products firm might afforest an area, measure the carbon sequestered on it in the commitment period, and receive tradable credits in that amount. In the second approach, the government could provide voluntary incentives for the same activity, but rather than the credit accruing to the private landowner, the sequestrations are credited to the U.S. account to be redistributed or retained to cover emissions not included in the cap and trade system.

Carbon sinks can quickly become sources if the sequestering activity is not maintained. For example, if a firm receives credit for the incremental sequestration in its growing post-1990 forest, then the policy should address what happens years later if the forest subsequently burns or succumbs to disease, perhaps when the land is owned by someone else.

How could land use sector firms receive credit for early action?

Many of the same issues outlined in the Early Credit Mechanism paper apply to the land use sectors. These issues, not reiterated here, include the problem of identifying baselines, performance measures, and the appropriate cap on the number of early credits. Sequestering activities present several other early action considerations.

Ramp up in forestry:
Carbon sequestration in new forests involves an especially long lead time. The first few years after an area is reforested, it actually emits more carbon than it sequesters due to the disruption of soils and decomposing brush produced by the planting process. Thus, to accrue significant carbon sequestrations in the first commitment period, early action for new forests is critical. Perhaps one of the most important early action items in the land use sector is the reduction of deforestation. Cover from lands deforested before the first commitment period will be decomposing during the first commitment period, increasing our emissions inventory. Moreover, were those lands to have been left forested, their sequestrations may have been creditable as sinks.

Early action and one-time sequestrations:
In all probability, the accounting system under the Protocol will only recognize sequestrations that take place during the commitment period. To the extent that an early action provides primarily a one-time sequestration, for example by increasing soil carbon content to a new plateau, early action will not contribute to the attainment of the target. From that perspective it would be preferable for the action to take place during the 2008 to 2012 period.

Economic rationales:
Except for forestry investments, the economic rationales for early credit apply less to sequestering activities than emitting activities. As with other industries with slow capital stock turnover and a long lead time for payoffs, the uncertainty about the seriousness of our treaty commitments may generate lower-than-optimal investment in the forestry sector. To the extent

that we can project certainty that carbon sequestered on afforested and reforested lands will receive full one-for-one emissions credits, we can reduce the option value to waiting to invest. The uncertainty surrounding the initial allocation of grandfathered permits is much less of a concern in sinks sectors because they have zero emissions to grandfather. The economic rationale for early credit may be limited for agricultural activities that do not require slow adjustments to production patterns.

Importance of maintenance:
The potential impermanence of carbon sequestration, as discussed above, makes credit for activities early in the 1999 to 2007 an issue. Early credit could be contingent on proper maintenance through 2007 or beyond, depending on how emissions from the same source would be treated during the commitment period.

Where do biomass and biomass-based fuels fit in?

Biomass fuel is used primarily by the industrial sector in the form of fuelwood and wood waste, while the transportation sector dominates the use of biomass-based fuel, such as ethanol from corn or woody crops. The IPCC inventory guidelines currently exclude CO2 emissions from biomass from the total CO2 emissions figure because the fuels had previously extracted the carbon from the atmosphere. CO2 emissions from biomass are reported for informational purposes, and 1995 estimates for biomass fuel emissions were 51 MMTCE.

The carbon emissions inventory treatment of harvested wood, including wood that was previously credited as forest sequestration, has yet to be determined. To the extent that biomass energy consumption offsets fossil fuel consumption, it reduces net carbon emissions.
Non-CO2 GHG emissions from biofuels are included in their respective inventories, and present relatively few confounding analytical issues.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:23-JUN-1998 11:04:44.00

SUBJECT: latest on meetings

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

TEXT:
Janet,

In terms of China meetings, here is the latest:

During bi-lat: you will meet with your counterpart (still to be determined who that will be)

SDPC on climate change: we will definitely have a meeting after the commercial contracts signing ceremony (for more details on this ceremony, see below).

SETC on climate change: we will definitely not be having a meeting with SETC because the vice minister who works on GCC will be out of town.

Ministry of Industry, Science, and Technology: David Bleyle is trying to set up a meeting with the Minister, Madame Deng (Deng Xiapeng's daughter), perhaps on Saturday afternoon.

Wu Yi: Wu Yi is a State Counselor on Zhu's staff, and I asked Bleyle if he could arrange for us to me with Wu. He said that may be difficult, with the possible exception of during the pre-meeting for the signing ceremony. However, that may be difficult because the signing ceremony is Daley's show.

Commercial Contracts Signing Ceremony: All in delegation are invited. It will run for about 1 1/2 hours. The delegation would arrive at 2pm at the Great Hall, and there would be a brief pre-meeting and questions from the press. Wu Yi will provide some opening remarks, Daley will talk for 3-5 minutes, and then signing of 7 contracts will occur.

Joe

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:23-JUN-1998 01:16:12.00

SUBJECT: composition of delegation for Korea

TO: greenfieva@ms6820wpoa.us-state.gov (greenfieva@ms6820wpoa.us-state.gov [UNKNOWN])
READ:UNKNOWN

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

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

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

TEXT:
Is a representative from EPA definitely going with us to Korea? I apologize for being out of the loop on this, but other than Al McGartland mentioning this at a meeting, and a voice mail I had today from Bill Hohenstein, I have not heard anything definitive on this. Bill's voice mail indicated that he thought Paul Schwengels would be joining us. However, he also mentioned that they would like Paul to go to China with us (which, as I understand it, is logistically impossible). Al and I talked about Paul, and his background (ancillary air quality benefits, technology) appears to complement the rest of the support staff. We have to nail down some logistics for the Korea trip before COB Wednesday, since Janet and I will be leaving, possibly as early as 6pm Wednesday night now, so it would be useful if I could hear definitively about Paul. Thanks,

Joe

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Rosalind V. Rasin (CN=Rosalind V. Rasin/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:24-JUN-1998 15:07:17.00

SUBJECT: State Dept. -- Climate Change papers attached

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

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

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D71]MAIL44218257J.126 to ASCII,
The following is a HEX DUMP:

SCENESETTER FOR KOREA: CLIMATE CHANGE

BACKGROUND

The U.S. and the Republic of Korea have a five decade strategic partnership shaped by the Cold War and the Sino-North Korean alliance that overshadowed the growth, prosperity and democratic evolution that made ROK one of the most prosperous economies in Asia. Korea prizes its close relations with the U.S., but given our long-term security relationship, many Korean officials find it difficult to comprehend the U.S. 21st century global agenda -- especially in areas like Climate Change. Moreover, the recent financial crisis has added to Korea's evident sense of "diplomatic insecurity" and a degree of resentment about being pushed to take steps that are not in Korea's economic interest. Importantly, too, Korea's decision to join the OECD is not universally popular at home as some believe Korea was aspiring to a level of global responsibility that it is unprepared to assume. Our goal should be to reassure Korea that we recognize such decisions vis-a-vis Kyoto require careful analysis of the economic implications. The good news is that many Korean economic officials have Ph.D.'s in economics, so you can have a technical conversation with them. But they may want to move slowly and cautiously.

In Korea's case you want to offer reassurance and welcome the chance to begin a dialogue on the potential of the flexibility mechanisms.

- Clearly we understand the priority you are placing on the current economic situation. Given U.S. leadership in the Asian financial crisis, there can be no question about the priority we also place on economic and political stability in the region and Korea, in particular.

- From our perspective, however, we can take this difficult period as an opportunity to build U.S. Korean cooperation in many areas that will contribute to future stability and prosperity in the region. We certainly believe Climate Change is among the areas where long-term U.S. Korean cooperation will be important.

- Given Korea's emphasis on attracting FDI, I would like to explore with you the possibility of including incentives for energy efficient and other environmentally friendly technologies in your economic programs. Moreover, I would like to discuss the role of energy efficient technology in your broader technology strategy, including opportunities for "leapfrogging" through development and export of energy efficient products.

- We hope to have a descriptive discussion of the economic implications of addressing Climate Change. We realize the necessary global action must be taken within a framework that protects economic growth while we seek longer term environmental benefits.
- We know you have given much thought to Korea's economic growth and energy requirements in the next century and would welcome a discussion of how you see long-term trends.

- My role in the Administration is to advise on both short- and long-term economic implications of policy actions. I would welcome the opportunity to share with you our approach to this issue.

- We see this as the beginning of an extended dialogue. We do not believe decisions can be made quickly, but we hope to lay a foundation for building a global partnership for action on Climate Change. OECD countries have capacity, technology, and research infrastructure to contribute much to the solution of the problem.

SCENESETTER FOR CHINA: CLIMATE CHANGE

BACKGROUND

U.S. - Sino relations, never without frictions, are nonetheless in a potentially propitious stage where we could begin to form a more strategic partnership in a number of areas. The purpose of your engagement with key Chinese officials on the economics of Climate Change is to promote a better understanding of how the flexibility mechanisms (e.g., the Clean Development Mechanism and international emissions trading) can reinforce China's macroeconomic growth plans while meeting the broader goal of mitigating the threat of Climate Change.

The U.S. and China are the world's two largest greenhouse gas emitters -- and China is projected to surpass the U.S. early in the next century. Clearly, China needs to play a leadership role among developing countries in adopting a "clean growth" strategy, if we are to be successful in addressing this problem. Given China's size and long-term growth prospects, it is in U.S. interests to encourage a reassessment of China's obstructionist position in the Climate Change negotiations, by highlighting the potential for closer U.S.-Chinese cooperation on Climate Change with a view toward building a partnership that improves China's understanding of how a market-based regulatory system can help them achieve both environmental and developmental goals.

With the key leaders you meet you need to underscore the needs for partnership, our joint responsibility to act, and our interest in discussing various approaches (investment through the Clean Development Mechanism and international emissions trading) with them.

To set the tone you might want to reinforce these "partnering" ideas with some of these thoughts.

- China and the U.S. are working together on a number of international issues, such as most recently in the economic and nuclear proliferation problems in South Asia. The Secretary of State, in her recent visit to China, underscored that we should find ways of cooperating more closely on a range of international issues, including long-term challenges like Climate Change.

- Given our unique positions in terms of national greenhouse gas emissions, U.S.-Chinese cooperation makes sense. A better understanding of how flexibility mechanisms can work to promote clean growth in China and ensure we achieve the environmental goals of Kyoto is our objective.

- We have begun a dialogue on environmental issues in the context of the Envionment and Development Forum. Following on the discusions held during Secretary Albright's recent visit to China, we believe we should broaden these exchanges and exploure how to cooerate more effectively on problems such as Climate Change.

- My role in the U.S. government is to ensure we understand the economic implications of policy decisions. No government, not China, not the U.S., can undertake policies that stop growth -- even for environmental objectives.

- In fact, we have been working hard in the U.S. to "grow the economy, and protect the environment". We believe our growing understanding of "regulatory markets" (market-based regulatory systems) can be as importatnt as U.S. technology in helping achieve both growth and environmental objectives.

- I would like to share some of our thinking with you and begin an exploration of how China can benefit from the Clean Development Mechanism and ultimately a global emissions market.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME: 7-JUL-1998 18:01:51.00

SUBJECT: interviews

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

TEXT:
Dave Wessel (on Asia) and John Berry (on gen'l economy) both would like to come in to interview you in the next couple of days. Your schedule is pretty clear. Is it ok if I ask Alice to go ahead and set these up?
Thanks.
Michele

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME: 8-JUL-1998 12:05:07.00

SUBJECT: Indicators of Economic and Social Wellbeing factbook

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

TEXT:
Janet --

This is my e-mail to Jon Orszag last night. If you should hear from Jon or Gene about this issue, I'd suggest two responses:

(1) On the current charts, we can include some comments on how the ratios move, as part of the bullet points, if they would find that useful.

(2) If they aren't happy with this, then I think we need to meet with PIR and with the COS office (Peter Rundlett) to settle the issue jointly. (I've talked with PIR and with Rundlett. I think they're likely to support us on this.)

Becky

---------------------- Forwarded by Rebecca M. Blank/CEA/EOP on 07/08/98 11:20 AM ---------------------------

Rebecca M. Blank
07/07/98 05:41:23 PM
Record Type: Record

To: Jonathan Orszag/OPD/EOP
cc: Sarah J. Reber/CEA/EOP
Subject: Indicators of Economic and Social Wellbeing factbook

Jon --

Thanks for your comments. We're incorporating all of them, except for your request to put the wage data by race into ratio form rather than showing wage levels. I feel pretty strongly about this -- this is a very different document than the ERP. It's essentially a statistical document, and I don't think you can validly present major indicators of well-being without showing wage levels by group. We initially looked at charts which showed ratios rather than levels (and talked with BLS about this as well), and there was unanimous agreement that we had to use the levels data.

Overall, the factbook shows some good news and some bad news throughout -- other indicators show much more improvement than wages.

Becky

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME: 8-JUL-1998 19:50:12.00

SUBJECT: OECD climate change work

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

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

CC: Steven N. Braun (CN=Steven N. Braun/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 spoke with John Weeks of the U.S. OECD Mission in Paris on climate change today in response to a fax he sent Steve Braun last week asking for more information about our priority issues. John wanted to talk because he is meeting with OECD Secretariat staff on Thursday to discuss the climate change work, and especially priority issues that we would like done by Buenos Aires, including work on trading and modeling. Much of our discussion followed on the memo we had previously shared with them. I suggested that the key priorities on trading would be:

1) Restrictions on trading
  a) assess the efficiency losses of various quantitative restrictions on the percentage of reductions that could be purchased abroad
  b) assess the feasibility of quantitative restrictions

2) Design of trading institutions
  a) focus on ways to minimize transaction costs
  b) explore the liability issues
  c) explore trading between governments, trading between a government and a firm, and trading between firms
  d) explore the potential roles of intermediaries (brokers, exchanges, etc.)

3) Umbrella trading versus full Annex I trading
  a) assess the costs to OECD members of both the Umbrella and Annex I trading where the Umbrella assumes that EU nations only trade among themselves and the Umbrella countries trade among themselves, and Annex I trading assumes trading among all Annex I nations

If there are other issues you think we should follow up on, let me know and I will talk to John about them.

John also suggested that we might want to draft a non-paper on trading issues to give to Thorvald Moe when Janet meets with him later this month. If we are interested in doing that, then we should get together and discuss it.

Joe

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME: 9-JUL-1998 12:17:03.00

SUBJECT: Response to McIntosh follow-up question.

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

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

CC: Mary Fibich (CN=Mary Fibich/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:
Following our discussion earlier this week, here is a revised draft letter. Cathy Fibich, suggests it is worth showing it to White House Counsel before sending it.

The original question was:

Please provide a table with FY 89-FY99 historical budget authority for your agency for any other components of the Administration's climate change program (i.e., in addition to those included in answer to questions 1 and 2). For each component, please indicate each specific budget account, the specific legislative authority for the program (including the specific statute, the section citation, and the language of the section), and a brief description of the program.

The key language in the follow-up question is

My question was intended for you to include not only program dollars but also salaries and expenses [sic] account dollars since they account for most of your agency's expenditures. In fact , because your agency has been a major participant in the Administration's climate change policy development process, your staff time has probably been considerable.=================== ATTACHMENT 1
===================

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D79]MAIL47470598N.126 to ASCII,

The following is a HEX DUMP:

DRAFT DRAFT

Dear Mr. McIntosh:

On June 3 you wrote to state that our partial response of May 18, 1998, to your March 13 letter was incomplete with respect to question 4 which pertained to historical budget authorizations. This letter provides additional information in response to your June 3 request.

Consistent with the budgetary practices used to develop the WHO budget, a single budget is prepared for the CEA. Costs are allocated to major object classes as they arise in connection with activities and projects assigned. We have no way of determining specific amounts of money expended for specific policy issues.

Circumstances change and the priorities of the President may alter which staff members are assigned to work on various issues. The number of staff working on climate change and the share of their time allocated to climate change have varied substantially. Since CEA has no records pertaining to the share of staff efforts dedicated to different issues, we have no basis for allocating any individual's time among different policy issues. Moreover, the collection of this type of information would be quite burdensome and serve to divert staff time and energy better spent on the actual issues. Our primary goal is to use CEA resources in a way that best serves the President regarding alternative policy options covering a wide range of economic issues.

Accordingly, we have provided you with total budget authority for CEA's Salaries and Expenses account. The part of our budget authority spent on climate related activities is included in this amount. See Table 1 below.

For your convenience and information, we are also enclosing copies of the CEA's Report to the President on the Activities of the CEA, as it appears in the *Economic Report of the President,* for the years that interest you. This Report describes the assignments of staff and the activities of the CEA on environmental issues generally, including those relating to climate change.

In question 4 of your March 13 letter, you asked for specific legislative authority for each of CEA's components of the Administration's climate change program, (including the specific statute, the section citation, and the language of the section). We are sending you copies of CEA's specific legislative authority, 15 U.S.C. 1021 - 1023.

Sincerely,

Janet L. Yellen

Table 1
Budget Authority
Fiscal Years 1989-1999

	Current (Appropriation)	Permanent (Offsetting Collections)	Total Budget Authority
FY 1989	$2,787,000	$0	$2,787,000
FY 1990	2,865,000	0	2,865,000
FY 1991	3,064,000	21,000	3,085,000
FY 1992	3,345,000	0	3,345,000
FY 1993	3,428,000	20,000	3,448,000
FY 1994	3,420,000	70,000	3,490,000
FY 1995[A]	3,430,000	5,000	3,435,000
FY 1996[A]	3,177,000	60,000	3,237,000
FY 1997	3,439,000	125,000	3,564,000
FY 1998[B]	3,542,000	(C)37,000	3,579,000
FY 1999[D]	3,666,000	0	3,666,000

A: FY 1995 includes rescission of $9,000;
FY 1996 includes rescission of $3,000
B: As of May 31,1998
C: Anticipated reimbursements $36,000;
Earned reimbursements $1,000
D: Represents House mark-up of FY '99 appropriation.
Sources: President's Budget (Appendix) and SF-133

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME: 9-JUL-1998 12:10:03.00

SUBJECT: Discussion w/ Berger

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

TEXT:
I think you should talk to Berger about not being automatically included in the mtgs on international economic issues. I think you can do it with a soft touch --- just suggest that you talked to Erskine and that you'd like to be included in the mtgs on SE Asia, Russia, etc if economic issues are going to be discussed.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:10-JUL-1998 15:42:34.00

SUBJECT: Re: Quick Update on Your Situation

TO: arose (arose @ haas.berkeley.edu @ INET @ LNGTWY [UNKNOWN])
READ:UNKNOWN

TEXT:
Many thanks for all of your efforts on my (and George's) behalf. I am xeroxing the (few) things I have written since my last review including testimony I have given and will send them to you on Monday. I have not included the 1998 Economic Report of the President on my c.v., although it is a significant project which has been completed under my supervision. I have written some portions of it myself, and provided guidance/editorial input on all of it. The description of activities of the members at the b ack of the ERP also provides a pretty complete summary of my activities here at the CEA and lists most of the issues with which I have dealt over the past year. I don't know if you need more description or not of my activities at the Fed. Let me know if there's anything else that would be helpful.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:12-JUL-1998 21:40:37.00

SUBJECT: compiled comments on TSD

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

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

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

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

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

TEXT:
Attached is a memo summarizing the comments we received on the TSD this weekend. There are several outstanding issues which we need to discuss at some point on Monday.

Joe

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D76]MAIL459001394.126 to ASCII,
The following is a HEX DUMP:

MEMORANDUM

TO: Janet Yellen
Todd Stern

FROM: Joe Aldy

DATE: July 12, 1998

RE: Summary of Comments Received on TSD Clearance Draft

Over the weekend, we received comments on the Technical Support Document by phone, fax, and email. Most comments concern the executive summary and the new section on making international trading work. In addition, there will be some minor editorial changes resulting from our fact-checking process (e.g., the cite in the text on emissions that reads "Energy Information Administration 1998" should actually have the date "1998a"), which we began last week and should be wrapped up by mid-day Monday. I have compiled the list of people who have responded and all comments below. I have included my recommendations for action.

Responses

We have heard from the following:

State:
- Melinda Kimble
- Rafe Pomerance
- Anne Pence (for Eizenstat)
- Victoria Greenfield (for Eizenstat)

Treasury:
- Ray Squitieri (for Wilcox)
- Ben Jones (for Summers)

OMB:
- David Bernell (for Glauthier)

EPA:
- Bill White (for Gardiner)

DOE:
- Mark Mazur

Melinda Kimble and Mark Mazur had no suggested changes. David Bernell called me on Friday to say he would try to get any comments by the 2pm Saturday deadline, but I have not heard from him. I also still need to sit down with Janet and Jeff and discuss some comments they have.

Comments on Executive Summary

p. i: In the second paragraph under Rationale for Taking Action, the line "this concentration is expected to reach twice current levels by 2100" should be rewritten as:

> "this concentration is expected to reach twice pre-industrial levels"
> (Treasury: Squitieri)
>
> Recommendation: The IPCC has developed a set of baseline projections (IS92 scenarios). The middle of the road scenario (IS92a) has a global concentration of about 700 ppm in 2100, a little less than then twice the current concentration (about 365 ppm), but more than twice pre-industrial (about 280 ppm). For other IPCC projections, concentrations could be well above or below 700 ppm. I suggest the following edit:
>
> "this concentration could be almost twice current levels by 2100"

p. ii: In the first full sentence of this page, the list of effects resulting from warmer temperatures is true, but is not the "whole truth". The comment notes "It's misleading to suggest that a warmer climate would on net, be bad for U.S. public health, as this sentence does." The following language is suggested as an add-on to the end of the sentence:

> "although warmer temperatures would also reduce wintertime deaths from cardiovascular and respiratory disease."
> (Treasury: Squitieri)
>
> Recommendation: accept edit.

p. ii: Rewrite first sentence of first paragraph of Kyoto Protocol section so it reads:

> "The Kyoto Protocol, which requires advice and consent of the Senate, would require..."
> (State: Greenfield)
>
> Recommendation: accept edit.

p. ii: Change order of sentences in second paragraph of Kyoto Protocol section so the line about the Protocol won't be sent to the Senate without meaningful participation by key developing countries is not immediately after the sentence that states the developing countries did not take on binding targets at Kyoto. Also, the Rafe asked that the term "robust" at start the last sentence of the paragraph be deleted. The suggestions ask that this paragraph reads as follows:

> "Developing countries did not ka eon binding emissions targets at Kyoto. The Clean Development Mechanism provides a down payment on meaningful participation, and the Administration is actively engaged in seeking greater participation from key developing countries. Participation in the clean development mechanism and emissions trading would likely lead to new opportunities for low cost reductions, benefitting developing and

developed countries alike. The President has said that he will not submit the Protocol to the Senate without meaningful participation from key developing countries."
(State: Pomerance, Pence, Greenfield)

Recommendation: we should discuss.

p. iii: In last sentence of first paragraph in Costs and Benefits of Mitigation, it is suggested that the clause after the comma ("so we have made no effort to quantify these benefits in our analysis") be deleted, because the "literature review" (Cline, Nordhaus, Fankhauser) is some attempt. (Treasury: Jones)

Recommendation: we should discuss.

p. iii: In the first sentence of the second paragraph in this section, there is apparent uncertainty about what net costs mean. Further, the absence of a benefits quantification should be further highlighted. The following rewrite is suggested:

"Recognizing these difficulties, our conclusion -- even without the benefits of mitigating climate change -- is that the costs for the United States...."

The second sentence would begin:

"Again, this would be so even without...."
(Treasury: Jones)

Recommendation: we should discuss.

p. iii: In the second sentence of the third paragraph in this section, "excluding" is italicized. The comment is that the entire clause should be italicized, so it would read as:

"*excluding the benefits of both mitigating climate change and restructuring the electricity sector....*"
(Treasury: Jones)

Recommendation: reject edit -- I don't think we should highlight what our analysis does not include like this in the first money sentence (the end of the sentence gives the $7-12 billion estimate).

p. iv: In the first full paragraph on this page, the suggestion is made to delete "noted" from "One noted economist" because Cline is not noted in this area of economics. (Treasury: Squitieri)

Recommendation: accept edit.

p. iv: In the last sentence of this paragraph, the suggestion is made to delete "very" before "real" and "large", so it would make this sound less like the PR department and more like the Econ department. (Treasury: Squitieri)

Recommendation: accept edit.

Making International Trading Work Section (pp. 22-23)

I received three sets of comments requesting some wordsmithing which we should discuss, especially on the Niagra Mohawk deal.

Other Comments

p. 24: In the top paragraph, the statement "will justify scrapping the old coal plant" should be changed to read:

"will justify abandoning the old coal plant."
(Treasury: Jones)

Recommendation: accept edit.

p. 52: At the end of the CCTI section, EPA has requested a change with a reference to more optimistic technology assumptions in the modeling. I understand that Fred Hansen has faxed the suggestion to Todd, and Bill White faxed this to us over the weekend (however, he faxed it to the members' fax machine, which I cannot access until Monday morning).

Recommendation: Based on my conversations with EPA staff, I believe this will be an issue we will need to discuss. I should add that I believe that even if one were to employ a reference to a modeled 1.25 and 1.5 AEEI scenarios, the IAT runs are inappropriate on methodological grounds because they include bumps in AEEI for every region/country in the model.

p. 57: The reference to the fact that U.S. industry is not moving en masse to Venezuela should be changed to Saudi Arabia. (Treasury: Jones)

Recommendation: accept edit.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:14-JUL-1998 17:50:05.00

SUBJECT: CBO Forecast, mid-session update

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

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

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

TEXT:
The mid-session update of the CBO forecast will be released tomorrow (Wednesday) afternoon. CBO staffers are briefing congressional leadership around 2:00 pm, and we will receive the figures sometime thereafter. I have heard clues leading me to suspect a rosier economic forecast.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:15-JUL-1998 17:42:44.00

SUBJECT: Revised notes on the GM strike

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D87]MAIL431102697.126 to ASCII,
The following is a HEX DUMP:

Notes on Economic Impact of the GM strike. 7-15-98 3:30 pm
S.Braun

Who is on strike:

- 3400 workers belonging to UAW local 659 at the Flint (Michigan) Metal Center (which stamps sheet metal in hoods and car fenders)
- 5800 workers belonging to UAW local 651 at the Flint Delphi East plant (which makes a variety of small auto parts, such as spark plugs)

Ripple effects:

Thus far, 27 of 29 GM assembly plants have shut down (and another 100 or so GM parts factories); in addition to the 9200 on strike, another 161,600 North American GM workers have been idled. The Saturn assembly plant continues to operate.

The number of workers at auto parts makers who supply GM and who could be laid off if the strike lasts long enough is potentially very large. According to *Ward's,* 1,637 suppliers employing 1.6 million workers, send a portion of their output to GM. Assuming that GM accounts for about a third of their business, a long strike could idle another 500,000 workers.

1998:Q2

GM (North America) produced 224,500 cars fewer than planned in June 1998; roughly 170,000 of this underbuild was in the U.S. so that lost second-quarter American output (not annualized) is:

$$1.7\times10^5\ units \times 1.88\times10^4(\$/unit) = 3.2\$billion$$

At an annual rate (which is how we account for GDP), the strike reduced second-quarter output by 4 times as much: 12.8 $billion--or 0.15 percent of GDP. The effect on the annual rate of growth would be 4 times as much: **Second-quarter GDP growth was reduced by about 0.6 percent at an annual rate.**

1998:Q3

If the GM strike were to be settled today (June 15), so that production could restart on Monday, 13 July, then GM's July production would fall 150,000 short of plans for North America and 115,000 short of plans for the U.S.. Over the balance of the third quarter, GM could make up this lost production for their car lines--where they have overcapacity, but probably could make up only half of their lost output of sport utility vehicles and minivans. (Automobiles constitute about 46 percent of GM sales.) I would guess that the third quarter underbuild for GM would be about 60,000 units. With calculations parallel to those above, this shortfall would lower the level of GDP by 4.5 $billion at an annual rate. Because growth was depressed by more than this in the second quarter, the net effect of the strike is to raise GDP growth by 0.3 percentage point at an annual rate in the third quarter. (The remaining 0.3 percent would be made up in the fourth quarter.)

In summary, if the strike were to be settled this week (by July 18), no real damage would have been done to the annual production of American cars. The strike would merely have reallocated output from the second quarter to the third and fourth quarter.

Effect of a Prolonged strike

As the strike continues, it will become increasingly difficult to recover this lost production, and the cost to national output will approach $300 million per day. A strike that extends into August (my guess) would cause non-recoverable losses to annual output. As General Motors is a very large corporation (together with its suppliers, it produces about 1 percent of national output), a strike that was not settled until the end of the third quarter, would reduce GDP growth in the third quarter by about 3½ percentage points at an annual rate, and would reduce the annual level of GDP by about ¼ percentage point.

On sales

GM probably has enough vehicles in stock to get through July without severe shortages. However, some GM nameplates are in short supply: Pontiac Grand Prix, Oldsmobile Intrigue and some minivans. GM has stopped shipping to fleet customers. (Source: Ronald Zarrella, GM group executive for North American sales, service and marketing--as quoted in *Wards Automotive Reports*, July 6, 1998)

Effect on the Labor Market Report

General Principles:

- Striking workers are not employed in the payroll survey, but are "not in the labor force" in the household survey--and therefore do <u>not</u> count as unemployed.
- A worker who works part of the survey week will appear in the payroll survey as employed, but with a short workweek.
- A worker who is laid off because of secondary effects is not in the payroll survey, and adds to unemployment in the household survey.

Effect on June labor-market report

The June survey week was early in the month, and so the effects of the strike on the June employment report were minimal.

- 3400 fewer workers in fabricated metals (that is, local 659)
- employment in motor vehicle assemblies fell by 6000, possibly from the ripple effects of the strike.
- The workweek in motor vehicle assemblies fell 0.9 hour--as many workers had short workweeks.

Effects on the July (and future) labor market reports

The July survey week is next week, and so **if the strike were to be settled this weekend**, the effects on the July report will be small--and will appear primarily as a short workweek in the payroll survey.

If the strike were to continue through the end of July, payroll employment would be down by about 117,000 GM workers and roughly another 100,000 (?) jobs at GM suppliers. These would bump the unemployment rate by about 0.2 percent. (The US labor force is about 137 million). The potential layoffs from GM supplies could be quite large, up to 500,000, but would be offset in the longer run by increased orders from other automakers.

On Unemployment Insurance

Thus far initial claims for unemployment insurance have gone up from 330,000 to 390,000 per week--an effect that is largely traceable to the GM strike. Insured unemployment has increased by about 300,000 since the beginning of July, and a large portion of these may be those laid off from the ripple effects of the GM strike.

GM is contesting whether UAW workers idled by an illegal strike by their fellow union members can collect unemployment insurance. (The employer taxes to support the UI system are experience rated according to a firm's layoff history.) Each state has slightly different laws, and the verdicts will differ by state--as happened in the March 1996 strike.

Prospects for longer strike

Differences about wages are easily splittable, but differences about strategic planning and work rules may not be. In addition, GM is seeking assurance from the UAW that other locals with grievances (in Dayton, Ohio and Indianapolis) will not strike over local issues--a promise that the UAW national leadership may be unable to make.. As a result there is a possibility of a long strike.

Overall comment

With Global overcapacity in the motor vehicle industry, this strike will damage GM and the GM workers in the long run, as it furthers GM's loss of market share. It is silly for the UAW to think that they can improve their job security by going on strike. I think that the Administration ought to use its good offices to cajole the striking locals into returning to work.

Main Issues

According to press accounts, the main UAW complaints are GM's refusal to invest as much a promised in the Flint plants, as well as the UAW's refusal to agree to the company's request to change the early dismissal rule at the Flint Metal Center (by mutual agreement in the last 3-year contract, workers are dismissed after completion of the day's quota,--even if after only 6 hours of work).

Legality of the strike

The 3-year national agreement exending from September 1996 through September 1999 prohibits strikes over local issues except for safety and health, subcontracting, and staffing. The two Flint locals have complaints in these areas, but (as discussed above) the main issues may lie elsewhere. The UAW press releases mention both kinds of complaints as in this exerpt:

> Workers at GM's Delphi East plant have to contend with excessive and damaging noise levels and lack of ventilation in welding areas," said Burks, who continued, "In addition the corporation has failed to address improperly ergonomically designed jobs, and violations of equipment lockout procedures that could lead to injury or death."
>
> "The situation at Delphi East is made worse by the presence of hundreds of unresolved grievances, as well as the threatened sale of parts of the plant and exiting other parts of the business," Shoemaker stated.

GM has initiated a lawsuit claiming that the "strikeable issues identified by the union are contrived and that the real issues...are ones that the union has greeed to be non-strikable." GM is asking the court to issue a *Boys Markets* injunction (after a 1970 Supreme Court case) to enjoin the strikes and to order arbitration of the underlying issues.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:15-JUL-1998 20:03:34.00

SUBJECT: TSD edit

TO: Joseph E. Aldy (CN=Joseph E. Aldy/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.D97]MAIL40362369W.126 to ASCII,
The following is a HEX DUMP:

Energy efficiency improvements over time are attributable to three factors: price-inducements to conservation of energy use; non-price policy measures to improve energy efficiency; and *autonomous* increases in energy efficiency. The first factor reflects the incentive provided by higher energy prices for firms and households to reduce energy consumption through efficiency measures and thereby make the economy as a whole more energy efficient. The second factor reflects the potential influence of a wide range of non-price public policies to improve the efficiency with which energy is used in the economy. For example, measures could be undertaken to speed the rate of diffusion and adoption of technologies which can simultaneously lower energy use and household and business energy bills. Finally, energy efficiency improvements occur over time which are independent of either prices or energy policies. For example, in the United States, the gradual transition from a manufacturing economy to a less energy-intensive service economy has improved the energy efficiency of the economy. The *autonomous energy efficiency improvement factor (AEEI)* reflects only the pace of efficiency improvements that are purely autonomous and thus independent of both energy prices and energy policies.

In modeling energy efficiency improvement, these three components are addressed in different ways. For the *autonomous* energy efficiency factor (AEEI), a plausible assumption is an improvement of about 1.0 percent per year. The developers of the Second Generation Model employ an AEEI of 0.96 percent per year as their default energy efficiency assumption. Similarly, the Energy Information Administration analysis (see Energy Information Administration 1997a) assumes a pace of energy efficiency improvement of 0.9 percent. In this analysis, we used the SGM default assumption concerning the autonomous energy efficiency parameter. For price-induced changes in energy efficiency, the model generates its own forecasts of changes in energy consumption that reflect the effects of greenhouse gas permit prices on energy prices.

Economists have traditionally experienced significant difficulty in modeling non-price policy-induced shifts in energy efficiency. For example, it is hard to assess the likely future pay-off from investments in energy R&D, although historical estimates of the social rate of return from such investments are substantial. We are similarly unable to quantify adequately the potential payoffs from the Administration's climate change technology initiative, its voluntary sectoral initiatives, the federal sector's own energy efficiency program or measures that could be adopted to spur the diffusion and adoption of existing technologies in key sectors or nationwide. However, many authorities in the field of energy policy believe that policy initiatives could spur substantially more rapid improvements in energy efficiency. Experts at five national laboratories managed by the Department of Energy, using an engineering approach rather than an economic paradigm, found that a third of the emissions reductions necessary to return to 1990 levels by 2010 could be achieved through the adoption of existing energy-efficiency technologies at no net resource cost. This translates into a non-price policy related efficiency contribution of 0.3% per year (Interlaboratory Working Group on Energy-Efficient and Low-Carbon Technologies 1997). The National Academy of Sciences reached qualitatively similar conclusions in a 1992 report. As reflected in the Department of Energy study, if a higher rate of energy efficiency improvement were achieved, the United States could meet a correspondingly larger fraction of its commitment through domestic reductions potentially at lower permit prices.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:15-JUL-1998 19:15:23.00

SUBJECT: Edit of page 38

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.D95]MAIL45590369A.126 to ASCII,
The following is a HEX DUMP:

Energy efficiency improvements over time are attributable to three factors: price-inducements to conservation of energy use; non-price policy measures to improve energy efficiency; and *autonomous* increases in energy efficiency. The first factor reflects the incentive provided by higher energy prices for firms and households to reduce energy consumption through efficiency measures and thereby make the economy as a whole more energy efficient. The second factor reflects the potential influence of a wide range of non-price public policies to improve the efficiency with which energy is used in the economy. For example, measures could be undertaken to speed the rate of diffusion and adoption of technolgies which can simultaneously lower energy use and household and business energy bills. Finally, energy efficiency improvements occur over time which are independent of either prices or energy policies. For example, in the United States, the gradual transition from a manufacturing economy to a less energy-intensive service economy has improved the energy efficiency of the economy. The *autonomous energy efficiency improvement factor (AEEI)* reflects only the pace of efficiency improvements that are purely autonomous and thus independent of both energy prices and energy policies.

In modeling energy efficiency improvement, these three components are addressed in different ways. For the *autonomous* energy efficiency factor (AEEI), a plausible assumption is an improvement of about 1.0 percent per year. The developers of the Second Generation Model employ an AEEI of 0.96 percent per year as their default energy efficiency assumption. Similarly, the Energy Information Administration analysis (see Energy Information Administration 1997a) assumes a pace of energy efficiency improvement of 0.9 percent. In this analysis, we used the SGM default assumption concerning the autonomous energy efficiency parameter. For price-induced changes in energy efficincy, the model generates its own forecasts of changes in energy consumption that reflect the effects of greenhouse gas permit prices on energy prices.

Economists have traditionally experienced significant difficulty in modelling non-price policy-induced shifts in energy efficiency. For example, it is hard to assess the likely future pay-off from investments in energy R&D, although historical estimates of the social rate of return from such investments are substantial. We are similarly unable to quantify adequately the potential payoffs from the Administration's climate change technology initiative, its voluntary sectoral initiatives, the federal sector's own energy efficiency program or measures that could be adopted to spur the diffusion and adoption of existing technologies in key sectors or nationwide. However, many authorities in the field of energy policy believe that policy initiatives could spur substantially more rapid improvements in energy efficiency. Experts at five national laboratories managed by the Department of Energy, using an engineering approach rather than an economic paradigm, found that a third of the emissions reductions necessary to return to 1990 levels by 2010 could be achieved through the adoption of existing energy-efficiency technologies at no net resource cost. This translates into a non-price policy related efficiency contribution of 0.3% per year (Interlaboratory Working Group on Energy-Efficient and Low-Carbon Technologies 1997). The National Academy of Sciences reached qualitatively similar conclusions in a 1992 report. As reflected in the Department of Energy study, if a higher rate of energy efficiency improvement were achieved, the United States could meet a correspondingly larger fraction of its commitment through domestic reductions potentially at lower permit prices.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:16-JUL-1998 09:58:13.00

SUBJECT: East Asia critiques

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

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

TEXT:
Here is a one-page list of critiques of East Asia policy.
Nouriel's notes spell out the details.================== ATTACHMENT 1 ==================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D33]MAIL477125691.126 to ASCII,
The following is a HEX DUMP:

Critiques

	Exponents and their arguments	Arguments against
Need easier fiscal policy (e.g., coordinated expansion in the region)		
Need easier monetary policy		
Need to allow further currency depreciation		
Need to step in to prevent banking disruptions and firm bankruptcies		
vs. Need to step in to force closing of bad banks and raising prudential standards		
Need less old-fashioned macro austerity (and more structural conditionality)		
vs. Need less structural intervention (IMF should "stick to its knitting")		
Need to lean on Western banks and other investors to take more of a hit		
Need to reduce US/G7/IMF role, to reduce moral hazard		
Need to be sympathetic to measures that slow down capital (e.g. short-term forex bank inflows)		

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:16-JUL-1998 13:37:10.00

SUBJECT: Press Guidance on Q2 GDP

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

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D69]MAIL46721079E.126 to ASCII,
The following is a HEX DUMP:

Quarterly GDP growth is almost always more erratic than projections. Available data now suggest that GDP growth in the second quarter will be well below the extraordinary first quarter pace of 5.4%. The Asian crisis continues to exert a drag on American exports. In addition, we anticipate, and the data now suggest, a substantial decline in the pace of stockbuilding from the record first quarter pace. Finally, prdocution cutbacks associated with the GM strike are also likely to hold down second quarter growth. Nevertheless, American households, and the American economy, remain in sound condition. With real disposable personal income growing at a solid 3.6 percent annual rate during the first five months of the year, consumer spending, which has been a source of strength throughout the expansion, remains robust. The Administration continues to project solid, albeit more moderate economic growth, with continued job creation and low unemployment in 1998 and beyond. Economic growth for 1998 as a whole now appears very likely to exceed the 2.9 percent growth projected in the Administration's Mid-Session Review.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:16-JUL-1998 12:47:53.00

SUBJECT: inventories: suggested language

TO: Steven N. Braun (CN=Steven N. Braun/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:
just a starting point. No great assertions, as you can see:

We had been forecasting that the US economy would slow down a bit this year, because the rates of growth over the last two years have been so very high (3.8 percent from QI 1996 to QI 1998).
It now looks like the rate of inventory investment was far lower in the second quarter than in the first, and that this reduced the overall growth rate in the second quarter. The inventory phenomenon is best thought of as a stage of transition fron a very high growth rate to a more moderate one.

It is possible that the loss of exports to East Asia is playing a role in this. We will know more when we have the May trade numbers tomorrow morning.

"Q: Was growth negative in QII?
Q: Might this be the beginning of a recession?"

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:17-JUL-1998 15:25:25.00

SUBJECT: latest version of the executive summary

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

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

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

CC: Alan S. Polasky (CN=Alan S. Polasky/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

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

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

TEXT:
Attached please find a rewrite based on this morning's meeting. Note that only Randy and I have worked on this, so it should not be considered the "official" CEA version until we have had an opportunity to incorporate Janet and Jeff's comments. Most of the new text reflects thievery from other sections of the document.

Joe

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D44]MAIL43544520Y.226 to ASCII,
The following is a HEX DUMP:

EXECUTIVE SUMMARY

The primary purpose of this analysis is to examine the costs and benefits of taking action to mitigate the threat of global warming. In particular, we examine the costs and benefits of complying with the emissions reduction target for the United States set forth in the Kyoto Protocol on Climate Change, negotiated in December 1997. For reasons discussed at length in this paper, it is our conclusion that, with the flexibility mechanisms included in the treaty, the United States can reach its Kyoto target at a relatively modest cost. And the benefits of mitigating climate change are likely to be substantial.

Before considering the economics of taking action, however, we ought to step back and ask the threshold question -- whether taking action to mitigate global climate change is necessary in the first place.

The Rationale for Taking Action

The great weight of scientific authority suggests that climate change is a serious problem and that prudent steps to mitigate it are in order. In essence, we need to take out an insurance policy with reasonably priced premiums. As long ago as 1992, the National Academy of Sciences, in a study entitled *Policy Implications of Greenhouse Warming*, concluded that "...even given the considerable uncertainties in our knowledge of the relevant phenomena, greenhouse warming poses a potential threat sufficient to merit prompt responses. ...Investment in mitigation measures acts as insurance protection against the great uncertainties and the possibility of dramatic surprises" (p. 68).

What the science tells us is that greenhouse gases are rapidly building up in the atmosphere as a result of the burning of fossil fuels and deforestation; that the concentration of these gases is 30 percent higher than it was at the beginning of the industrial revolution; and that this concentration is expected to reach almost twice current levels by 2100 -- a level not seen in 50 million years. Theory and computer models suggest that this increased concentration of greenhouse gases could warm the earth by about 1.8 to 6.3 ° F by 2100. By way of comparison, the last ice age was only about 9° F colder than today. Moreover, much evidence suggests that warming is already underway. For example, we know from ice cores and other data that we are living in the hottest century since at least 1400, that the 1990s are the hottest decade on record, that 1997 is the hottest year, and that the nine hottest years have all occurred since 1987.

Scientists predict a range of likely effects from global warming. For example, the rate of evaporation is expected to increase as the climate warms, leading to increasingly frequent and intense floods and droughts. Sea level is projected to rise 6-37 inches by 2100. A 20-inch rise could submerge about 7,000 square miles of U.S. territory. Warmer temperatures would be expected to increase the risk of mortality from heat stress, aggravate respiratory disease, and increase the range and rates of transmission of some infectious diseases.

Scientific opinion is not unanimous on these points, but most independent climate scientists believe that global climate change poses real risks. A few scientists contest the notion that increasing concentrations of greenhouse gases will warm the planet, while a few others argue that the earth is indeed getting warmer, but that this is a good thing -- "a wonderful...gift from the industrial revolution," in the words of one. But these are distinctly minority views. The prevailing view is that the risks of climate change warrant prudent and prompt action. Prompt because to wait for greater scientific certainty could have very large costs. Greenhouse gases are long-lived and the decisions being taken by governments and firms in the next decade with respect, for example, to the kinds of power plants to build or the kinds of energy sources to develop, are likely to have significant consequences for our ability to limit the buildup of greenhouse gases.

Consequently, there is a substantial rationale for acting now. Our task is to act in a manner that responds appropriately to the scope of the risk while at the same time being economically sensible.

The Kyoto Protocol

The Kyoto Protocol, which requires the advice and consent of the Senate, would commit industrialized nations to take on binding targets for greenhouse gas emissions, and includes three basic kinds of flexibility provisions that were proposed by the United States. These provisions -- commonly referred to as "when", "what", and "where" flexibility -- have great potential to significantly lower the costs of meeting the Kyoto targets. "When" flexibility appears in the form of a multi-year commitment period (2008-2012), and allowance for "banking" of emissions reductions. The freedom for countries or companies to delay or accelerate reductions within an agreed upon time frame can help lower costs. "What flexibility" is provided by the inclusion of all six greenhouse gases -- so that reductions in emissions of one gas can be used to substitute for increases in emissions of another -- and the coverage of certain "sink" activities, such as afforestation or reforestation, that absorb carbon. Most important, the Protocol incorporates "where" flexibility in the form of international emissions trading and joint implementation among countries that take on binding targets, coupled with a "clean development mechanism" allowing industrial countries or firms to earn emissions reduction credit for investments in clean energy projects in the developing world. These mechanisms can provide opportunities for industrial countries and firms to secure low-cost reductions and for developing countries to achieve sustainable growth.

Developing countries did not take on binding emissions targets at Kyoto, although they did agree to provisions for the Clean Development Mechanism. The President has said that he will not submit the Protocol to the Senate without meaningful participation from key developing countries. While the Clean Development Mechanism provides a down payment on such participation, the Administration is actively engaged in seeking greater developing country participation. Developing country participation in the Clean Development Mechanism and in international trading would likely lead to new opportunities for low cost reductions, benefitting developing and developed countries alike.

Domestic Policies

The President announced in October that greenhouse gas emissions reductions would be achieved through a domestic program that would establish a cap on emissions and allow firms to trade emissions permits during the 2008-2012 commitment period. Economists generally accept that such a trading program achieves emissions reductions at the lowest cost to society. Prior to implementing this cap and trade system, the Administration supports tax incentives, R&D, electricity restructuring, and other measures, which made good economic and energy policy sense, while also reducing greenhouse gas emissions.

Costs and Benefits of Mitigation

Analyzing the costs and benefits of mitigating climate change is a difficult undertaking for three reasons. First, uncertainties remain about significant details of certain provisions in the Protocol. Second, available models have inherent limitations in their abilities to analyze even short-term costs and benefits. Third, it is extremely difficult to quantify the long-term economic benefits of climate change mitigation, so while we have summarized the literature, we have not calculated a monetary value of these benefits.

Recognizing these difficulties, our conclusion is that the costs for the United States to meet its Kyoto emissions target are likely to be modest if those reductions are undertaken in an efficient manner employing the flexibility measures of international trading, joint implementation, and the Clean Development Mechanism. This would be so even without considering the benefits of mitigating climate change itself or the impact certain additional factors -- such as the President's domestic climate change proposals, the ancillary benefits of improved air quality, or the inclusion of sinks -- could have on lowering the costs of mitigation.

The conclusion about the costs of complying with the Kyoto Protocol is not entirely dependent on, but is fully consistent with, formal model results. For example, given the flexibility measures just noted, with key developing countries participating in trading, and *excluding* the benefits of both mitigating climate change and restructuring the electricity sector, estimates derived using Battelle's Second Generation Model suggest that the resource costs of attaining the Kyoto targets for emission reductions might amount to $7-12 billion per year in

2008 to 2012 or just 0.1 percent of projected GDP. The same model predicts that emission permits in 2010 would cost between $14 and $23 per ton of carbon equivalent -- which would translate into an increase of about 4 to 6¢ per gallon of gasoline. The increase in energy prices would raise the average household's energy bill in 2010 by between $70 and $110 per year -- a relatively small amount compared to typical energy price changes. Moreover, this increase would be substantially offset by the decline in electricity prices resulting from the Administration's electricity restructuring proposal.

These numbers are instructive. They demonstrate the importance of international flexibility measures and the potential for meeting our Kyoto target at a relatively modest cost. However, it is just as important to understand what these numbers do *not say*. They do not tell us about either (a) the economic *benefits* of mitigating climate change or (b) the potential for domestic policy measures to reduce costs further and/or to increase the percentage of greenhouse gas reductions we can accomplish at home. The reason is that this illustrative analysis employed a model that can assess policies of domestic and international trading but, by its terms, does not account for either of these two factors.

Benefits of mitigating climate change. The economic benefits of mitigating climate change include both ancillary benefits, such as improved air quality, and the avoided costs of events such as droughts and floods. The ancillary benefits of reducing greenhouse gas emissions -- in particular, the corresponding reductions in conventional air pollutants like sulfur dioxide or nitrogen oxides -- could alone produce savings equal to about a quarter of the costs of meeting our Kyoto target.

There are also substantial long-term benefits of mitigating global climate change. Monetary estimates of damages from the environmental, health, and economic impacts of global warming during the next century range in the tens of billions of dollars per year. One noted economist, William Cline, has estimated that a doubling of pre-industrial concentrations of greenhouse gases would cost the U.S. economy about 1.1% of GDP annually -- some $89 billion a year in today's terms. Moreover, these estimates do not reflect the potential costs of so-called "non-linearities" -- the risk that global warming will lead not to gradual and predictable problems, but to relatively abrupt, unforeseen, and potentially catastrophic consequences. Although we do not think the benefits of mitigating climate change are, at this stage, quantifiable with adequate precision, they are nonetheless likely to be real and large in the long run.

The impact of policies not included in illustrative analysis. The Administration is committed to several domestic initiatives to reduce greenhouse gas emissions. These initiatives, which make sense on economic and/or energy policy grounds and are consistent with our commitments under the 1992 Rio Treaty, could reduce costs further and/or increase the amount of reductions accomplished through domestic action. First, the Administration's $6.3 billion budget proposal to promote energy efficiency and renewable energy, as well as follow-on efforts that will undoubtedly occur between now and 2008, should help increase the rate of technology development and diffusion. Many of the components of the this initiative reflect recommendations made in a recent report by the President's Committee of Advisors on Science and Technology (PCAST), who concluded that "the inadequacy of current energy R&D is especially acute in relation to the challenge of responding prudently and cost-effectively to the risk of global climatic change from society's greenhouse gas emissions.... Much of the new R&D needed to respond to this challenge would also be responsive to the other challenges" (PCAST 1997, p. i). Accelerating the adoption of climate-friendly technologies would further contribute to emissions reductions.

Second, the Administration's electricity restructuring proposal is estimated to reduce greenhouse gas emissions at home by about 25 to 40 million metric tons per year. Competition would provide a direct profit incentive for generators to produce more electricity with less fuel and improve energy efficiency. Several specific provisions in the Administration's proposal would yield emission reductions.

Third, the Administration is conducting industry consultations that will lead to voluntary agreements with major energy-intensive industries, energy providers, and others to yield further emissions reductions. For example, the Partnership for Advanced Technology in Housing announced in May established goals for voluntary improvements in home energy use that would result in an estimated 24 million metric tons of reductions.

As noted above, models like the Second Generation Model, that are well equipped to assess policies such as a tradable permit program, are poorly equipped to assess policies like these. If these policies stimulate a higher rate of energy efficiency improvement, the United States could meet a correspondingly larger fraction of its commitment through domestic reductions potentially at lower permit prices.

In addition to these domestic program, the illustrative analysis did not account for the effects of carbon sinks in reducing net greenhouse gas emissions. Opportunities to reduce net emissions through carbon sinks could further reduce the costs of achieving the Kyoto target.

Conclusion

The current state of the science provides a powerful rationale to take prompt, prudent action to mitigate climate change; the agreement negotiated in Kyoto includes flexibility mechanisms that will allow the United States to meet its Kyoto target at a modest cost. Additional factors not included in the Battelle model we reference -- such as the President's domestic climate change policies, the inclusion of sinks and the ancillary benefit of improving air quality -- could lower costs even further and increase the percentage of reductions made through domestic action. The benefits of avoiding long-term impacts of global climate change, while not precise enough to quantify at this stage, are likely to be very important. In short, this is an insurance policy we should buy and it is one we can buy for reasonably priced premiums.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Alan S. Polasky (CN=Alan S. Polasky/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 3-NOV-1998 12:16:31.00

SUBJECT: climate change and cars

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

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

CC: Quindi C. Franco (CN=Quindi C. Franco/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:
Yesterday afternoon there was a meeting convened by Sally Katzen to discuss possible tax credits for fuel efficient vehicles to be included in the 2000 budget. The performance based tax credit in the 1999 budget died, largely because of lack of support from the Big 3 domestic producers. For a variety of reasons, the domestic producers wish to have a technology based tax credit rather than a performance based credit.

Transportation is a large sector that has no climate change iniative at present. There is a strong desire to put together an initiative that will pass muster with the Big 3 as well as the environmental community. There is a small group (CEQ, OSTP, EPA) that was tasked to draft options this week. The goal is to bring these options to principals within the next week to two week.

There are a number of issues that get rolled into this discussion making drafting the initiative, or even talking clearly about it, difficult. Important issues include the competitiveness of Detroit and foreign manufacturers, CAFE constraints , the Tier II emissions standards that EPA will propose in the next few months, and the role of the oil industry in supplying cleaner fuels. I would be happy to walk through these issues prior to this going to principals. Steve

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Jake Siewert (CN=Jake Siewert/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME:17-JUL-1998 03:57:10.00

SUBJECT: Revised Q & A on Economy

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

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

CC: Jeff B. Liebman (CN=Jeff B. Liebman/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

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

TEXT:
Janet --

This is slightly revised version of the Q & A you sent to Jeff. I tried to make it easier for MCurry to use without changing the substance. Let me know if it looks o.k. Thanks.

Jake

MG -- Can you see what Gene thinks.================== ATTACHMENT 1 ==================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D44]MAIL497923797.126 to ASCII,
The following is a HEX DUMP:

Post Report on the Economy Slowing
July 16, 1998

Q: Are you concerned that economic growth may be slowing?

A: It is important to keep in mind that quarterly GDP growth is almost always more erratic than projections. At the moment, the data we have suggest that economic growth in the second quarter will be well below the extraordinary first quarter pace of 5.4%.

There are a number of factors at work here. First of all, the Asian crisis continues to exert a drag on American exports. As Asian economies falter, they buyer fewer American goods. We also anticipate a substantial decline in the pace of stockbuilding from the record first quarter pace. Finally, production cutbacks associated with the GM strike are also likely to hold down second quarter growth.

Nevertheless, American households, and the American economy, remain in sound condition. Real disposable personal income grew at a solid 3.6 percent annual rate during the first five months of the year, and consumer spending, which has been a source of strength throughout the expansion, remains robust. The Administration continues to project solid, albeit more moderate economic growth, with continued job creation and low unemployment in 1998 and beyond. In fact, it is very likely that economic growth for the year as whole now will be higher than our last official projection -- the 2.9 percent growth projected in the Mid-Session Review.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Nouriel Roubini (CN=Nouriel Roubini/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:19-JUL-1998 18:43:56.00

SUBJECT: Analysis of the U.S. trade imbalance and its future prospects: A note

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

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

TEXT:
Janet, Jeff, following your suggestion to flesh out the implications of
the trade report, I wrote a note analyzing the US trade imblance and its
future prospects. I attach the note to this message.
Nouriel
================== ATTACHMENT 1 ==================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D32]MAIL49405640J.226 to ASCII,
The following is a HEX DUMP:

NR 7/19/98

Analysis of the U.S. trade imbalance and its future prospects.

The deficit on trade in goods and services widened from $14.3 billion in April to $15.7 billion in May, the largest deficit on record. The May 1998 goods deficit of $22.8 billion was the largest monthly goods deficit on record. The services surplus was unchanged at $7.1 billion. Compared to a similar point in 1997, year-to-date goods exports in 1998 are up 1.8 percent. Exports in May decreased $0.9 billion from April. Goods imports were up 6.8 percent in the first 5 months of 1998. Imports in May increased by $0.5 billion relative to imports in April.

Clearly, the Asian crisis continues to exert a strong drag on American exports; as the Asian economies have faltered, they are buying fewer American goods; moreover, imports from the region are now rising as a result of the depreciation of the East Asian currencies.

The deterioration in the trade balance is even more severe if we look at month-on-month data. Relative to May 1997, goods exports are down 3.5% and goods imports are up 6.5%. Relative to their peak in December 1997, May exports sre down 6.3%. Compared to May 1997, May 1998 exports to Asian countries are sharply down as follows:

Indonesia	-73.2%
Korea	-46.9%
Thailand	-30.8%
Malaysia	-28.8%
Singapore	-19.5%
Japan	-16.3%
China	-15.5%
Philippines	-11.6%
Taiwan	-8.5%
Hong Kong	-6.0%

As another indication of the likely effect of the East Asia crisis, the decline in U.S. exports to 7 East Asian countries (Japan, Korea, China, Indonesia, Thailand, Malaysia and Philippines) in the first 5 months of 1998 was $23.6 billion at an annual rate, relative to the first 5 months to 1997, representing an 18% drop (se Table 1). Using the seasonal adjutment method developed by the CEA, the decline in U.S. exports to these 7 East Asian countries in the first 5 months of 1998 was $28.2 billion at an annual rate, relative to the first 5 months to 1997, representing an 20% drop. The pecentage drops of export, using this seasonal adjustment, is 47% to Korea, 23% to the ASEAN-4, 12% to Japan and 2% to China.

While the data show a narrowing of the trade May deficit (relative to April) with Japan, China, the Pacific Rim and the impacted crisis countries, these figures are based on non-seasonally adjusted data. The CEA seasonal adjustment shows that the deficit towards all these countries has actually worsened in May relative to April; the overall seasonally-adjusted deficit towards 10 East

Asian countries (Japan, Korea, China, Indonesia, Thailand, Malaysia, Philippines, Hong Kong, Singapore and Taiwan) worsened in May to $15.8bllion from $14.4 billion in April, or a 52% deterioration relative to the May1997 deficit of $10.4 billion.

The deterioration of the trade deficit is even more severe in real terms considering the fact that import prices are sharply falling and real imports rising; this tends to worsen real net exports and exert a negative drag on real GDP. Moreover, a J-curve effect is at work. As the Asian currencies depreciated, U.S. imports in nominal dollars from the region did not increase very much. Between July 1997 and April 1998, seasonally adjusted imports from the above 10 countries were very moderately up (+3.5%): while real quantities of imports were going up, imports price were falling and this kept the increase in the nominal dollar value of imports contained. But the effect on nominal imports is likely to become larger as price and quantity effects work out over time.

Notice the following points:

1. While nominal imports are not sharply higher, real quantities of imports are rapidly increasing. For example, the fall in import prices from the 4 NICS (Korea, Hong Kong, Singapore and Taiwan) has been equal to 8.8% between June 1997 and June 1998. While nominal dollar imports from these four countries were effectively unchanged between June 1997 and May 1997, the drop in import prices represents a real increase in imports of around 8%. As the fall of the currencies of the 4 NICS has been significantly smaller than that of Indonesia and Thailand, the fall in import prices from these two countries has been much larger (than that of the $ NICS) and thus the increase in our real imports even bigger.

2. As the J-curve effect takes time to work out, the initial effect of a dollar appreciation (Asian currencies depreciation) on the value of imports is negative or (as in the data) close to zero (as falling import prices outweigh increases in the quantities of imports). However, over time the quantity effect start to dominate the price effect and one should expect to observe an increase in the dollar value of imports. This is exactly what has happened in May when the value of imports from the 10 Asian countries has started to show an increase (+1.6% relative to May).

3. We can expect to observe further reductions in the import prices. There is usually a lag between the time a currency appreciates and the time when import prices fully reflect such appreciation. The pass-through of exchange rates to import prices is slow. Therefore, we can expect further falls in U.S. imports prices as the effects of the Asian depreciations creep into out import prices from the region.

4. As the quantity effects of the depreciation start to work out more strongly as time passes, we are likely to observe in the next few months a sharp increase in our imports from the Asian region. Some preliminary data for the month of June appear to confirm that. As reported by Bloomberg, "Imports from Asia are flowing through the port of Long Beach, the largest U.S. container port, at a record-breaking pace. In June, Asian imports rose 13.4% from June 1997. For the year, Asian imports through Long Beach are up about 16% over last year's pace. U.S. exports to Asia continued to fall, though, and dropped 17.6% in June from a year earlier". As official imports from the 10 East Asian countries were up only about 6% between June 1997 and May 1988, these preliminary data suggest that the June data will show a sharp increase in U.S. imports from the region. This is consistent with the lagged J-curve effects and the slow pass-thorugh of exchange rates to import prices.

5. The sharp drop in import prices is driven both by Asia and the effects that Asia had had on primary commodity prices. Relative to June 1997, June 1998 import prices are down 5.6% for all imports, 28.8% for petroleum imports, 3.6% for non petroleum imports, 8.8% for the imports from the 4 NICS, 4.8% for imports from Japan and 24% for non-manufactured goods from developing countries. As U.S. export prices have

fallen less than U.S. import prices (3.3% driven by a fall in agricultural prices relative to the 5.6% drop in import prices), the U.S. has benefitted from an improvement in its terms of trade that translated into an increase in the real income of households. This positive terms of trade effect has supported real incomes and real consumption demand; the increase in real consumption will compensate in part the negative effect on real GDP of the real increase in imports; the size of this effect on consumption will depend on the marginal propensity to consumption out of real income. However, the terms of trade improvement also means that our real (as opposed to nominal) trade deficit is larger (and growing faster) than the nominal deficit. Also, as the trade deficit is likely to further deteriorate in the next few months and the terms of trade further improve (as import price keep on falling with the lagged pass-through of exchange rates to import prices), the real trade imbalance can be expected to deteriorate even more dragging further down the growth rate of real GDP.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: DAVID.WILCOX@MS01.DO.treas.sprint.com@INET@LNGTWY (DAVID.WILCOX@MS01.DO.treas.sprint.com@INET@LNGTWY [UNKNOWN])

CREATION DATE/TIME:19-JUL-1998 22:20:27.00

SUBJECT: revised saving document

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

TEXT:
Date: 07/19/1998 10:06 pm (Sunday)
From: David W. Wilcox
To: EX.MAIL."yellen_j@a1.eop.gov", EX.MAIL."elmendorfd@frb.gov"
Subject: revised saving document=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D38]MAIL490386408.226 to ASCII,
The following is a HEX DUMP:

Social Security Reform and Saving:

Considerations Raised by Congressional and Think-Tank Plans

National saving is an important determinant of economic prosperity, because a higher rate of national saving finances more investment. Over the longer term, regardless of whether the additional investment is undertaken at home or abroad, more investment leads to a higher standard of living.

U.S. net national saving rate has improved considerably in the last few years, from 3.1 percent of GDP in 1992 to 6.5 percent in 1997.

- This improvement owes entirely to a turnaround in Federal government saving. Between 1992 and 1997, the unified deficit declined from x.x percent of GDP to y.y percent. And Federal saving is expected to continue to improve, with the unified budget projected to show a surplus of z.z percent of GDP this year, and x.x percent by 2002.

- In contrast, personal saving has declined from x.x percent of GDP to y.y percent. An important cause of this decline has been the boom in the stock market. Nonetheless, today's low rate of personal saving raises the concern that many members of the baby boom generation will not be adequately prepared for retirement.

Despite the recent improvement in national saving, it remains low by international standards. Relative to the 25 industrialized countries surveyed in a recent OECD publication, the U.S. ranked fourth lowest in terms of gross national saving (a measure that does not adjust for depreciation). Moreover, as the table on the next page [to be supplied] shows, the U.S. has saved considerably more at times in the past.

Much of the debate surrounding national saving and Social Security reform revolves around the potential role of the budget surpluses. Purely from the perspective of maximizing national saving, the best policy would likely be simply to pay down the national debt. This would guarantee that government saving is preserved to the full extent, and would elicit the smallest offsetting reductions from the private sector. However, there is a broad consensus that this would not be a sustainable policy politically, and that absent some other action, the surpluses would be spent or used for tax cuts.

Social Security Reform and National Saving

Social Security reform could represent the opportunity for preserving a larger portion of the surpluses for national saving. It will influence national saving through many different channels. But one influence will stand far above all others: Social Security reform will make an enormous contribution to national saving if it prevents the budget surpluses from being tax-cutted away or spent for low-priority purposes. Reform could have this effect by any of several different means:

- Transferring the surplus to the Social Security Trust Fund might dissuade those who would use the surplus for purposes that would reduce saving.

- Using the surplus to purchase private-sector securities for the Trust Fund might further discourage spenders or tax-cutters, because under current scoring rules, a purchase of equities or other private-sector securities would be scored as an "expenditure," and so would reduce the unified surplus, leaving less available for other purposes. (However, there is considerable question as to whether current scoring rules might not be modified if this strategy were to be seriously contemplated.)

- Using the surplus to fund individual accounts might also effectively preserve at least part of the surpluses for national saving, although probably a lesser amount than would be preserved through mechanisms involving the Trust Fund.

  -- Government saving would be reduced by the amount of the funding provided to individual accounts.

  -- In the first instance, personal saving would be increased by the same amount, leaving national saving unchanged. The key question, however, is whether -- and if so, to what extent -- households and businesses would react in ways that would offset some of the benefit to national saving.

    o Some households might react to the increase in their wealth provided by the individual account by cutting back on their other saving. For example, 401(k) contributors would likely reduce savings in response to IAs, because IAs and 401(k)s would share many features and hence appear to be close substitutes and it is very easy for an employee to alter 401(k) contributions.

    o Some businesses might react to the introduction of individual accounts by reducing the generosity of the retirement benefits they provide to their employees. For example, indeed, about 15 percent of employees (roughly 2.4 million workers) covered by DB plans are subject to explicit offset formulas in their plans, which reduce benefits by a portion (typically 50 percent) of Social Security benefits. This is only the most direct and mechanical example of how employer offsets might occur.

- The magnitude of these offsets is essentially impossible to know. However, two qualitative results are likely:

  o If the surpluses are used to fund individual accounts, it is very likely that the positive impact on national saving will be greater the more progressive the funding mechanism. Low-income households have much less other saving they could reduce in response to individual accounts, and are much less likely to be covered by employer-provided pensions of any type.

- Transferring a given amount of the surplus into individual accounts would likely elicit a larger offset, in terms of reduced private saving, than would a similar-sized transfer into the Trust Fund, because individual accounts would be more tangible and "real" to average Americans.

- A number of analysts have suggested that Social Security reform -- in particular, establishment of individual accounts -- could raise national saving by quite a different means. Specifically, these analysts have suggested that, by giving a broad swath of the population direct experience with managing financial assets, individual accounts could sensitize many people to the importance of retirement planning and saving, and thereby could actually increase private saving rather than evoke an offsetting reduction.

  - One relevant piece of evidence tending to corroborate this hypothesis is that employer-sponsored pension and saving systems tend to result in much greater participation when employees are provided with basic education about investing and the importance of saving for retirement.

Can a country save too much?

At the last briefing we had with you on this topic, you asked whether it was possible for a country to save too much.

- The generally agreed-upon answer among economists is that it is indeed possible for a country to save too much over the long term, but it is difficult to do so.

  - In this context, a country is judged to be "saving too much" if its capital stock is so large that depreciation exceeds the return on the last unit of capital. In this case, a country could improve its well-being by actually "disinvesting," thereby foregoing some return on capital, but also sparing itself the larger depreciation expense.

- The evidence in the case of the United States is clear, that we have not been saving too much by this definition during the 20th century.

- Japan is often cited as a possible counterexample. Indeed, in many of our consultations with the Japanese, we encourage them to take actions that would have the effect of causing them to save less.

  - This advice reflects our concern with the near-term prospects for the Japanese economy, not with their longer-term accumulation of capital. In the short term, they need to save less in order to stimulate domestic demand. Over the longer term, they could return to high rates of national saving without jeopardizing their economy.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:20-JUL-1998 21:02:32.00

SUBJECT: employment effects

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

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

TEXT:
Below is the employment section with a new sentence on the President's assurance that we will respond to our moral obligation to help dislocated workers. Let me know what you think.

Employment

The Second Generation Model is conditioned on the assumption that aggregate employment effects are negligible. Given the small projected energy price increases anticipated and the long lead time before any impact would occur, this assumption is appropriate. Although there may be job gains in some sectors and job losses in others, the analysis of the Kyoto Protocol with effective international trading and developing country participation suggests that there will not be any significant aggregate employment effect under permit prices of $14/ton to $23/ton. Some employment reduction could occur in energy-intensive sectors, although given the very small predicted change in energy prices, impacts in most such sectors are apt to be modest. To address any dislocations that may occur as a result of policies to reduce greenhouse gas emissions, the President indicated in his October 1997 speech that appropriate assistance would be provided to affected workers. Furthermore, new jobs will be created in other sectors -- such as in environmental protection technologies, energy production, and energy efficient technologies. Many of these are high-tech jobs that pay high wages.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:21-JUL-1998 18:50:29.00

SUBJECT: draft for 2 pm meeting

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.D56]MAIL491377805.226 to ASCII,
The following is a HEX DUMP:

Indicators of Current Production	1998:Q1	1998:Q2
Labor-market Indicators		
1. Production-worker hours	3.2	0.8
2. Unemploment rate	4.7	4.4
3. Industrial Production	1.2	2.5
4. GDP spending indicators	5.4	-0.6
		(-1.0% to +1.0%)
--contribution to GDP growth (in percentage points)--		
5. Consumption ex. MV	4.3	2.8
6. Residential Investment	0.7	0.5
7. Business Fixed Investment (ex. MV)	1.8	1.1
8. Federal gov't	-0.7	0.2
9. S&L gov't	0.1	0.2
10. Inventory Investment (ex MV)	1.8	-2.0
11. Motor vehicle production	-0.4	-0.5
12. Net Exports	-2.2	-3.0

• **GDP in 1998:Q2 is still a forecast.**

• **The labor-market indicates continued 2nd-quarter growth, but at a slower rate**

- production-worker hours rose 0.8 percent (AR)--much less of an increase than in 1998:Q1 but a rise nevertheless.
- the unemployment rate fell another 0.3 percentage point to 4.4 percent

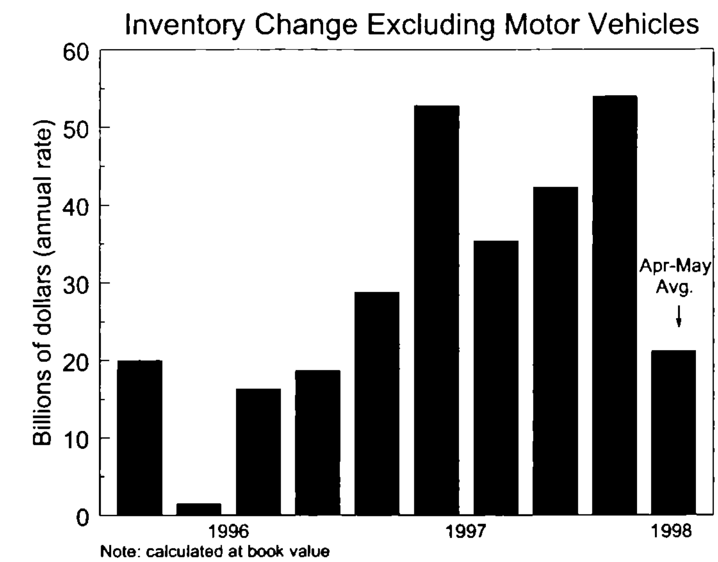
• **The industrial sector rose further**

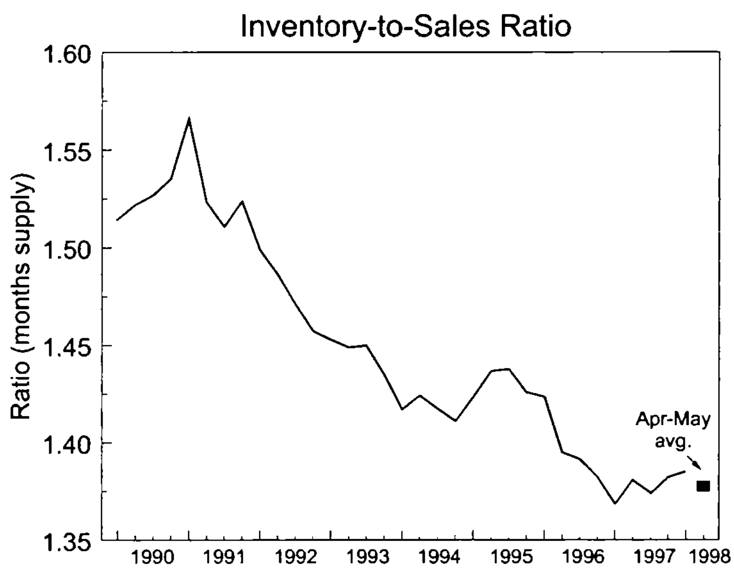
• **Spending components of GDP are very incomplete, but point to a small decline**. The Commerce department releases its advance estimate on Friday, July 31, and a figure between -1 percent and +1 percent is likely. The annual revision for 1996 & 1997 will be announced at the same time.

•Robust increases continue in consumption, residential construction, and business fixed investment.

•2nd Quarter weakness localized in 3 components:

- Inventory Investment (ex. motor vehicles)
- Motor vehicle production
- Net exports

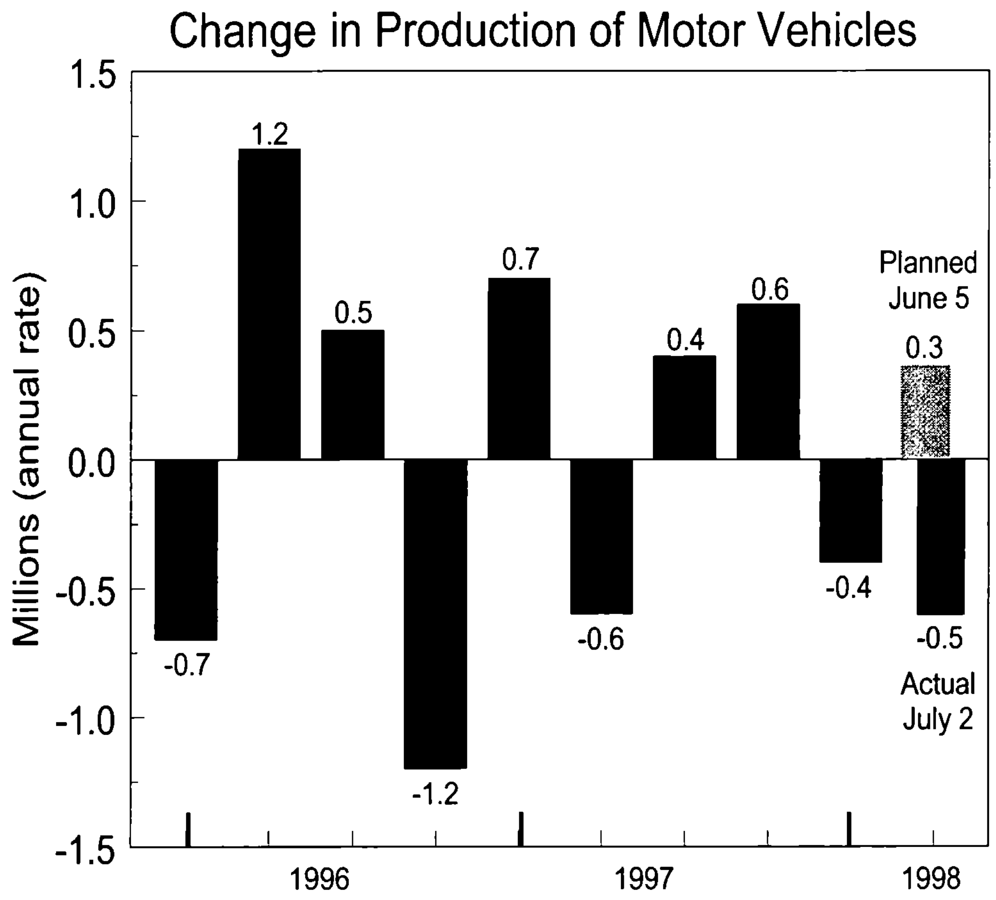




Inventory Investment

- Although stockbuilding continues, April and May data show that it continues at a much rate.
- Over the past year, inventories grew fast so as to keep pace with fast-growing sales; ries remain lean with respect to sales.
- A \$20 to \$25 billion annual rate of inventory investment as is likely in 1998:Q2 is :nt with a 2 percent annual rate of growth. So if final sales slow to a 2 percent annual rate of then the drop in inventory investment may be over.

[Automated Records Management System Hex-Dump Conversion]



[Automated Records Management System Hex-Dump Conversion]

Motor vehicle production

- Motor vehicle production fell well short of planned schedules, and dropped lion units at an annual rate.
- The drop was due entirely to the strike at GM (which subtracted :entage point at an annual rate from GDP growth).
- General Motors (together with its suppliers) produces about 1 percent of

- If the strike were to persist through the end of the September, 3rd quarter ould be reduced by 3½ percent.
- If the strike were to end today, most the lost production could be recouped s year.
- A strike that extends through the end of July would result in overable losses and would cost the U.S. economy up to $300 million per day.

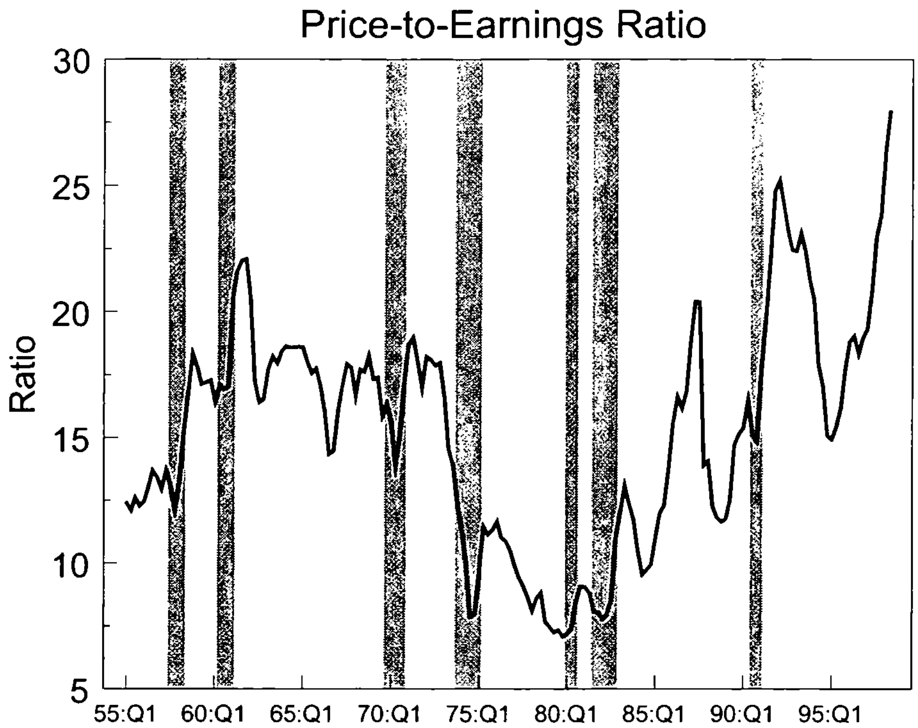
Net Exports

- Exports have fallen sharply since last year--with all of the decline accounted for by to 7 troubled Asian economies.
- With import prices down, the growth in real imports exceed the growth of nominal and much of the strength in consumer demand going towards the purchase of imports.
- Because the Asian economic crisis is expected to continue, and because of the rise in the net exports are expected to erode further.

		Forecast			*1998*	*1998*
	1998:Q1	*1998:Q2*	*1998:Q3*	*1998:Q4*	*Yr/Yr*	*Q4/Q4*
Real GDP growth						
Current projection	5.4	0.0	2.0	2.0	3.0	2.3
MSR	3.4	2.4	2.0	2.0	2.9	2.4

What next? The adjustment to a slower pace of inventory investment is now behind us, and if the auto strike is settled soon, the shape of aggregate demand may be qualitatively similar to the second quarter, with weak net exports offsetting solid growth rates for consumption and business investment.

Comparison with budget plans. Economic growth is almost always more volatile than projections. This year, first quarter growth turned out stronger than expected--while the second quarter appears to have been weaker. We think it likely that the second quarter growth rate will show no growth, and will be followed by 2 percent growth in the second half. If so, growth for the year as a whole, will be almost identical to the economic assumptions upon which the Mid-Session budget was calibrated.


Price-to-Earnings Ratio
Ratio
30
25
20
15
10
5
55:Q1
60:Q1
65:Q1
70:Q1
75:Q1
80:Q1
85:Q1
90:Q1
95:Q1

Risks:
Stock-market prices are higher relative to earnings than ever before--a valuation implies very large future growth in profits, or very low real interest rates. Both seem unlikely, but not impossible. A 25 percent drop in the stock market would cut real GDP growth by 0.6 percent over the next four quarters.

Worsening Asian crisis: Japan's recession worsens and the yen keeps on falling--making the East Asian recession worse. Contagion spreads to other countries. Russian reforms fail leading to contagion in Eastern Europe; financial crisis develops in Pakistan, India and Brazil.

GM strike: If the GM strike persists through the third quarter, it will lower 3rd-quarter growth by 3½ percent. Under these circumstances, a positive growth rate in the third quarter will be impossible.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:21-JUL-1998 20:14:51.00

SUBJECT: Nouriel's revisions to the net exports section

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 07/21/98
08:14 PM ---------------------------

Nouriel Roubini
07/21/98 05:48:51 PM
Record Type: Record

To: Steven N. Braun/CEA/EOP
cc:
Subject: Re: my revisions to the net exports section

Steve, I attach the document you sent me with my revisions on the net
exports section.
Nouriel

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

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D25]MAIL42469780P.226 to ASCII,
The following is a HEX DUMP:

Indicators of Current Production	1998:Q1	1998:Q2
Labor-market Indicators		
1. Production-worker hours	3.2	0.8
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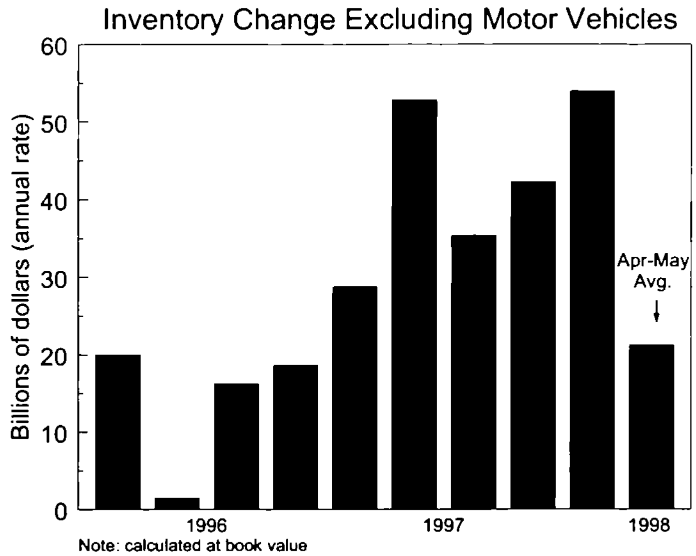

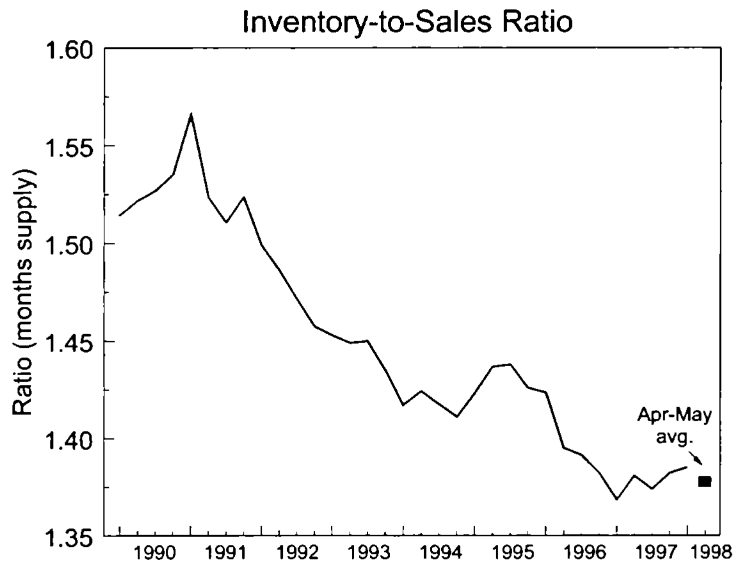

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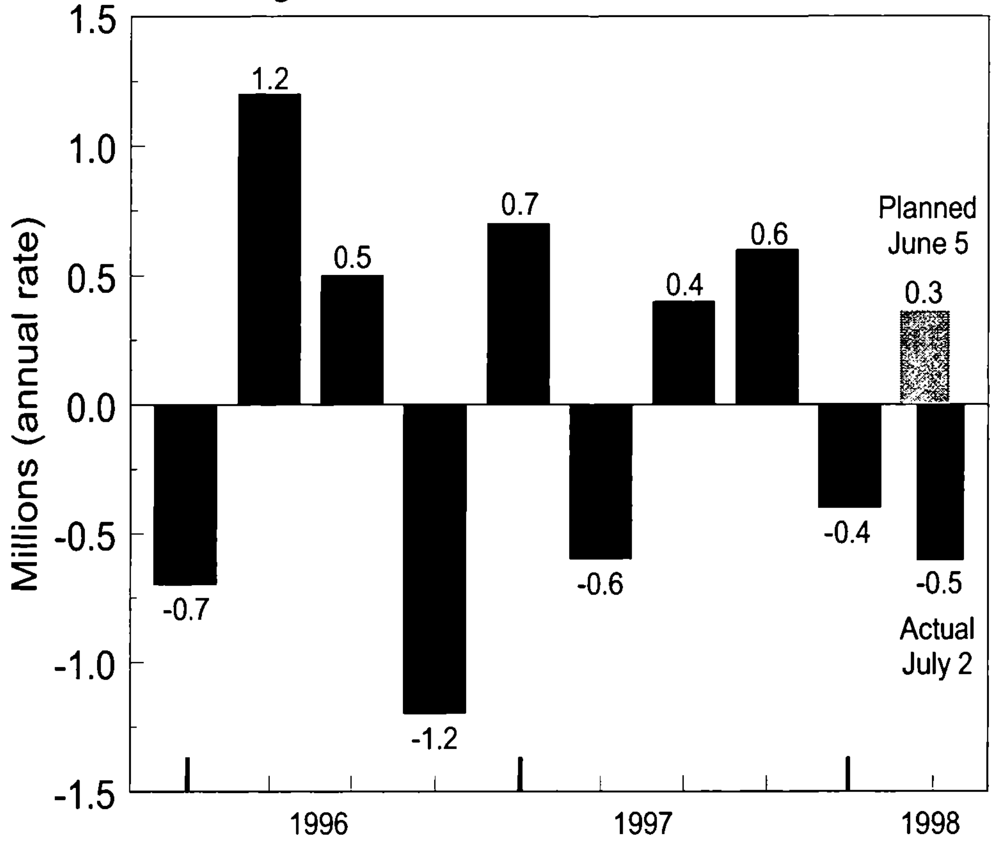
[Automated Records Management System Hex-Dump Conversion]

Change in Production of Motor Vehicles



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- A strike that extends through the end of July would result in
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Net Exports

- Exports have fallen sharply since last year--with almost all of the decline accounted for ›rts to 7 troubled Asian economies (Japan, Korea, China, Indonesia, Thailand, Malaysia and ines).
- As an indication of the likely effect of the East Asian crisis, the decline in U.S. exports to \sian countries in the first 5 months of 1998 was $24 billion to $28 billion, at an annual rate, ing on the seasonal adjustment method used.
- The strength in consumer demand is going towards the purchase of imports. With import lown, the growth in real imports exceeds the growth of nominal imports.
- Because the Asian economic crisis is expected to continue, and because of the rise in the ıet exports are expected to erode further. However, the negative contribution of net exports to is likely to be smaller in the second half of the year than in 2Q.

[Automated Records Management System Hex-Dump Conversion]

	1998:Q1	*Forecast* *1998:Q2*	*1998:Q3*	*1998:Q4*	*1998* *Yr/Yr*	*1998* *Q4/Q4*
Real GDP growth						
Current projection	5.4	0.0	2.0	2.0	3.0	2.3
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What next? The adjustment to a slower pace of inventory investment is now behind us, and if the auto strike is settled soon, the shape of aggregate demand may be qualitatively similar to the second quarter, with weak net exports offsetting solid growth rates for consumption and business investment.

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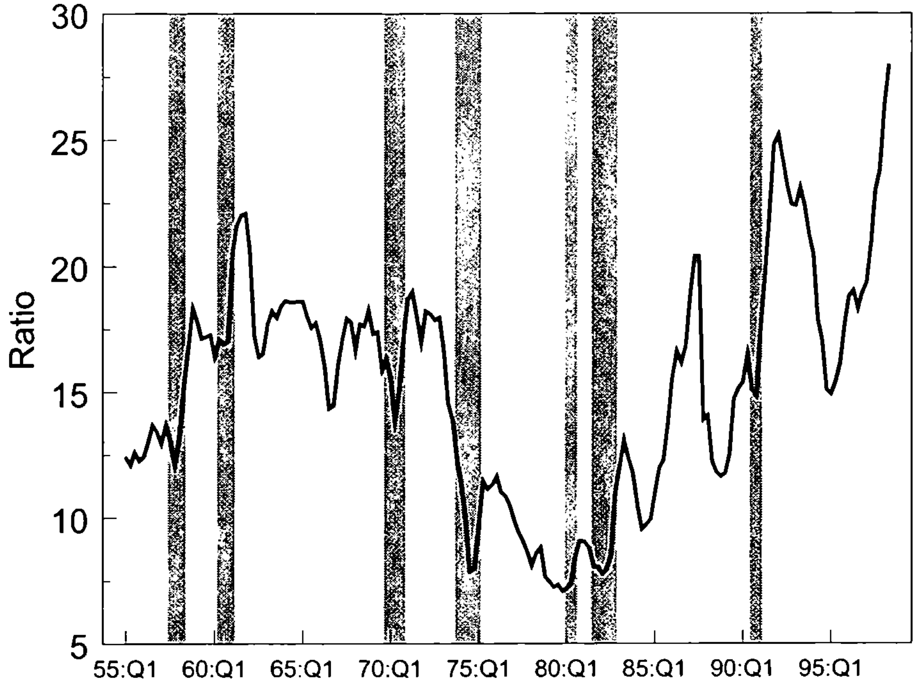
Price-to-Earnings Ratio



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Worsening Asian crisis: Japan's recession worsens and the yen keeps on falling--making the East Asian recession worse. Contagion spreads to other countries. Russian reforms fail leading to contagion in Eastern Europe; financial crisis develops in Pakistan, India and Brazil.

GM strike: If the GM strike persists through the third quarter, it will lower 3rd-quarter growth by 3½ percent. Under these circumstances, a positive growth rate in the third quarter will be impossible.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:21-JUL-1998 09:28:32.00

SUBJECT: Re: employment effects

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

TEXT:
The new section looks fine, although I wonder if the last sentence about the new jobs being high tech with high wages is fact checkable. If not, perhaps we should soften the assertion that they "will be..." to "they are likely to be..."

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:21-JUL-1998 16:04:56.00

SUBJECT: Race Factbook

TO: David L. Blank (CN=David L. Blank/OU=ONDCP/O=EOP @ EOP [ONDCP])
READ:UNKNOWN

TEXT:
---------------------- Forwarded by Janet L. Yellen/CEA/EOP on 07/21/98
04:04 PM ---------------------------

Maria Echaveste
07/21/98 01:17:17 PM
Record Type: Record

To: Sylvia M. Mathews/OMB/EOP, Gene B. Sperling/OPD/EOP, Janet L. Yellen/CEA/EOP
cc: Jonathan Orszag/OPD/EOP, Peter Rundlet/WHO/EOP, Leslie Bernstein/WHO/EOP, Judith A. Winston/PIR/EOP
Subject: Race Factbook

Folks--looks like we need one last meeting. Let's get that memo from Gene and Janet's shops into Sylvia and me by tonight and Leslie will arrange for us to meet tomorrow for a short meeting. Peter--thanks for the update.
---------------------- Forwarded by Maria Echaveste/WHO/EOP on 07/21/98
12:45 PM ---------------------------

Peter Rundlet
07/21/98 12:26:24 PM
Record Type: Record

To: Maria Echaveste/WHO/EOP
cc: Marjorie Tarmey/WHO/EOP
Subject: Race Factbook

I just wanted to give you a heads-up on a dispute over one graph in the draft version of the Race Factbook. There was a meeting today at 10:30 to discuss this, and we made no progress in solving it. Janet Yellen (and Becky Blank) and Gene are fighting over whether to include a line graph that shows that the median weekly earnings of male workers has declined over the past 5 years or so.

Janet Yellen, Becky Blank, Kathy Wallman, Judy W, Lin Liu, Ann Lewis, Jonathan Orzag and I attended today's meeting. Essentially, Jonathan (on behalf of Gene) held firm that the wage chart should be pulled. Janet, Becky, and Kathy strongly urged that it be included because it is one of a few key indicators and because pulling it would raise credibility problems for the whole document. Judy, Lin, and Ann were all sympathetic to Becky, et al., primarily for the concern over credibility. Gene and Janet fought the same battle over an identical chart for the ERP, and Gene won. Janet's argument is that the ERP is an inherently political document and so it was more understandable to pull it before than it is now.

Because everyone held firm, and because there were no ultimate arbiters (like you or Sylvia), no progress made. Gene wasn't there to argue his case himself. I told them that they needed to draft a memo outlining their positions, and including the views of Judy and Ann, for you and Sylvia. A decision is needed by tomorrow at the latest.

A memo should be crossing your desk by the end of the day.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Maria Echaveste (CN=Maria Echaveste/OU=WHO/O=EOP [WHO])

CREATION DATE/TIME:21-JUL-1998 13:21:57.00

SUBJECT: Race Factbook

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

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

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

CC: Judith A. Winston (CN=Judith A. Winston/OU=PIR/O=EOP @ EOP [PIR])
READ:UNKNOWN

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

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

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

TEXT:
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RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Charles F. Stone (CN=Charles F. Stone/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:21-JUL-1998 18:17:35.00

SUBJECT:

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

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

TEXT:
FYI, this is a copy of what went in tonight's briefing book to the
President. ==================== ATTACHMENT 1 ====================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D14]MAIL44375780C.226 to ASCII,
The following is a HEX DUMP:

Council of Economic Advisers

The Current Economic Outlook

July 22, 1998

Indicators of Current Production

Contributions to GDP Growth

(percentage points)

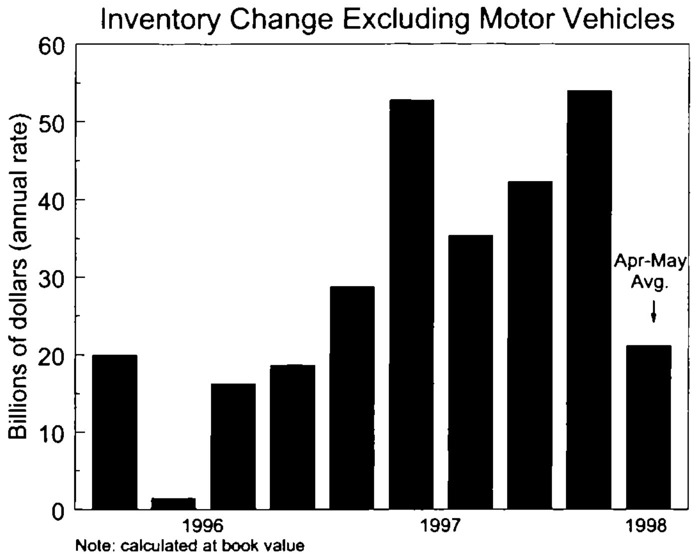
Component of GDP	1998:Q1	1998:Q2
Consumption (excluding motor vehicles)	4.3	2.8
Residential Investment	0.7	0.5
Business Fixed Investment (excluding motor vehicles)	1.8	1.1
Federal Government	-0.7	0.2
State and Local Government	0.1	0.2
Inventory Investment (excluding motor vehicles)	1.8	-2.0
Motor Vehicle Production	-0.4	-0.5
Net Exports	-2.2	-3.0
TOTAL	5.4	-0.6
Other Indicators of Current Production		
Production-Worker Hours (percent change)	3.2	0.8
Unemployment Rate (percent)	4.7	4.4
Industrial Production (percent change)	1.2	2.5

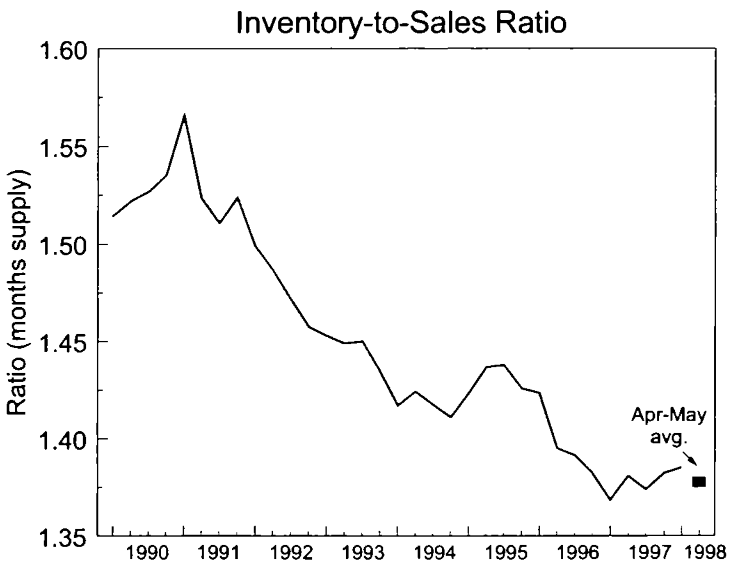
Note: Growth in GDP and its components in 1998:Q2 are estimates.

- Available (incomplete) data on spending components indicate that GDP declined in the second quarter.
- Areas of particular weakness include:
  - inventory investment (excluding motor vehicles)
  - motor vehicle production
  - net exports
- Other labor market and production indicators suggest positive but slower growth in the second quarter.

- The advance estimate of GDP growth in the second quarter, to be released July 31, is most likely to be in the range of -1.0 to 1.0 percent.

Inventories

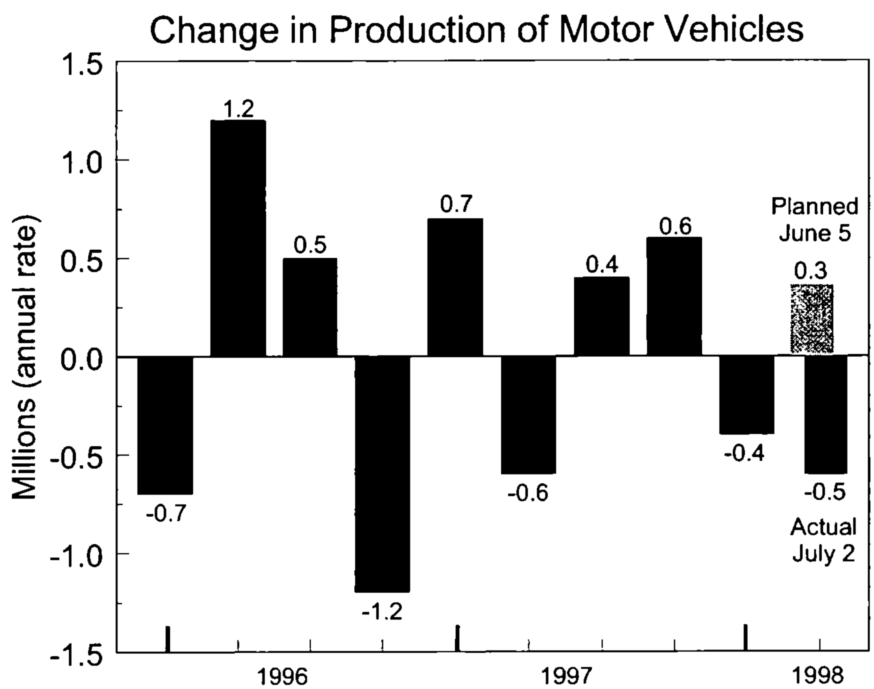




- After a rapid buildup in the first quarter, inventory investment rose only modestly in April and May. Changing to a slower pace of inventory accumulation slows GDP growth.

- The inventory-to-sales ratio remains quite low, with little or no evidence of an inventory overhang.

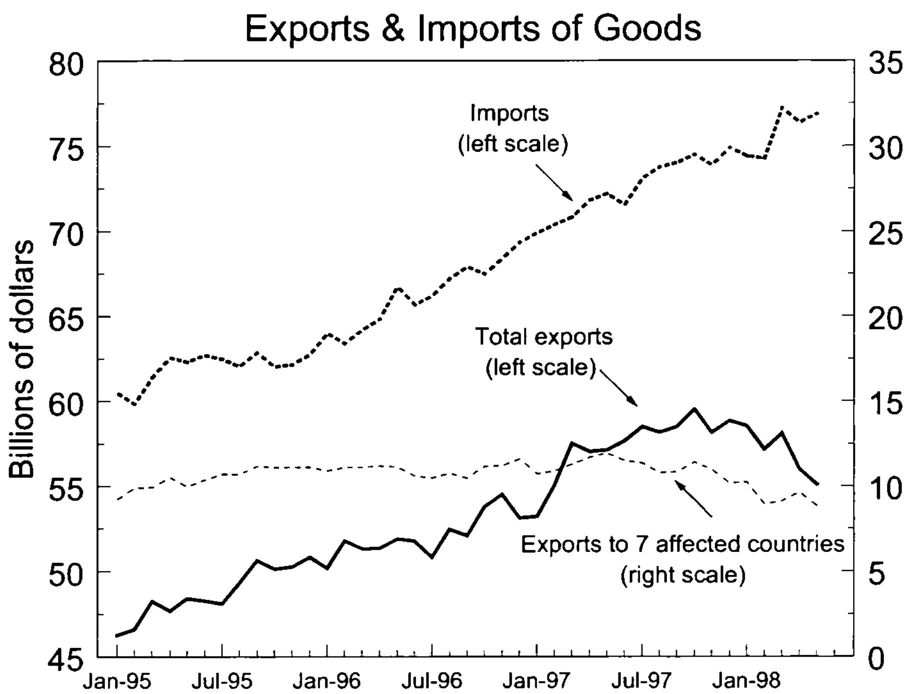
Motor Vehicle Production



- Motor vehicle production fell well short of planned schedules as a result of the GM strike, which subtracted about 0.6 percentage point from second quarter growth.

[Automated Records Management System Hex-Dump Conversion]

Net Exports



- Exports have fallen sharply since last year—with almost all of the decline accounted for by exports to seven troubled Asian economies.

Forecast and Risks

Forecasts of Real GDP Growth in 1998

	Q1	Q2	Q3	Q4	Yr/Yr	Q4/Q4
Current CEA Projection	5.4	0.0	2.0	2.0	3.0	2.3
Mid-Session Review	3.4	2.4	2.0	2.0	2.9	2.4
Macroeconomic Advisers (consensus forecast)		0.1	2.0			

- Even if there is zero growth in the second quarter, if the economy settles down to 2.0 percent growth in the second half of the year, growth for 1998 as a whole could be slightly greater than what is forecast in the Mid-Session Review.

- Important risks to the forecast include the following:

    - sharp drop in the stock market

    - worsening of the Asia crisis

    - prolonged GM strike

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:21-JUL-1998 20:22:46.00

SUBJECT:

TO: Steven N. Braun (CN=Steven N. Braun/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.D70]MAIL47989780S.226 to ASCII,
The following is a HEX DUMP:

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Industrial Production (percent change)	1.2	2.5

Note: Growth in GDP and its components in 1998:Q2 are estimates.

- Available (incomplete) data on spending components indicate that GDP declined in the second quarter.

  --Consumption, residential construction and business fixed investment all continue to increase at robust rates and the fundamentals underlying these spending components remain favorable for continued growth, albeit at a more moderate pace than the roughly 4% we have enjoyed over the past year.

  --Consumption: Consumption probably grew about 4.3% at an AR in Q2 following a sizzling 6.1% in Q1. For example, real disposable personal income grew at a solid 3.6% annual rate in the first 5 months of the year; consumer confidence remains high; the stock market has reached all time highs boosting wealth; the job market remains tight and expectations concerning future conditions are favorable.

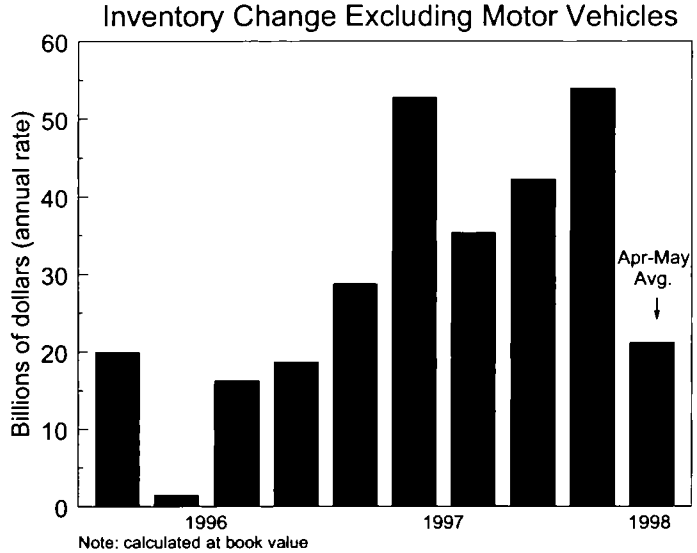
--Investment/Housing: Financial conditions remain favorable for investment. Long term interest rate declines this year continue to stimulate consumption, investment and housing.

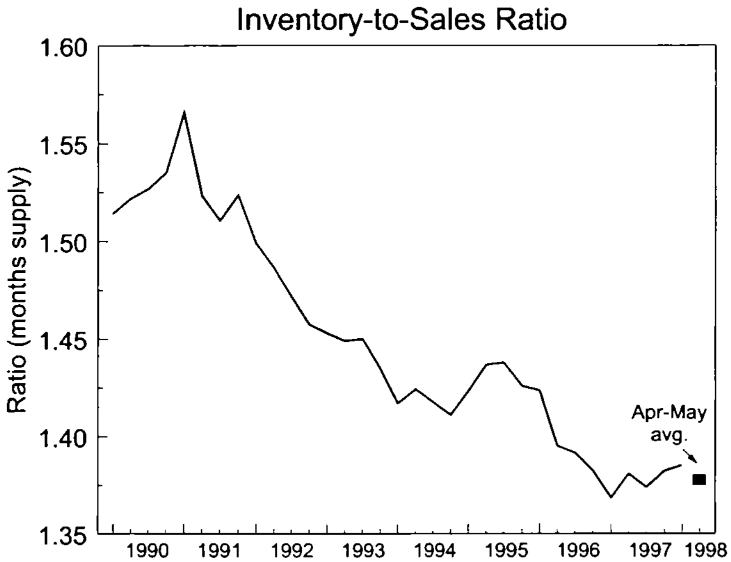
- Areas of particular weakness include:
  - inventory investment (excluding motor vehicles)
  - motor vehicle production
  - net exports

- Other labor market and production indicators suggest positive but slower growth in the second quarter.
  - -- production-worker hours rose 0.8 percent (AR)--much less of an increase than in 1998:Q1 but a rise nevertheless.
  - -- the unemployment rate fell another 0.3 percentage point to 4.4 percent
  - -- The industrial sector rose further (2.5% total IP increase in Q2 and 2.2% in mfg net of MV&P. Even with MV&P, manufacturing production rose 1.7% in Q2, down from 2.3%.

- The advance estimate of GDP growth in the second quarter, to be released July 31, is most likely to be in the range of -1.0 to 1.0 percent.

Inventories



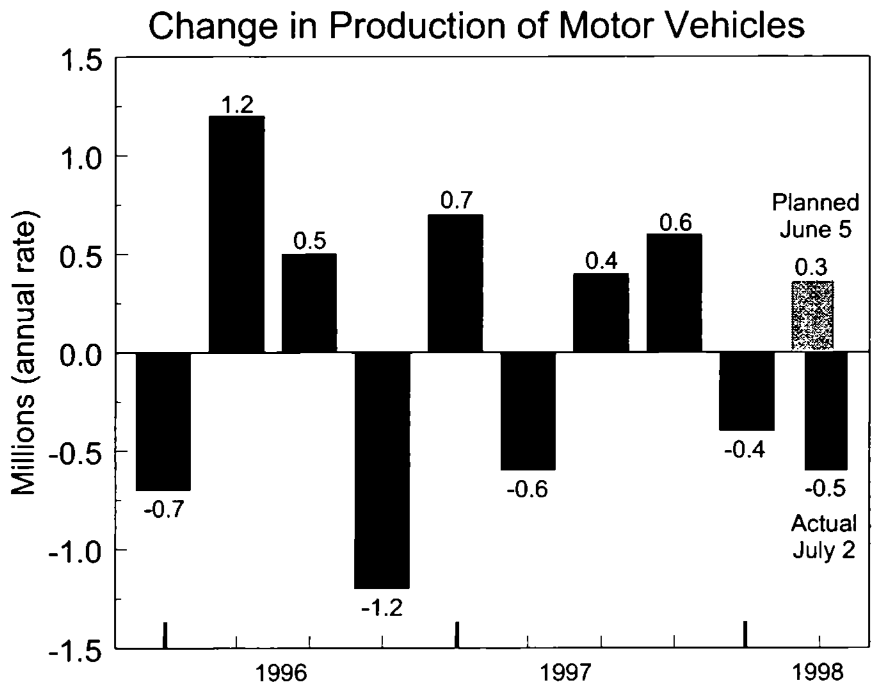


- After a rapid buildup in the first quarter, inventory investment rose only modestly in April and May. (Business inventories in total actually fell 0.1% in May and retail inventories fell sharply. This was the news causing the stories about a decline in Q2 GDP.) Changing to a slower (more normal, more sustainable) pace of inventory accumulation slows GDP growth. Inventory investment has been unsustainably rapid--probably because sales have been growing so rapidly and a high level of inventory investment has been needed to keep inventories in pace with sales. But, as sales growth slows, as it is now, it is natural and typical for inventory investment to decline. Inventory investment is probably being cut to avoid an overstocking of inventories. A $20 to $25 billion annual rate of inventory investment, as is likely in 1998:Q2, is consistent with a 2 percent annual rate of growth. So if final sales slow to a 2 percent annual rate of growth, then the drop in inventory investment may be over.

- Inventories are a very volatile component of GDP.

- The inventory-to-sales ratio remains quite low, with little or no evidence of an inventory overhang. (In retail, where inventories fell, retail sales were unusually strong, suggesting not an overhang but unexpectedly strong sales.)

Motor Vehicle Production



- Motor vehicle production fell well short of planned schedules (and dropped by 0.5 million units at an annual rate) as a result of the GM strike, which subtracted about 0.6 percentage point from second quarter growth. (1 million units at an AR translates into a about a 1% change in GDP).

- The drop was due entirely to the strike at GM. GM (together with its suppliers) produces about 1 percent of GDP.

- If the strike were to end today, most of the lost production could be recouped later this year, resulting in unusually strong growth in the fourth quarter.

- If the strike were to persist through the end of September, however, 3rd quarter GDP would be reduced by 3 ½ percent.

- A strike that extends through the end of July would result in non-recoverable losses and would cost the U.S. economy up to $300 million per day.

<u>Net Exports</u>

- Exports have fallen sharply since last year—with almost all of the decline accounted for by exports to seven troubled Asian economies (Japan, Korea, China, Indonesia, Thailand, Malaysia and Philippines). The decline in U.S. exports to these countries in the first 5 months of 1998 amounted to $24 to $28 billion at an annual rate, depending on the method of seasonal adjustment. Excluding our exports to these 7 economies, our exports grew a robust 6.3% during this same period.

- With import prices down, the growth in real imports exceed the growth of nominal imports and much of the strength in consumer demand is going towards the purchase of imports.

- We expect net exports to continue to erode going forward, so net exports will continue to be a drag on GDP growth. But we also expect them to be less of a drag in the future than they have been over the past two quarters (the subtractions from GDP growth will decline) if the Asian crisis stabilizes. Obviously this is a source of considerable risk.

Forecast and Risks

Forecasts of Real GDP Growth in 1998	Q1	Q2	Q3	Q4	Yr/Yr	Q4/Q4
Current CEA Projection	5.4	0.0	2.0	2.0	3.0	2.3
Mid-Session Review	3.4	2.4	2.0	2.0	2.9	2.4
Macroeconomic Advisers (consensus forecast)		0.1	2.0			

- Even if there is zero growth in the second quarter, if the economy settles down to 2.0 percent growth in the second half of the year, growth for 1998 as a whole could be slightly greater than what is forecast in the Mid-Session Review. Economic growth is almost always more volatile than projections. First quarter growth was much stronger than we expected and second quarter appears to have been weaker. But the year as a whole may be okay.

- If the adjustment to a slower pace of inventory investment is now behind us, and if the auto strike is settled soon, the picture in the second half of the year could be one in which negative contributions to net exports offset solid growth rates for consumption and business investment, resulting in around 2% growth. This is the view of a consensus of forecasters polled by Macro Advisers.

- Important risks to the forecast include the following:

  - sharp drop in the stock market: Stock-market prices are higher relative to earnings than every before--a valuation which implies either very large future growth in profits, very low real interest rates, or historically low equity premia. All seem unlikely, but not impossible. A stock market drop of 25% would cut real GDP growth by 0.6% over the next four quarters through the wealth effect on consumption alone. It could obviously have a much broader impact on confidence, on investment, and on international financial markets. Before tax corporate book profits have declined for the past two quarters and a further decline in Q2 seems likely.

- worsening of the Asia crisis
- prolonged GM strike. If the GM strike persists through the third quarter, it will lower 3rd quarter growth by 3.5%. Under these circumstances, a positive growth rate in the third quarter will be all but impossible.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:21-JUL-1998 17:50:00.00

SUBJECT: Re: Race Factbook

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

TEXT:
---------------------- Forwarded by Rebecca M. Blank/CEA/EOP on 07/21/98 05:49 PM ---------------------------

Maria Echaveste
07/21/98 02:31:32 PM
Record Type: Record

To: Jonathan Orszag/OPD/EOP
cc: Marjorie Tarmey/WHO/EOP, Sylvia M. Mathews/OMB/EOP, Peter Rundlet/WHO/EOP, Rebecca M. Blank/CEA/EOP
bcc:
Subject: Re: Race Factbook

Jon--I just assumed since there were emails all over the place that peter's suggestion for a very brief statement of the issue would be helpful for those of us who have no idea or expertise in this area--however, I will acquiesce, no paper--just make sure Gene and Janet are prepared to present their cases in an understandable and concise manner. peter--thanks for trying to help.

Jonathan Orszag
07/21/98 01:56:17 PM
Record Type: Record

To: Maria Echaveste/WHO/EOP
cc: Marjorie Tarmey/WHO/EOP, Rebecca M. Blank/CEA/EOP, Peter Rundlet/WHO/EOP
Subject: Re: Race Factbook

Maria:

Given the sensitivity of this issue, I think it would be to just have a meeting and not to put this on paper. Is this okay with you?

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Leslie Bernstein (CN=Leslie Bernstein/OU=WHO/O=EOP [WHO])

CREATION DATE/TIME:21-JUL-1998 15:30:07.00

SUBJECT: Race Factbook

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

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

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

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

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

TO: Michelle R. Waldron (CN=Michelle R. Waldron/OU=PIR/O=EOP @ EOP [PIR])
READ:UNKNOWN

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

TEXT:
Can we do this at 3pm tomorrow?
---------------------- Forwarded by Leslie Bernstein/WHO/EOP on 07/21/98
03:23 PM ---------------------------

Maria Echaveste
07/21/98 01:17:17 PM
Record Type: Record

To: Sylvia M. Mathews/OMB/EOP, Gene B. Sperling/OPD/EOP, Janet L. Yellen/CEA/EOP
cc: Jonathan Orszag/OPD/EOP, Peter Rundlet/WHO/EOP, Leslie Bernstein/WHO/EOP, Judith A. Winston/PIR/EOP
Subject: Race Factbook

Folks--looks like we need one last meeting. Let's get that memo from Gene and Janet's shops into Sylvia and me by tonight and Leslie will arrange for us to meet tomorrow for a short meeting. Peter--thanks for the update.
---------------------- Forwarded by Maria Echaveste/WHO/EOP on 07/21/98
12:45 PM ---------------------------

Peter Rundlet
07/21/98 12:26:24 PM
Record Type: Record

To: Maria Echaveste/WHO/EOP
cc: Marjorie Tarmey/WHO/EOP
Subject: Race Factbook

I just wanted to give you a heads-up on a dispute over one graph in the draft version of the Race Factbook. There was a meeting today at 10:30 to discuss this, and we made no progress in solving it. Janet Yellen (and Becky Blank) and Gene are fighting over whether to include a line graph that shows that the median weekly earnings of male workers has declined over the past 5 years or so.

Janet Yellen, Becky Blank, Kathy Wallman, Judy W, Lin Liu, Ann Lewis, Jonathan Orzag and I attended today's meeting. Essentially, Jonathan (on behalf of Gene) held firm that the wage chart should be pulled. Janet, Becky, and Kathy strongly urged that it be included because it is one of a few key indicators and because pulling it would raise credibility problems for the whole document. Judy, Lin, and Ann were all sympathetic to Becky, et al., primarily for the concern over credibility. Gene and Janet fought the same battle over an identical chart for the ERP, and Gene won. Janet's argument is that the ERP is an inherently political document and so it was more understandable to pull it before than it is now.

Because everyone held firm, and because there were no ultimate arbiters (like you or Sylvia), no progress made. Gene wasn't there to argue his case himself. I told them that they needed to draft a memo outlining their positions, and including the views of Judy and Ann, for you and Sylvia. A decision is needed by tomorrow at the latest.

A memo should be crossing your desk by the end of the day.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Charles F. Stone (CN=Charles F. Stone/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:21-JUL-1998 17:26:20.00

SUBJECT: send to Melissa Green by 5:45

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.D94]MAIL42272780L.226 to ASCII,
The following is a HEX DUMP:

The CEA will review the latest economic indicators and forecasts for GDP growth in the second quarter and the rest of the year. In the light of recently released data on trade flows and inventories, most forecasters have revised downward significantly their estimates of second quarter GDP growth. Many analysts now expect the advance estimate of second quarter GDP, to be released on July 31, to show near-zero, and conceivably negative growth. The CEA review will highlight three factors responsible for this changed assessment: the General Motors strike, the impact of the Asian financial crisis on U.S. trade, and the significant decline in inventory investment from its record level in the first quarter. CEA will also examine the prospects for growth in the second half of 1998 and the year as a whole and analyze some of the key risks to the forecast.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:21-JUL-1998 16:05:38.00

SUBJECT: Race Factbook

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

TEXT:
---------------------- Forwarded by Janet L. Yellen/CEA/EOP on 07/21/98
04:05 PM ---------------------------

LESLIE
BERNSTEIN
07/21/98 03:25:12 PM

Record Type: Record

To: See the distribution list at the bottom of this message
cc:
Subject: Race Factbook

Can we do this at 3pm tomorrow?
---------------------- Forwarded by Leslie Bernstein/WHO/EOP on 07/21/98
03:23 PM ---------------------------

Maria Echaveste
07/21/98 01:17:17 PM
Record Type: Record

To: Sylvia M. Mathews/OMB/EOP, Gene B. Sperling/OPD/EOP, Janet L.
Yellen/CEA/EOP
cc: Jonathan Orszag/OPD/EOP, Peter Rundlet/WHO/EOP, Leslie
Bernstein/WHO/EOP, Judith A. Winston/PIR/EOP
Subject: Race Factbook

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---------------------- Forwarded by Maria Echaveste/WHO/EOP on 07/21/98
12:45 PM ---------------------------

Peter Rundlet
07/21/98 12:26:24 PM
Record Type: Record

To: Maria Echaveste/WHO/EOP
cc: Marjorie Tarmey/WHO/EOP
Subject: Race Factbook

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A memo should be crossing your desk by the end of the day.

Message Sent
To:____
Janet L. Graves/OMB/EOP
Melissa G. Green/OPD/EOP
Michelle R. Waldron/PIR/EOP
Michelle Crisci/WHO/EOP
Jonathan Orszag/OPD/EOP
Peter Rundlet/WHO/EOP
Janet L. Yellen/CEA/EOP

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:21-JUL-1998 16:04:34.00

SUBJECT: Briefing Description

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

TEXT:
Here's a start on the paragraph. I expect to be back about 5:30 from my
Social Security meeting.==================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D48]MAIL44896680C.226 to ASCII,
The following is a HEX DUMP:

Recently released data on trade flows and inventories have led most forecasters to revise down significantly their estimates of second quarter GDP growth. Many analysts now expect the advance estimate of second quarter growth, to be released on July 31, to show near zero and conceivably negative GDP growth. We will review recent economic indicators, highlighting the three factors responsible for this changed assessment: the General Motors strike, the impact of the Asian financial crisis on U.S. trade, and the significant decline in inventory investment from its record level in the first quarter. We will also examine the prospects for growth in the second half of 1998 and the year as a whole and analyze some of the key risks to the forecast.