SHORT-TERM ECONOMIC AGENDA
Monday, January 18th, 1993

Coopers & Lybrand
1800 M Street, NW
Suite 400

Agenda:

2:00 - 2:05 Introduction and framework for discussion
Bob Rubin, National Economic Council

2:05- 2:10 Budgetary parameters for short-term agenda
Leon Panetta, Office of Management and Budget

2:10 - 2:15 Short-term economic outlook
Laura Tyson, Council of Economic Advisers

2:15 - 2:20 Tax policy
Treasury

2:20 - 3:20 Presentations

Agriculture
Commerce
Education
Energy
Environmental Protection Agency
Health and Human Services
Housing and Urban Development
Interior
Labor
Technology: (Office of Science and Technology Policy, Office of the Vice-President)
Transportation

3:20 - 3:50 Questions
Rubin, Panetta

3:50 - 4:00 Next Steps
Rubin, Panetta

TALKING POINTS FOR BOB RUBIN: INTRO

* I want to thank everyone for responding so quickly to our request for options for the President-elect's short-term economic agenda. I thought everyone did an excellent job -- especially considering all of the competing demands on your time.

* As you know, no decision has been made on whether to proceed with a short-term economic package for the remainder of fiscal year 1993. However, if the President-elect does decide to move forward, we need to be prepared to present him with a well-designed package.

* What I would like to accomplish in this meeting is to give everyone the opportunity to briefly discuss the initiatives that they believe should be in the President's short-term package.

* Based on the discussions we have had to date, I think the package will be composed of roughly $10 to $20 billion in additional domestic discretionary spending, and another $10 billion in tax incentives. The tax portion of the package, however, will probably be moved later in the year.

* Priority will be given to those initiatives with the following characteristics:

    1. **Increases economic growth and creates jobs immediately**: The whole point of a stimulus package is to get the economy moving immediately. We need to select programs that will have an impact in this fiscal year. The President-elect has stressed the importance of some tangible sign of activity as a result of this package by this summer.

    2. **Implements the President-elect's long-term investment agenda, as outlined in Putting People First**: We should look for initiatives that also tackle our long-term problems -- such as slow productivity growth and underinvestment in our people, our infrastructure, and in plant and equipment and R&D.

3. **High return on investment**: We need to make sure that we are selecting investments with the highest "bang for the buck." For example, if child immunization saves 10 dollars for every dollar we invest, that's an investment worth making.

* As you might imagine, the sum total of your proposals was much higher than the likely size of the stimulus package. Therefore, it's very important that you identify what your top priorities are. I'd like to know which initiatives you would fund if you only had a $1 billion, or if you had one-third of your proposed budget.

* Also, I think we should take to heart President-elect Clinton's instructions to work together as a team. Obviously, all of you will be advocates for your Department. But we are also members of Bill Clinton's team. We should also be thinking about how this package will fit together -- and how we can make it greater than the sum of the parts.

* Before we begin the presentations, I'd like Leon to say a few words on budget process, Laura Tyson to discuss the short-term economic outlook, and (Bentsen or Altman) to discuss tax policy and other Treasury issues.

Draft 1/17/93

CUTTER TALKING POINTS ON NEXT STEPS

* Although the President-elect has not yet decided whether or not to go forward with a short-term economic package in Fiscal Year 1993, we need to move quickly to prepare an intelligent menu of options.

* As we've discussed, the total dollar value of the options you have submitted is substantially higher than the likely level of the short-term economic package.

* Accordingly, I would like to have you or your deputies meet with my staff on Tuesday or Thursday morning to discuss what your priorities are.

* Leon and his staff at OMB will be preparing an analysis of the spend-out rates of the proposals you have submitted.

* This Friday, I would like to hold a meeting of the National Economic Council at the Deputies level to begin discussion of a Decision Memorandum for the President on the short-term economic package.

Draft 11/17/92

BO/GS/SM

THE WHITE HOUSE

WASHINGTON

File: Economic Plan

February 1, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: ROBERT E. RUBIN

SUBJECT: **Memoranda from Laura Tyson and Alan Blinder**

The attached memoranda from Laura Tyson and Alan Blinder provide additional analytic context for the decisions that you will have to make with respect to the economic plan.

Laura and I will meet with you briefly before tomorrow's two-hour meeting, for Laura to discuss these two memoranda and for me to give you some additional comments that I have garnered from various people whose judgment I respect on these matters.

Attachments

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

THE CHAIRMAN

February 1, 1993

MEMORANDUM FOR THE PRESIDENT

ATTENTION: ROBERT RUBIN, NEC

FROM: LAURA TYSON, CHAIR-DESIGNATE LDT
ALAN BLINDER, CHIEF ECONOMIST AB

SUBJECT: Why Deficit Reduction Matters?

This memo outlines the main economic issues that should be considered in devising a deficit-reduction plan. The memo was prepared by Laura Tyson and Alan Blinder and was reviewed and approved by OMB and Treasury. It concludes with individual statements sketching the positions of the three agencies (CEA, OMB, and Treasury) on the appropriate amount of deficit reduction.

1. The Relationship Between the Deficit and Future Living Standards

Deficit reduction is not an end in itself, nor is it a "jobs" program. It is a means to the end of higher productivity, real wages, and national living standards. In short, it is about securing a better economic future for ourselves and even more importantly for our children.

Most economists believe that a sustained and substantial reduction in the deficit will increase the national saving and investment rates--which are now quite low. Over the long run, a permanently higher investment rate will increase the economy's productive capacity and raise the nation's living standards. This is the primary economic justification for reducing the deficit.

However, the process whereby deficit reduction improves living standards is a slow one. According to our simulation results, for example, even under the most optimistic scenario, cutting approximately $132 billion off the 1997 projected deficit would add at most 0.7% to the economy's productive capacity in that year. Over the longer run, the increase in investment made possible by deficit reduction of this magnitude might add as much as 4.0% to the nation's productive capacity by the year 2013. That is twice the size of a typical recession, and would translate into significant extra consumption (private and public) for the average family in the next generation.

2. Deficit Reduction and Public Investment

Well chosen and carefully designed increases in public investment, e.g. investments in education, training, infrastructure, and technology, are another way to increase the economy's investment rate and future living standards. Although there is a debate among economists about whether public investment programs have higher or lower rates of return than private investment, most economists agree that such programs, if well-designed and executed, contribute to the economy's long-run productive potential. Consequently, deficit reduction at the expense of public investment is self-defeating. Some economists go even further and argue that government deficits that finance public investment do not reduce the economy's overall investment rate and are therefore not a policy concern. But, of course, our current deficit exceeds public investment.

The main difficulty with relying on government investment rather than deficit reduction to boost future incomes is that, unlike private investment which is guided by market forces, political factors can easily dominate the choice of public investment projects. On the other hand, the overbuilding of commercial real estate in the 1980s indicates that private investment decisions themselves can sometimes yield undesirable outcomes, especially if skewed by inappropriate tax incentives.

In our view, a prudent course to increase the nation's overall investment rate includes a gradual multi-year deficit reduction program, tax incentives to promote private investment, and a shift in government spending toward public investment programs. This is the course the economic team is working to design.

3. The Interest Burden of Large Deficits

Almost 14% of the Federal budget (about $200 billion) now goes to interest payments. Even if we reduce the deficit to $225 billion by FY 1997, interest costs will rise to $260 billion--the extra $60 billion is as large as the entire investment portion of our budget. Most talk about the enormous "burden" of this interest is fallacious since it ignores the fact that one group of Americans (taxpayers) simply pays the money to another group (bondholders). But foreigners own about 18% of the debt. More important, taxes must be levied to pay all this interest; and such taxes both distort economic incentives and impose political costs.

4. Nonquantifiable Benefits of Deficit Reduction

A. Reducing the Risks of Instability in Financial Markets

A credible deficit-reduction package will reduce the risk of a financial crisis occasioned by anxieties about the growing burden of government borrowing on national and international capital markets. Without credible and substantial deficit reduction, the prospects for long-run stable growth continue to be held hostage to this risk. Indeed, many economists believe that concerns about growing future deficits are a major factor behind the persistence of high long-term interest rates despite a weak economy. And some believe that, if we fail to introduce a serious deficit-reduction package, there is a serious possibility of a financial market crisis either in the form of an upward spike in interest rates, a collapse in the dollar's value or a combination of the two.

If avoiding a financial crisis is the major motivation for deficit reduction, then both its size and its composition should be evaluated in terms of their credibility as it is likely to be judged by financial markets. Reducing the deficit enough to stabilize the debt/GDP ratio would seem to be the minimum required to allay the anxieties of financial markets. The reason is simple: an ever-increasing debt/GDP ratio is intrinsically unsustainable. Our choice is between stopping it now or stopping it later, and much more harshly. In this regard, it is worth remembering that very long-run projections show a rising debt/GDP ratio.

B. Improving Our Ability to Coordinate Macroeconomic Policies with the G7

Our efforts to coordinate macroeconomic policies with our G7 partners have been unsuccessful in recent years, in part because we have brought little credibility to the negotiating table. Our G7 partners have repeatedly expressed anxiety about our Federal budget deficits and their drain on global capital markets and interest rates. By promulgating a credible multi-year deficit-reduction package, we take a step toward harmonizing macroeconomic policies in ways that will boost global growth. For example, if Japan and Germany react to our deficit-reduction program by stimulating their economies, the contractionary effects would be partially offset by more rapid growth in our exports.

C. Enhancing the Ability of the Federal Government to Respond to Unforeseen Security and Economic Challenges

Large deficits restrict the government's ability to respond to unforeseen economic and/or national security crises that require unanticipated increases in government spending. For

example, the deficit precluded the Bush Administration from using expansionary fiscal policy to offset the recession of 1990-91. The deficit is also likely to continue to hamper our ability to fashion effective policies to promote economic stability and democracy in the former Soviet Union.

D. Deficit Reduction and Relations with Congress

If the Administration does not come forward with a deficit-reduction plan that is credible to members of Congress, it is likely that we will lose control of the budgetary process to them. In particular, passage of a balanced budget amendment--which is a terrible idea for the economy as well as for the effectiveness of the government--becomes a real possibility, as does the enactment of a new and stronger budget process bill of the Gramm-Rudman variety.

On a more positive note, solving the deficit problem would help alleviate the myopia of Congressional decision-makers whose unending concern with the deficit leads them to adopt costly short-term budgetary fixes that overlook or shortchange the nation's long-term investment needs.

5. The Short-Run Dangers of Deficit Reduction

The long-term benefits of deficit reduction involve potentially large short-run costs. Cutting the deficit requires some combination of increased taxes and reductions in valued government programs. Cutbacks in programs hurt those who benefit both directly and indirectly from these government activities, while tax increases reduce disposable incomes and distort incentives. In short, both spending cuts and tax increases not only cause political pain but also reduce demand and economic growth. That is why it is best to reduce the deficit when the economy is strong. During periods of recession or anemic economic growth, deficit reduction will further weaken an already weak economy. This is the rationale for stimulating the economy in the near term and introducing a gradual multi-year deficit-reduction package that hits when the economy is closer to capacity.

As we have repeatedly emphasized in our briefings, it is possible that stimulative monetary policy by the Federal Reserve and/or a sustained bond market rally triggered by credible deficit reduction could offset the short-run demand and output losses caused by cuts in government spending or increases in taxation. But it is impossible to predict with any degree of certainty what course Federal Reserve policy will follow or how the bond market will respond to a given amount and timing of deficit reduction. Indeed, there is even uncertainty about whether the Federal Reserve would be able to offset completely the fiscal restraint implicit in deficit reduction even if it

wanted to. There is a long lag between a monetary policy decision and its effects on demand. Therefore, it is difficult to time monetary policy actions so that their effects coincide with periods of economic weakness, let alone with fiscal policy actions.

6. How Much Deficit Reduction is Enough?: Shades of Difference

Although there is widespread agreement that the deficit is currently too large, there is considerable disagreement about how fast we should move to reduce it. Those who argue for a fast pace stress the need to act credibly to convince the bond market, the Federal Reserve, the Congress, Ross Perot, and the American people that we are serious about realizing our goal. Unfortunately, each of these groups may well have a different standard against which they will assess whether we are acting fast enough. The bond traders and Ross Perot, for example, are probably looking for much tougher action than the American public.

Those who argue for a somewhat slower pace of deficit reduction stress the potential dangers of strenuous deficit-reduction measures in an economy which is likely to be characterized by excess capacity and modest growth during the next few years. In an ideal world, the safest strategy might be to devise a deficit-reduction plan that would trigger in only after the economy reached capacity output. But such an approach would be technically difficult to legislate and would probably not be credible, since observers would conclude that the triggering date would never materialize.

CEA Position

As we have suggested before, an economically defensible deficit-reduction package--and one which we believe will be strenuous enough to be credible to most observers--would contain enough deficit reduction to stabilize the debt/GDP ratio by 1997. Such a package would require an additional $118 billion in spending cuts and revenue increases in FY 1997, over and above the $27 billion in defense spending cuts proposed by the Bush Administration. This implies a total deficit reduction package of $145 billion which is the amount of deficit reduction you have mentioned in recent interviews. Such a package would reduce the projected uncapped CBO baseline deficit of $384 billion for FY 1997 by 38%. We believe that as long as this package embodies real spending cuts and revenue increases as opposed to "smoke and mirrors," it would be a credible signal to the financial markets, to the voters, and to the world that you are honoring your commitment to serious deficit reduction.

Such a package could be seen as the first step in a 8-10 year deficit-reduction strategy. We do not believe that more massive deficit-reduction measures between now and 1996 are required on economic grounds. The long-term economic benefits resulting from an additional $25-30 billion in deficit reduction during that time frame are very small, while the short-term economic and political risks are quite large.

As the recent CBO report indicates, the amount of time taken to close the deficit--5 or 10 years--will actually have little impact on the long-term benefits of eliminating the deficit, provided that our deficit-reduction package is credible and is carried through. This is because much of the rise in the deficit expected over the next decade occurs after 1998 and is due to exploding health care costs. Thus any plan to bring down the deficit by large amounts--and hold it there--in the late 1990s and into the next century will require changes in our health care system.

Treasury Position

The CEA's proposal to stabilize the ratio of debt to GDP by 1997 implies a reduction of $117 billion in 1997. The Treasury believes that this is an inadequate amount and will undermine confidence in the your commitment to deficit reduction. You have already stated publicly that the Administration was aiming to reduce the original 1992 deficit of $290 billion by one half, or $145 billion. Because of revisions in the out years, the $145 billion reduction no longer cuts the 1997 deficit by one half as promised in the campaign. Backing away from the $145 billion figure will appear to be reneging for the second time on the commitment to deficit reduction.

Stabilizing the debt to GDP ratio is too arcane a concept for the public. However, even if stabilization were a reasonable goal, a credible effort would require more than $117 billion for at least two reasons. First, a stabilization program must recognize the period after 1997; even with $145 billion of deficit reduction the ratio of debt to GDP continues to rise after 1997. Second, aiming for the minimal target fails to account for the fact that, based on experience over the period 1980 to 1992, CBO has systematically underestimated future deficits over a 5-year period by roughly $60 billion. There is a substantial risk that the "deficit problem" will recur and that further painful action will have to be taken if a modest $117 billion program were legislated this year.

In short, the commitment to stabilizing the debt to GDP ratio will neither be understandable to the public nor seen as tough enough by the financial community.

OMB Position

While OMB concurs with the basic analysis in the CEA memo, we believe that a more vigorous deficit reduction plan is necessary. We believe that a deficit reduction package of at least $145 billion from a baseline of $357 billion in FY 1997 is necessary to send a strong signal that the Administration is serious about deficit reduction and intends to pursue the dual strategy of increasing public investment and reducing public dissaving in order to increase future living standards.

In addition, we share Treasury's concern that the debt/GDP ratio is not an appropriate criterion for selecting a deficit target. Stabilizing the debt/GDP ratio is only a statement that we don't want the deficit problem to get worse. We believe that the debt/GDP ratio must be reduced over time, which requires particularly strong action today given the rising deficits projected for later in this decade. We believe the deficit should be eliminated as quickly as possible consistent with maintaining a growing economy.

OMB also shares Treasury's concern that failure to act boldly enough now risks leaving the deficit a political issue in 1996--which would put the Administration in the unhappy situation of paying a political price for some unpopular actions now, and yet still being vulnerable on the deficit later.

Finally, OMB would emphasize more heavily than the CEA our belief that the Fed and the bond markets will respond very favorably if we are aggressive enough in our deficit reduction plan. We also believe that the Administration should err on the side of a stronger deficit reduction position because the risks of slippage (e.g., though unforeseen expenditures) tend to all be on the upside.

cc: Lloyd Bentsen, Secretary of Treasury
Ronald Brown, Secretary of Commerce
Robert Reich, Secretary of Labor
Leon Panetta, Director of OMB
Roger Altman, Deputy Secretary of Treasury
Alice Rivlin, Deputy Director of OMB
Bo Cutter, Deputy Assistant to the President, NEC
Alicia Munnell, Assistant Secretary-Designate, Treasury
Joe Minarik, Associate Director, OMB

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

February 1, 1993

THE CHAIRMAN

MEMORANDUM FOR THE PRESIDENT

ATTENTION: Robert Rubin, NEC

FROM: LAURA TYSON, CHAIR-DESIGNATE LT
ALAN BLINDER, CHIEF ECONOMIST AB

SUBJECT: "Eight Million Jobs"

1. The Current Situation

There is a widespread impression that this has been a "jobless recovery" so far. At one level, this is true: job growth since the recession trough has been just 1.5 million jobs, or 1.3%--much less than in previous recoveries. But, at another level, the claim is false: job growth has not been particularly abnormal given the laggard growth of GDP. **The real reason why so few new jobs have appeared since the spring of 1991 is that GDP has grown so little.**

The attached chart illustrates this point by comparing the 1991-92 recovery with the average of the six previous recoveries. What is measured is the amount by which GDP growth has exceeded employment growth--as it always does in recoveries. The graph shows that we are now more or less tracking historical patterns. More sophisticated statistical procedures lead to roughly the same conclusion.

The implication of this is that **if the economy grows more or less in line with the CEA forecast, rapid job growth is about to begin.** Specifically, we expect a bit more than 2 million new jobs within the next year, and about 2.7 million in the year after that.

2. The Eight-Million Job Target

Our judgment is that **the campaign promise of 8 million new jobs is redeemable** if all goes well--although, there is little room for slippage. We estimate job growth of 8.9 million between the third quarter of 1992 and the third quarter of 1996 (just before the election) under the CEA "optimistic" forecast. Under our "pessimistic" forecast, this drops to 6.8 million. Putting 75% weight on "optimistic" and 25% weight on "pessimistic" would lead to a forecast of 8.3 million new jobs.

For comparison, the newest CBO forecast is looking for 8.8 million new jobs over the next four years--almost exactly the same as ours. The November Blue Chip forecast used to prepare Mr. Darman's last budget built in just 6.5 million new jobs over four years.

3. Deficit Reduction and Jobs

As we said in the long February 1st memo on deficit reduction, **deficit reduction should not be thought of as a "jobs program."** The goal of deficit reduction is to raise productivity and real wages, not to "create jobs." We mention this not to belittle deficit reduction; after all, real wages are the single most important determinant of standards of living for the ordinary American. But, if we are to embark on a serious program of deficit reduction, we ought to know why.

There has been a great deal of talk in recent days about how many jobs might be "created" by our deficit reduction package. The answer is: approximately zero! Here is why.

As a matter of arithmetic, the number of jobs is the product of:

(a) population

(b) the fraction of the population that wants to work

(c) the fraction of job seekers that are employed.

In a market economy like ours, this last fraction gravitates toward the full-employment number (say, 94.5%, which is an unemployment rate of 5.5%), albeit slowly, no matter what fiscal or monetary policy does. That means that any effects of conventional fiscal and monetary policies on the number of jobs must be transient. The only way policy can have a permanent effect (short of changing population growth!) is to increase the fraction of the population that is employable, and part of our investment program is devoted to this end. But the number of newly-employable people thereby created is bound to be quite small.

The previous paragraph should not be misread as saying that fiscal policy is irrelevant to jobs, for it can have a profound effect on the speed at which the economy returns to full employment. For short-run analysis--which includes periods of up to 4-5 years!--the number of jobs is indeed quite sensitive to fiscal policy. This is the sense in which:

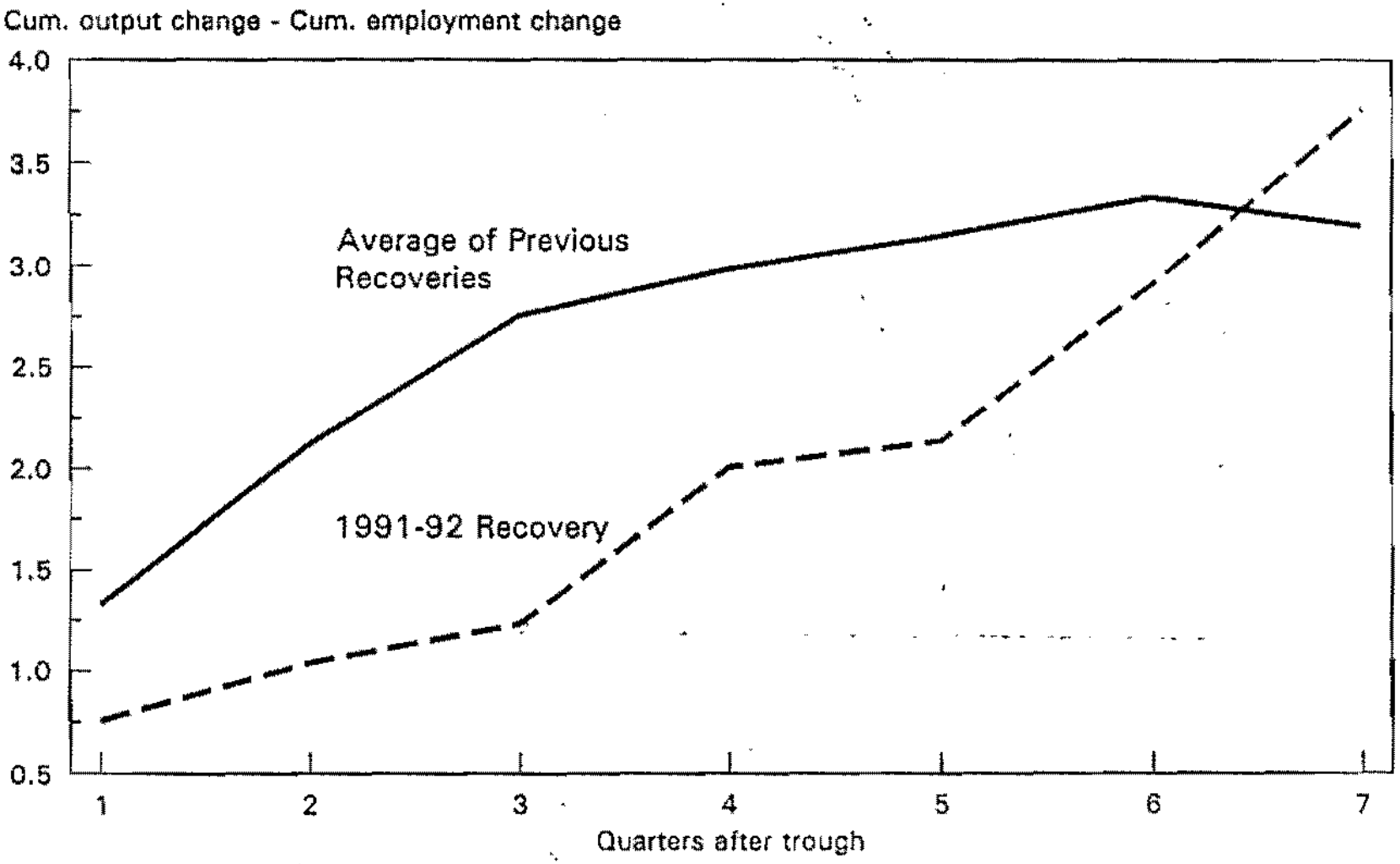
(a) our stimulus package will (transitorily) create about 600,000 additional jobs;

(b) deficit reduction will (transitorily) destroy jobs unless the Federal Reserve and/or the bond market help out.

In sum, fiscal and monetary policy have large effects on the number of jobs in the short run, but negligible effects in the long run.

Employment and Output Growth

in Post WWII Recoveries



Sources: Department of Commerce and Department of Labor.

Note: Excludes recoveries of 1949-51 and 1980-81

File: Economic Plan

MEMORANDUM

February 1, 1993

TO: President Clinton

FROM: Leon E. Panetta

SUBJECT: Your questions on the budget

Following are the answers to your questions about the Federal budget:

1. **What are the causes of the "structural" deficit, and in what proportion?**

   As you know, the structural deficit is the deficit that would remain if the economy were at "full employment."

   Identifying the causes of the structural deficit is a judgment call; one person could say that we spend too much on defense, while another could say that we spend too much on health, and another could say that we do not collect enough taxes.

   The most objective answer comes from a comparison of changes over time, though even that leaves room for judgment. Choosing as a base year for comparison a time of high defense spending (say, 1986) would yield a different view than another time of low defense spending (for example, 1979). Further, though particular budget items might have increased at the same time as the structural deficit also increased, giving an appearance of cause and effect, anyone could argue that those program increases were wise and that other programs should have been cut to compensate.

   Following is a comparison of the budget from 1980 -- chosen as a base for comparison because it is just before the Reagan era began -- and 1992 -- the most recent completed fiscal year:

STRUCTURAL DEFICIT COMPARISONS

			Change,	Percent of GDP		
	1980	1992	Percent	1980	1992	Change
Full-Employment Revenues	538,900	1,163,900	116.0%	20.4%	19.8%	-0.5%
Full-Employment Outlays	586,700	1,365,400	132.7%	22.2%	23.3%	1.1%
STRUCTURAL DEFICIT	47,800	201,500	321.5%	1.8%	3.4%	1.6%
OUTLAYS						
National Defense	133,995	298,361	122.7%	5.1%	5.1%	0.0%
Human Resources						
Medicare	32,090	119,024	270.9%	1.2%	2.0%	0.8%
Medicaid	14,000	67,800	384.3%	0.5%	1.2%	0.6%
Social Security	118,547	287,545	142.6%	4.5%	4.9%	0.4%
Other	148,737	299,225	101.2%	5.6%	5.1%	-0.5%
Physical Resources	65,985	74,788	13.3%	2.5%	1.3%	-1.2%
Other Functions	44,996	74,901	66.5%	1.7%	1.3%	-0.4%
Net Interest	52,538	199,429	279.6%	2.0%	3.4%	1.4%
Undistributed Offsetting Receipts	(19,942)	(39,280)	97.0%	-0.8%	-0.7%	0.1%
TOTAL OUTLAYS	590,947	1,381,791	133.8%	22.3%	23.5%	1.2%
RECEIPTS						
Payroll Tax	138,748	385,491	177.8%	5.2%	6.6%	1.3%
Other	378,364	706,140	86.6%	14.3%	12.0%	-2.3%
TOTAL RECEIPTS	517,112	1,091,631	111.1%	19.6%	18.6%	-1.0%
DEFICIT	73,835	290,160	293.0%	2.8%	4.9%	2.2%

GDP INCREASE

As you can see, between 1980 and 1992, the structural deficit increased from 1.8 percent to 3.4 percent of the GDP, or an increase of 1.6 percentage points. Over that same time, outlays increased by 1.2 percent of GDP, and revenues declined by 1.0 percent of GDP, increasing the actual deficit by 2.2 percentage points. (The extra 0.6 percentage point increase in the actual deficit over the structural deficit means that the economy moved farther from full employment; that change was cyclical, not structural.) One might say, because the actual increases of outlays and revenues were of about the same size as a percentage of GDP, that the outlay and revenue contributions were about equal.

However, a closer look tells a more complex story. The fastest growing spending categories -- Medicare, Medicaid, and net interest -- accounted for more than the total increase in outlays by a wide margin. Those three programs increased by 2.8 percent of GDP, while other outlays decreased by 1.6 percent of GDP (Medicare's 0.8 percent plus Medicaid's 0.6 percent plus net interest's 1.4 percent, minus the total increase of 1.2 percent). Defense spending increased substantially as a percentage of GDP from 1980 until 1986, but then began to decline, ending the period where it began. However, that temporary bulge in defense spending did increase the structural deficit by increasing the net interest cost of servicing the debt.

On the other side of the ledger, revenues other than the payroll tax (with the payroll tax defined to include the full OASDHI tax plus railroad retirement contributions) decreased by 2.3 percent of GDP, while the payroll tax increased by 1.3 percent of GDP.

Looking at both sides of the ledger, Social Security outlays increased as a percentage of GDP, but Social Security revenues also increased, so that this program taken as a whole did not add to the red ink.

[Please note that the structural deficit is defined here to exclude deposit insurance -- both because it is a temporary bulge in the deficit, and because it is a transfer of financial assets rather than an end use of actual resources (labor and capital) in the economy.]

Looking prospectively, the view is basically the same. Following is another table comparing 1992 and 1998. (This table is calculated by CBO rather than OMB, and so concepts are slightly different but do not alter the story in any meaningful way.) The structural deficit is increasing by a little over one percent of GDP (the numbers are affected by rounding), with Medicare, Medicaid and net interest leading the way. Other outlays and revenues are actually decreasing the deficit.

STRUCTURAL DEFICIT COMPARISONS

	1992	1998	Change, Percent	Percent of GDP 1980	1992	Change
STRUCTURAL DEFICIT	201.5	350.5	73.9%	3.4%	4.5%	1.0%
OUTLAYS						
Discretionary (Total)	537.4	584.0	8.7%	9.2%	7.4%	-1.7%
Mandatory						
Medicare	129.4	259.0	100.2%	2.2%	3.3%	1.1%
Medicaid	67.8	146.0	115.3%	1.2%	1.9%	0.7%
Social Security	285.1	385.0	35.0%	4.9%	4.9%	0.0%
Other	228.9	261.0	14.0%	3.9%	3.3%	-0.6%
Deposit Insurance	2.6	-10.0	-484.6%	0.0%	-0.1%	-0.2%
Net Interest	199.4	292.0	46.4%	3.4%	3.7%	0.3%
Undistributed Offsetting Receipts	-68.8	-78.0	13.4%	-1.2%	-1.0%	0.2%
TOTAL OUTLAYS	1381.8	1639.0	33.1%	23.5%	23.4%	-0.2%
RECEIPTS						
Payroll Tax	413.7	559.0	35.1%	7.0%	7.1%	0.1%
Other	677.9	923.0	36.1%	11.6%	11.7%	0.2%
TOTAL RECEIPTS	1091.6	1482.0	35.8%	18.6%	18.8%	0.2%
DEFICIT	290.2	357.0	23.0%	4.9%	4.5%	-0.4%

2. How much have revenues grown in each of the last four years?

3. Same for expenditures, by area? ...by department?

Following are data that show the growth of revenues and outlays.

Perhaps the most meaningful revenue figures are expressed as percentages of the GDP. Total Federal revenues have declined from 19.2 percent of the GDP in 1989 to 18.6 percent in 1992. Individual income taxes fell from 8.6 percent of the GDP to 8.1 percent over the same period; corporate taxes fell from 2.0 percent to 1.7 percent. This decline is the typical outcome of recession, when individual incomes and corporate profits fall. Note that the total of all other taxes actually increased slightly as a percentage of the GDP.

On the outlay side, the figures reflect the overall budgetary trend of increased health care costs and net interest, with most other expenditures close to flat relative to the economy. (Note that the Treasury is given departmental responsibility for net interest payments.)

Receipts and Outlays by Source

	1989	1990	1991	1992	Percent Change 1989-92
Outlays by Superfunction					
		(billions $)			
Defense	303.6	299.3	273.3	298.4	-1.7
Health	48.4	57.7	71.2	89.6	85.1
Medicare	85.0	98.1	104.5	119.0	40.1
Social Security	232.5	248.6	269.0	287.5	23.7
Other Human Resources	202.8	214.9	245.0	277.5	36.8
Physical Resources	81.1	125.5	134.5	74.8	-7.7
Net Interest	168.3	184.2	194.5	199.4	18.5
Other Functions	57.8	60.9	71.1	74.9	29.6
Offsetting Receipts	-37.2	-36.6	-39.4	-39.3	-5.6
Total	1143.2	1252.7	1323.8	1381.8	20.9
		(percent of GDP)			Difference in Percentage points
Defense	5.9	5.5	4.9	5.1	-0.8
Health	0.9	1.1	1.3	1.5	0.6
Medicare	1.6	1.8	1.9	2.0	0.4
Social Security	4.5	4.8	5.2	5.6	1.1
Other Human Resources	3.9	4.2	4.7	5.4	1.4
Physical Resources	1.6	2.3	2.4	1.3	-0.3
Net Interest	3.3	3.4	3.5	3.4	0.1
Other Functions	1.1	1.1	1.3	1.3	0.2
Offsetting Receipts	-0.7	-0.7	-0.7	-0.7	0.0
Total	22.1	22.9	23.5	23.5	1.4

Receipts and Outlays by Source

	1989	1990	1991	1992	Percent Change 1989-92
Receipts					
		(billions $)			
Individual Income Taxes	445.7	466.9	467.8	476.5	6.9
Corporate Income Taxes	103.3	93.5	98.1	100.3	-2.9
Employment Taxes	332.9	353.9	370.5	385.5	15.8
Other	47.9	55.5	49.9	55.6	16.1
Total	990.7	1031.3	1054.3	1091.6	10.2
					Difference in Percentage points
		(percent of GDP)			
Individual Income Taxes	8.6	8.5	8.3	8.1	-0.5
Corporate Income Taxes	2.0	1.7	1.7	1.7	-0.3
Employment Taxes	6.4	6.5	6.6	6.6	0.1
Other	0.9	1.0	0.9	0.9	0.0
Total	19.2	18.9	18.7	18.6	-0.6

Receipts and Outlays by Source

Outlays by Agency	1989	1990	1991	1992	Percent Change 1989-92
		(billions $)			
Legislative Branch	2.1	2.2	2.3	2.7	27.7
The Judiciary	1.5	1.6	2.0	2.3	54.1
Exec. Office of the President	0.1	0.2	0.2	0.2	53.2
Funds Appropriated to the Pres.	4.3	10.1	11.7	11.1	159.6
Agriculture	48.3	46.0	54.1	56.5	16.9
Commerce	2.6	3.7	2.6	2.6	-0.2
Defense-Military	294.9	289.8	261.9	286.6	-2.8
Defense-Civil	23.5	25.0	26.5	28.3	20.5
Education	21.6	23.1	25.3	26.0	20.5
Energy	11.4	12.1	12.5	15.5	36.3
Health and Human Services-except Soc. Sec.	172.3	193.7	218.0	258.0	49.7
Health and Human Services-Soc. Sec.	227.5	245.0	266.4	281.4	23.7
Housing and Urban Development	19.7	20.2	22.8	24.5	24.3
Interior	5.2	5.8	6.1	6.6	25.7
Justice	6.2	6.5	8.2	9.8	57.7
Labor	22.7	25.3	34.0	47.2	108.2
State	3.7	4.0	4.3	5.0	34.5
Transportation	26.6	28.6	30.5	32.5	22.1
Treasury	230.6	255.2	276.3	293.4	27.3
Veterans Affairs	30.0	29.0	31.2	33.9	12.8
Environmental Protection Agency	4.9	5.1	5.8	6.0	21.3
General Services Administration	-0.5	-0.1	0.5	0.5	201.3
NASA	11.0	12.4	13.9	14.0	26.5
Office of Personnel Management	29.1	31.9	34.8	35.6	22.4
Small Business Administration	0.1	0.7	0.6	0.4	363.5
Other Independent Agencies	32.9	74.5	81.2	18.6	-43.6
Undistributed Offsetting Receipts	-89.1	-98.9	-110.0	-117.1	-31.5
Total Outlays	1143.2	1252.7	1323.8	1381.8	20.9

		(percent of GDP)			Difference in Percentage points
Legislative Branch	0.0	0.0	0.0	0.1	0.0
The Judiciary	0.0	0.0	0.0	0.0	0.0
Exec. Office of the President	0.0	0.0	0.0	0.0	0.0
Funds Appropriated to the Pres.	0.1	0.2	0.2	0.2	0.1
Agriculture	0.9	0.9	1.0	1.1	0.2
Commerce	0.0	0.1	0.0	0.0	-0.0
Defense-Military	5.7	5.6	5.1	5.5	-0.2
Defense-Civil	0.5	0.5	0.5	0.5	0.1
Education	0.4	0.4	0.5	0.5	0.1
Energy	0.2	0.2	0.2	0.3	0.1
Health and Human Services-except Soc. Sec.	3.3	3.7	4.2	5.0	1.7
Health and Human Services-Soc. Sec.	4.4	4.7	5.1	5.4	1.0
Housing and Urban Development	0.4	0.4	0.4	0.5	0.1
Interior	0.1	0.1	0.1	0.1	0.0
Justice	0.1	0.1	0.2	0.2	0.1
Labor	0.4	0.5	0.7	0.9	0.5
State	0.1	0.1	0.1	0.1	0.0
Transportation	0.5	0.6	0.6	0.6	0.1
Treasury	4.5	4.9	5.3	5.7	1.2
Veterans Affairs	0.6	0.6	0.6	0.7	0.1
Environmental Protection Agency	0.1	0.1	0.1	0.1	0.0
General Services Administration	-0.0	-0.0	0.0	0.0	0.0
NASA	0.2	0.2	0.3	0.3	0.1
Office of Personnel Management	0.6	0.6	0.7	0.7	0.1
Small Business Administration	0.0	0.0	0.0	0.0	0.0
Other Independent Agencies	0.6	1.4	1.6	0.4	-0.3
Undistributed Offsetting Receipts	-1.7	-1.9	-2.1	-2.3	-0.5
Total Outlays	22.1	22.9	23.5	23.5	1.4

4. Is the deficit measured by budget authority or actual outlays?

Outlays. The deficit is a cash concept, and therefore is measured using cash spending (outlays) rather than the authority to spend in the future (budget authority). Note also that outlays (cash going out) is the conceptual analog to receipts (cash coming in).

5. Need a detailed account of differences between this plan and Putting People First -- e.g., deficit projections bigger by ___ in each of 1994-97; revenues estimated in PPF wrong by ___ in ___ area (e.g., foreign corporations); investment reduced by ___ in ___ area; revenue growth estimates wrong by ___; spending cuts in ___ off by ___; tax cuts different by ___ in ___ area.

Putting People First was written for fiscal years 1993 through 1996; the current budget plan is being written for 1994 through 1997. Therefore, numbers do not match perfectly.

As you know, the deficit baseline has deteriorated significantly since PPF was written. Because it was written for different fiscal years, an exact comparison is impossible; but the total baseline deterioration for 1997 would be well in excess of $100 billion. All budget forecasters committed essentially this same error.

The attached table highlights the differences between PPF and the current plan with respect to policy changes, simply moving the PPF numbers out one year to make them line up with the current plan. In the table, all policy changes that reduce the deficit are shown as minuses.

The table shows that the investments have been trimmed, but by shrinking amounts over time. This reflects the fact that many of the investment programs come on line a bit more slowly than PPF assumed.

Also, because of the baseline deterioration, we have been forced to provide more deficit reduction in every category than was contemplated in PPF. The early years show smaller cuts in nondefense discretionary, however, again because those program changes take some time to take full effect.

FY 1994 BUDGET CURRENT STATUS
(in billions of dollars)

	1993	1994	1995	1996	1997	94–97
Putting People First (delayed one year)						
Spending Increases:						
Stimulus and investment		42	54	59	64	220
Spending Decreases:						
Discretionary		−22	−26	−30	−38	−117
Entitlements		−5	−7	−8	−8	−28
Revenue Increases		−31	−37	−39	−43	−150
Total Proposals		−16	−16	−18	−25	−75
Current status						
Spending Increases:						
Stimulus and investment	15	24	34	43	51	152
Spending Decreases:						
Discretionary	---	−10	−20	−33	−43	−49
Entitlements	---	−13	−25	−38	−51	−60
Revenue Increases	---	−37	−62	−70	−76	−80
Total Proposals	15	−37	−74	−98	−119	−37
Debt Service	0	0	−2	−7	−14	−23
Net Deficit Reduction	16	−36	−76	−105	−133	−60
Difference						
Spending Increases:						
Stimulus and investment	15	−18	−21	−16	−13	−68
Spending Decreases:						
Discretionary	---	12	6	−2	−5	68
Entitlements	---	−8	−18	−31	−43	−32
Revenue Increases	---	−6	−25	−31	−34	70
Total Proposals	---	−21	−58	−80	−94	38
Debt Service	0	0	−2	−7	−14	−23

6. **For proposed revenue raisers and spending cuts, need to know who gets hurt (by income level expressly) and whether they have been cut in budget actions of last five years.**

Treasury (for revenues) and OMB (for spending) are preparing detailed analyses of the distributional effects of the current plan. Please note that for some tax changes and many outlay changes, the precise distributional effects are very difficult to determine. For example, a significant share of alcohol consumption is a business expense, and it could be passed on to consumers or absorbed as lower business profits; and government worker-training expenditures benefit both the workers and the businesses that hire them.

Pending that detailed analysis, there follow five tables. The first pairs the comparable spending changes from the 1990 budget reductions (the Omnibus Budget Reconciliation Act of 1990, or OBRA 1990) with the current plan. It shows that the proposed cuts are for the most part targeted at the more well-to-do program recipients -- probably to a greater extent than OBRA 1990.

The second and third tables show the distributional effects of taxing 85 percent of Social Security at current thresholds, and allowing COLAs at CPI minus one percent. The income taxation of Social Security benefits is distinctly progressive. For Federal employees and retirees, the COLA restriction also is significantly progressive. Among Social Security beneficiaries, it is slightly regressive. Our COLA restriction on the last dollars of Social Security benefit, based on poverty thresholds, may be less regressive; we are preparing detailed analysis of it.

The fourth table compares the revenue provisions of OBRA 1990 with those now under consideration. It indicates that the vast majority of new provisions bear most heavily on upper-income individuals and on corporations; only a small portion of the total revenue take is comprised of the energy taxes and "sin" taxes.

The fifth table refers only to the tax provisions of OBRA 1990, and shows that they were progressive -- decreasing the percentage of income paid in tax by the lowest income categories, and increasing it for the others, and especially for the most well-off. Given the favorable comparison between the particular tax cuts in the current plan and those in OBRA 1990, it is reasonable to expect that such a distributional table for the new plan would be at least as attractive.

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EFFECT BY INCOME CLASS OF OBRA 1990 CHANGES AND PROPOSED SAVINGS
(outlays in billions)

OBRA:	Change 1991-95	Comments
Savings:		
150: CCC commodity provisions	-11.0	The main provision reduced base payment acres by 15 percent for all farmers. This would probably hurt small farms more than large farms. Small farms are generally in the lower half of the income distribution.
500: GSL reforms	-1.7	No effect. Provisions primarily eliminated high-default schools from the program and did not affect beneficiaries.
570: Medicare	-42.2	Increased Part B deductible from $75 to $100; fixed premiums for 1991-95. Net effect by income class is not clear, but deductible increase would be regressive.
500: CSRS Lump sum	-7.5	No change by income class. Provision required benefits to be in annuity form, not lump sum, through 1995.
Expansions:		
150: Medicaid	2.2	These four expansions increased benefits to the poor or near poor.
500: Earned income tax credit	15.2	These four expansions increased benefits to the poor or near poor.
500: AFDC	1.4	These four expansions increased benefits to the poor or near poor.
500: SSI	1.0	These four expansions increased benefits to the poor or near poor.
PROPOSED SAVINGS:	**Savings 1994-98**	
150: CCC: Total income over $100,000	-1.4	Would affect upper income groups.
150: Limit payments to $50,000	-1.0	Would affect primarily the upper income groups or large farms.
150: Other CCC reforms	-5.3	Many of these proposals eliminate payments to farmers who choose not to grow crops. The effect by income class is not clear, but the reductions would probably affect higher income groups more than lower income groups.
500: Direct student loans	-3.6	No effect. Savings result from revised administrative provisions and do not affect beneficiaries.
570: Medicare:		
(1) Maintain 1996 SMI premium with floor	-6.5	This provision would increase premiums by the same amount for all beneficiaries. Thus, as a percent of income, the low income groups would be affected more than upper income groups.
(2) 30% coinsurance when Medigap pays some beneficiaries	-10.9	This provision would increase the cost of additional private insurance. Some would no longer purchase such insurance and therefore would use fewer services or finance medicare gaps and coinsurance from out-of-pocket expenses. This would not affect the poor, whose medical expenses would still be paid by medicaid. Probably a proportional effect by income class.
500/650: Social security and retirement Option 2	-92.4	See attached table. Social security reductions are generally proportional to the distribution of social security benefits. Since more than half of social security benefits go to the bottom 40 percent of the income distribution, the cuts are slightly regressive.

INCREASED TAXES PAID WITH 85 PERCENT RULE ON TAXABILITY
OF SOCIAL SECURITY AND RAILROAD RETIREMENT [SS-RRR]
Estimates for 1994, Based on 1991 Data from the March, 1992
Current Population Survey
(Only households with SS-RRR recipients tabulated.)

HOUSEHOLD QUINTILE: PRE-TAX INCOME	NUMBER OF FILING UNITS WITH SS-RRR (millions)	BASELINE TAXES PAID (*) (bils.$)	INCREASE IN TAXES (bils.$)	PERCENT INCREASE IN TAXES (%)	SHARE OF INCREASE (%)
TOP	2.35	$21.4	$2.384	+11.1 %	54.5 %
4	2.91	7.5	1.445	+19.3 %	33.1 %
3	4.84	4.8	.541	+11.4 %	12.4 %
2	7.56	1.6	.002	0	0
BOTTOM	8.73	.1	0	0	0
IN GROUP QUARTERS	{.09}	{negl.}	{0}	{0}	{0}
TOTAL	26.48	$35.4	$4.372	+12.3 %	100.0 %

(*) Note, estimates do not yet correct for underreporting for any income type, including SS-RRR. Estimates do not include imputed tax exempt interest in SS-RRR taxability calculation at this time. Update to new economic assumptions of 01-29-93 will shortly include a range of estimates, to deal with the above issues.

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COLA AT CPI MINUS 1

Pre-tax cash income quintile	Total income	Total social security	Total income losses	Social security losses	Federal retirees' losses	Federal employees' losses
Bottom	3.8%	24.3%	14.0%	22.8%	2.9%	0.5%
Second	9.6%	30.8%	21.5%	31.2%	14.6%	3.7%
Middle	15.9%	21.5%	19.2%	21.9%	20.7%	12.0%
Fourth	24.2%	12.9%	19.1%	13.2%	25.5%	28.9%
Fifth	46.5%	10.5%	26.2%	10.8%	36.3%	54.8%

From 1/30/93 memo from Rich Bavier to Barry Anderson (revised).

NOTE:

- The table illustrates the first year of the "minus-one" provision, but the later years and the six-month delay effects would not look very different.

- The social security COLA-1 percent proposal takes proportionally more from the upper quintiles because their benefits tend to average a little larger.

- The poverty effects of the Federal retirement and Federal pay changes are small. Federal retirees, and especially Federal employees, tend to have incomes that put them relatively high in the distribution.

TAXPAYERS HURT BY REVENUE INCREASES CONTAINED IN THE OMNIBUS BUDGET RECONCILIATION ACT OF 1990

	Receipt Effect (billions of $) 1991-1996
Increase in maximum marginal individual income tax rate: The maximum marginal individual income tax rate was increased from 28% to 31% for families/singles with taxable income greater than $194,000/ $114,000 in 1991. The AMT rate was increased from 21% to 24%. The AMT is applicable to income in excess of the exemption amounts of $40,000 for families and $30,000 for singles.....	29.5
Limit itemized deductions: Otherwise allowable deductions were reduced for taxpayers with adjusted gross income in excess of $100,000 in 1991.....	11.0
Phase-out personal exemptions: The deduction for personal exemptions was phased-out for families/singles with adjusted gross income in excess of $150,000/$100,000 in 1991.....	10.0
Increase amount of wages and self-employment income subject to the medicare hospital insurance payroll tax: The maximum amount of wages and self-employment income subject to the medicare tax in 1991 was increased from $53,400 to $125,000.....	34.1
Increase excise taxes on distilled spirits, beer and wine: Excise taxes on distilled spirits were increased by $1.00 to $13.50 per proof gallon. Excise taxes on beer generally were doubled from $9.00 to $18.00 per barrel. Wine, which generally had been taxed at rates ranging from $0.17 to $2.40 per wine gallon, is now taxed at rates ranging from $1.07 to $3.30 per wine gallon. While affecting all income classes, these taxes tend to be regressive.....	11.0
Increase tobacco excise taxes: Excise taxes on all tobacco products were increased by 50% over two years. While affecting all income classes, these taxes tend to be regressive.....	6.1

Increase highway and motor boat fuels excise tax: Excise taxes imposed on gasoline and special motor fuels used in highway transportation and motor boats were increased from $.09 to $.14 per gallon. The excise tax on diesel fuel used in highway transportation was increased from $.15 to $.20 per gallon. While affecting all income classes, these taxes tend to be regressive..... 26.8

Extend telephone excise tax: The 3% tax imposed on local and toll telephone service, which was scheduled to expire after December 30, 1990, was permanently extended. While affecting all income classes, this tax tends to be regressive..... 16.1

Impose excise tax on certain luxury goods: An excise tax equal to 10% of the retail price in excess of specified thresholds was levied on the following: automobiles above $30,000, boats and yachts above $100,000, aircraft above $250,000, and furs and jewelry above $10,000. Because of the thresholds and the items taxes, these taxes tend to fall on high income individuals..... 2.0

TAXPAYERS HURT BY REVENUE PROPOSALS
CURRENTLY UNDER CONSIDERATION

	Receipt Effect (billions of $) 1994-1998
Increase in maximum marginal individual income tax rate: The maximum marginal individual income tax rate would be increased from 31% to 36% for families/singles with taxable income greater than $140,000/$115,000 in 1994. The AMT rate would be increased from 24% to 28%.....	65.1
10% individual income tax surcharge: A surcharge of 10% would be levied on adjusted gross income in excess of $1 million.....	8.5
Extend phase-outs of itemized deductions and personal exemptions: The current law phase-outs of the benefits of itemized deductions and personal exemptions would be extended beyond their current law expiration dates of December 31, 1995 and December 31, 1996, respectively. Taxpayers with adjusted gross incomes in excess of $108,000 would be affected by the itemized deduction provision. Families/singles with adjusted gross income in excess of $163,000/ $108,000 would be affected by the personal exemption provision.....	17.8
Repeal HI wage base: The cap on wages and self-employment income subject to the medicare tax would be repealed in 1994. This would affect individuals with income in excess of $140,700.....	27.8
Include 85%, rather than 50% of social security benefits in modified adjusted gross income for Federal income tax purposes: 85% of social security and railroad retirement Tier I benefits would be included in taxable income and subject to income tax at the current thresholds of $32,000 for couples and $25,000 for single taxpayers.....	29.1
Increase in alcohol and tobacco excise taxes: The specifics have not been worked out. While affecting all income classes, these taxes tend to be regressive.....	23.1

Broad-based energy tax: The specifics have not been worked out. While affecting all income classes, these taxes tend to be regressive..... 82.3

Extend $.025 per gallon highway and motor boat fuels excise tax: Under current law, $.025 per gallon of the excise taxes on highway and motor boat fuels is scheduled to expire on September 30, 1995. Under this proposal the additional tax would be extended. While affecting all income classes, this tax tends to be regressive..... 7.7

SUMMARY OF DISTRIBUTIONAL EFFECTS, BY INCOME CATEGORY /1
Revenue Provisions of the Omnibus Budget Reconciliation Act of 1990
(1990 Income Levels)

Income Category 2/	Changes in Federal Taxes 1/ 3/		Federal Taxes Under Present Law /4		Federal Taxes Under Proposal /1 /4		Effective Tax Rates	
							Present Law	Proposal
	Billions	Percent	Billions	Percent	Billions	Percent	Percent	Percent
Less than $10,000..	-$0.3	-2.0%	$14.2	1.6%	$14.0	1.6%	13.3%	13.1%
10,000 to 20,000....	-2.1	-3.2%	65.8	7.6%	63.7	7.2%	15.6%	15.1%
20,000 to 30,000....	1.8	1.8%	102.5	11.9%	104.3	11.8%	18.4%	18.8%
30,000 to 40,000....	2.3	2.0%	115.8	13.4%	118.1	13.4%	20.0%	20.4%
40,000 to 50,000....	1.8	2.0%	87.9	10.2%	89.7	10.2%	21.4%	21.9%
50,000 to 75,000....	2.6	1.5%	172.8	20.0%	175.3	19.9%	24.7%	25.1%
75,000 to 100,000..	1.4	2.1%	66.5	7.7%	68.0	7.7%	25.8%	26.4%
100,000 to 200,000..	2.4	2.3%	104.4	12.1%	106.7	12.1%	26.2%	26.8%
200,000 and over.....	8.4	6.3%	133.3	15.4%	141.7	16.1%	25.2%	26.8%
Total, all taxpayers..	$18.3	2.1%	$863.2	100.0%	$881.5	100.0%	21.8%	22.3%

Source: Joint Committee on Taxation

1/ Distributional analysis includes effects from the Budget Reconciliation (H.R. 5835). Revenue Provisions with respect to beer, wine, and distilled spirits taxes, tobacco tax, motor fuels tax, telephone tax, increase in HI wage cap, increased individual and AMT rates, phaseout of personal exemption, limitation on itemized deductions, individual AMT component of oil and gas production incentives, increase and modification of the EITC, child health insurance tax credit and increase in the standard deduction for tax payers with children under 1 year old. Analysis does not take into account any effects from changes in taxpayer behavior.

2/ The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: (1) tax-exempt interest, (2) employer contributions for health plans and life insurance, (3) inside buildup on life insurance, (4) workers' compensation, (5) nontaxable social security benefits, (6) deductable contributions to individual retirement accounts, (7) the minimum tax preferences, and (8) net losses in excess of minimum tax preferences from passive business activities.

3/ Estimates of total tax liability presented in distributions will not match estimated changes in receipts because of differing time periods (CY 1990 vs. FY 1991-95), because of varying patterns of fiscal year receipts.

4/ Distributions represent combined effects of individual income taxes, payroll taxes, Federal excise taxes, and estate and gift taxes. For the purpose of distributions, the full burden of payroll taxes is assigned to employees. Excise taxes are assumed to be borne fully by individuals either directly through purchase of the taxed commodity or indirectly through higher prices on all commodities as businesses pass along these added costs. Because of the uncertainty concerning the incidence of the corporate income tax, it is excluded from this table. Information in table excludes individuals who are depenents of other taxpayers.

7. Measured by actual outlays the investment program seems anemic and much less than anyone recommended at the Economic Conference -- $30 billion after all is only 1/2 percent of GDP. How can we credibly claim to be stimulating anything but PR? How many jobs will be created by what expenditures? What gets the quickest return? best dollar/job creation ratio?

There is a wide range of opinion on an appropriate economic stimulus at this time; the $50 billion figure that you heard at the Economic Conference is the top of the range, while other economists would argue that there should be no stimulus at all. We have come down on the side of a small-to-moderate sized stimulus for the following reasons:

First, a stimulus that frightened the bond markets because it was too large, and engendered a tightening from the Federal Reserve, would be counterproductive. The apparent consensus of the markets is that a $20 billion to $30 billion stimulus is in the right ball park. Exceeding that range would be risky, especially because the markets will not believe the ultimate deficit reduction package until they see it enacted into law.

On the other hand, even a $20 billion to $30 billion stimulus is worth doing. Even though it is not large, it does increase economic activity, and thus provides a margin of insurance against a triple-dip to the recession. Furthermore, the individual program increases -- WIC, Head Start, immunizations, full funding for ISTEA, youth summer jobs, CDBG assistance to States and localities, and so on -- will provide real benefit to persons and sectors of the economy that are hurting.

There are constraints on the size of a stimulus package. Even the most meritorious programs can expand only so far in a short time. This is particularly true of the physical investment programs -- ISTEA and other public works. Pushing farther risks that monies will be used for low-priority activities, or will be shifted to pay for projects that were already being undertaken -- with no net stimulus to the economy. We believe that our spending program choices are just about to the limit of what they can productively do.

The formal briefing materials prepared by OMB will provide the latest outlay and obligation figures, as well as job creation estimates, for each of the stimulus programs.

8. **Beyond 1997:**

What happens to the deficit in the next four years if health care is under inflation and population growth?

What about moving up Social Security retirement age increases to start in 1997?

How much does indexing contribute to the structural deficit, e.g., if you give back inflation revenues to taxpayers you don't eliminate inflation from government costs -- salaries, light bills, weapons, etc.

Ditto for declines in corporate tax revenues.

As the following table shows, holding Federal health costs to the rate of growth of inflation and population would produce enormous savings. The only caveat is that we still need to find the policies to achieve that goal without excessive costs in the quality and availability of health care.

Moving up the Social Security retirement age increase would provide savings -- for a time. Once that increase would have been fully in effect anyway, the savings go to zero. The attached table shows the long-term effect if the retirement age is increased to 67-1/2 instead of 67 years of age; those long-term savings are substantial.

Putting the Medicare eligibility age up along with Social Security would provide even larger savings. However, this policy would impose a significant strain on employers and individuals unless a new National system is enacted to provide coverage. At present, many early retirees either lose their employer-based coverage or add considerably to their employers' health insurance costs.

Individual income tax indexation does slow the growth of Federal revenues. However, indexation does not hold revenues constant in nominal terms, but only in inflation-adjusted terms. In other words, if a worker's income increases with inflation, his indexed income tax liability also increases with inflation; without tax indexation, his income tax liability would increase faster than inflation. So even indexed income tax liabilities should keep up with the cost of goods in the economy; what has gone wrong in recent years is that income growth has been so slow.

Corporate income tax revenues are not explicitly indexed; their behavior during inflation is erratic. On the one hand, depreciation allowances do not keep up with inflation, and so taxes can increase faster; on the other hand, interest cost deductions can increase faster during inflation, which can slow tax growth.

LONG-RANGE OUTLAY ISSUES

(billions of dollars)

02/01/93

	2000	2005	2010	2015	2020	2025	2030
Hold medicare and medicaid to inflation and population beginning in 1997:							
Deficit	-390	-470	-632	-982	-1579	-2421	-3587
Percent of GDP	4.6%	4.5%	5.0%	6.6%	9.0%	11.8%	14.9%
Reduction from baseline	109	329	682	1217	2010	3236	5088
Percent of GDP	-1.3%	-3.2%	-5.4%	-8.1%	-11.4%	-15.7%	-21.1%
Freeze all COLA's beginning in 1997:							
Deficit	-443	-640	-1004	-1656	-2700	-4230	-6500
Percent of GDP	5.2%	6.1%	8.0%	11.1%	15.4%	20.5%	26.9%
Reduction from baseline	56	159	310	543	889	1427	2175
Percent of GDP	-0.7%	-1.5%	-2.5%	-3.6%	-5.1%	-6.9%	-9.0%
Raise Social Security retirement age to 67 1/2 on accelerated schedule beginning 1997:							
Deficit	-499	-797	-1307	-2176	-3546	-5580	-8544
Percent of GDP	5.8%	7.7%	10.4%	14.5%	20.2%	27.1%	35.4%
Reduction from baseline	0	2	7	23	43	77	131
Percent of GDP	0.0%	-0.0%	-0.1%	-0.2%	-0.2%	-0.4%	-0.5%
Tie Medicare eligibility to Social Security retirement age: beginning 1997:							
Deficit	-498	-789	-1294	-2158	-3491	-5479	-8405
Percent of GDP	5.8%	7.6%	10.3%	14.4%	19.9%	26.6%	34.8%
Reduction from baseline	1	10	20	41	98	178	270
Percent of GDP	-0.0%	-0.1%	-0.2%	-0.3%	-0.6%	-0.9%	-1.1%
Addenda:							
Baseline deficit	-499	-799	-1314	-2199	-3589	-5657	-8675
Percent of GDP	5.8%	7.7%	10.4%	14.7%	20.4%	27.5%	35.9%
GDP	8553	10415	12609	14973	17582	20590	24141

Pkt: Economic Plan

MEMORANDUM

February 1, 1993

To: Distribution List

Fr: Ricki Seidman

Re: Coordinated Effort to Promote Economic Plan

As we discussed at the political meeting this evening, we need to launch an all-out effort to develop support for the President's economic plan that will be announced on February 17, 1993. Your department should prepare a memo with two components:

- suggestions for message/approach that are important to the constituencies/concerns with which you are dealing; and
- a list of proposed activities that your department could undertake (or activities that should be undertaken by other departments) to lay the predicate for and promote the plan, executing the message that you have described.

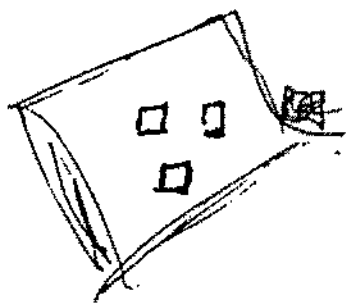
The list should be inclusive, rather than exclusive. Be creative.

Your list should include suggestions for events/actions that involve the President and events/actions that would involve surrogates, including the Vice President, the First and Second Ladies, members of the Cabinet, White House senior staff, and others.

Think of "set the stage" activity that should take place before February 17th, follow-up activity to occur between the 17th and March 1st, and longer term activity for the following weeks.

Please get your memo to me by **Wednesday at 4:00 p.m.** This material will provide the basis for the overall plan.

<u>List</u>
Rahm Emmanuel/Joan Baggett
Christine Varney
Alexis Herman/Mike Lux
Regina Montoya/John Hart
Howard Paster/Susan Brophy/Steve Ricchetti/Lorraine Miller
Carol Rasco/Bruce Reed/Bill Galston
Bob Rubin/Gene Sperling/Bo Cutter
Marla Romash
Maggie Williams/Lisa Caputo
David Dreyer/Bob Boorstin/Michael Waldman/Ann Walker
(FYI)Stephanopoulos/Gearan/Podesta



THE WHITE HOUSE

WASHINGTON

February 13, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: ROBERT E. RUBIN

SUBJECT: **Treasury Memos on the "Credit Crunch"**

You frequently express concern about the "credit crunch". The following two memos outline Secretary Bentsen's views as to what actions should be taken in the reasonably near future. A decision memo will be forthcoming by Monday, so that you can include discussion of this issue in your speech.

You can disregard these memos and wait for the decision memo, or read them as background.

ER/Bo/GS/SM

THE SECRETARY OF THE TREASURY
WASHINGTON

February 10, 1993

MEMORANDUM FOR: Robert E. Rubin

FROM: Lloyd Bentsen LB/RA

RE: Credit Crunch

Treasury is working on proposals to alleviate the credit crunch and this is an update on where we stand. We believe that there are some immediate steps that the Administration can take that deserve inclusion in the President's February 17th speech.

We have operated using a couple of goals.

First, we need a coordinated response from all bank regulators. The Office of the Comptroller and the Office of Thrift Supervision are on board and the Fed and the FDIC have agreed in principle with our proposals. It is also important that the SEC agree on some of the measures.

Second, we can take immediate administrative action -- legislation will have to come later. There are a number of regulatory actions described below that can be implemented as soon as regulations are drafted.

Third, we need to send the right signals. We need to let Congress and other concerned parties know that we will not do anything that jeopardizes safety and soundness. At the same time, we need to send a strong message to bankers that we hear their concerns and are acting to alleviate them.

With these goals in mind, we are prepared to take approximately nine regulatory actions that we could take in conjunction with the Fed and FDIC. Most of these are highly technical, but should bring an immediate and positive response from the banking community. They include:

1. Changing loan review procedures to address the "character loan" problem.

2. Establishing examination procedures for loans secured by real estate that will focus on the borrower's ability to pay over time.

3. Establishing appropriate guidelines for returning partially charged-off loans to performing status.

4. Increasing coordination by regulatory agencies to minimize uncertainty and disruption.

5. Establishing workable appeals processes that would allow expedient resolution and direct input from Washington.

There will be two primary effects of these changes. They will make it administratively easier for lenders to lend. And, the psychological impact on lenders of such a regulatory shift will be considerable. We will develop estimates for the credit availability impact of these proposals.

We also plan to include some safety and soundness regulatory changes such as increasing attention on "derivative" financial instruments and interest-rate risks.

Treasury will also review possible legislative actions which could provide relief including bankruptcy reform and reduced reporting requirements. We will report to the White House within 90 days of the possibility of legislative initiatives. The President can make a statement to that effect in his speech.

We would, of course, like to review any specific language in this area which might be used in the President's materials.

5/17

THE SECRETARY OF THE TREASURY
WASHINGTON

February 11, 1993

12 PM2:05

Memorandum for: BOB RUBIN

From: Lloyd Bentsen

Re: Credit Crunch

Enclosed you will find information that has been prepared by Frank Newman and Gene Ludwig concerning proposed administrative actions on addressing the credit crunch. Roger Altman has worked with them in compiling this and I think it is an excellent start down the road to alleviating the problem.

Attachment

cc: Roger Altman
Frank Newman
Gene Ludwig

CREDIT CRUNCH ALLEVIATION PROGRAM

A. **Regulatory actions (by OCC & OTS, in coordination with Fed and FDIC)**

1. Reduce uncertainty by getting required and backlogged regulations out soon.

2. Establish workable appeals process for financial institutions to review significant differences in judgement directly with appropriate regulatory officials.

3. Establish examination and rating procedures that separate "other mentioned" loans from higher-risk classifications. (This is esp. important for loans to small and medium-sized businesses, and directly addresses "character loans.").

4. Establish appropriate guidelines for returning partially charged-off loans to performing status, for loans that have reached fully collectible status.

5. Establish examination procedures for loans secured by real estate, that focus on the borrower's ability to pay over time, rather than presuming immediate liquidation.

6. Increase coordination of examinations by regulatory agencies to minimize uncertainty and disruption to bank of thrift operations, whenever backup or duplicate examinations are required by law.

7. Change bank and thrift regulatory reporting guidelines to avoid unnecessarily classifying a loan as "in substance foreclosure," when the borrowers is reasonably expected to pay the loan.

8. Revise treatment of loans used to finance the purchase of real estate from banks to ensure reasonable standards.

9. Revise appraisal procedures to limit requirements for appraisals to times when they genuinely assist in making informed credit decisions.

B. At the same time, increased regulatory attention will be focused on the following areas:

1. Swaps and other "derivative" financial instruments.

2. Interest-rate risk.

C. Changes requiring legislation will be developed for proposal to Congress, dealing initially with:

1. Bankruptcy reform

2. Paperwork burden.

February 10, 1993

FEB. 17 SPEECH

Credit Crunch Issues

I. **Outline of Credit Crunch Issues**

* Credit critical to economic growth and development has not been readily available, particularly to small and medium sized businesses.

* This "credit crunch" has been caused in part by an excessive regulatory burden imposed on banks and thrifts by their regulators.

* Through sensible regulation that focuses on real risk as opposed to excessive burdens we can both ensure the safety and soundness of our financial services sector and put an end to this credit crunch.

* Over the last several weeks the Treasury Department and the Office of the Comptroller of the Currency have examined this issue closely and have come up with a program that is a significant first step in achieving this balance.

* This program includes primarily administrative and regulatory changes that will be implemented within the next several weeks by both the Office of the Comptroller of the Currency and the Office of Thrift Supervision. This program includes changes in the area of in substance foreclosure, treatment of OAEM loans, examination procedures for loans secured by real estate, limitations on required appraisals, and an appeals process for banks which believe they have been unfairly treated in the examination process.

* We have consulted with the Federal Reserve Board and the FDIC and have reason to believe that they will adopt a similar program.

II. Text Related to Credit Crunch Issues.

The availability of credit in our country is critical to our economic growth and development. In recent years credit has not been sufficiently available, particularly to small and medium sized companies, due in part to an overreaction to difficulties experienced by some banks with some borrowers.

This Administration does not intend to let the credit crunch continue. I believe that we can make credit available again to

creditworthy borrowers, without going back to a period of lax standards that characterized the 1980s. Moreover, I believe that through a more realistic analysis of lender risk and the application of this analysis to examination standards, we cannot only put an end to the credit crunch, but we can at the same time actually increase the safety and soundness of our financial services system. And, I believe that these goals can and must be accomplished in a manner that enhances our commitment to equal credit opportunity and community reinvestment.

To this end, we have developed a new program that is designed to do four things: (1) make credit available again to creditworthy borrowers; (2) maintain sound underwriting standards for loans and improve the safety and soundness of banks and thrifts through realistic risk analysis; (3) reduce unnecessary regulatory burdens that cost taxpayers money and weaken financial services institutions; and (4) advance our commitment to equal credit opportunity and community reinvestment.

Specifics of this program, much of which can be accomplished within the next few months administratively, will be developed in coordination with the Federal Reserve and the FDIC, who have already been consulted regarding the principles of the program. The program as it has been developed thus far includes changes in the area of "in substance foreclosure", treatment of OAEM loans, examination procedures for loans secured by real estate, limitations on required appraisals and an appeals process for banks which believe they have been unfairly treated in the examination process.

THE WHITE HOUSE

WASHINGTON

February 13, 1993

MEMORANDUM FOR SECRETARY BENTSEN

FROM: ROBERT E. RUBIN

SUBJECT: **Congressman Rostenkowski Letter on the Incremental Investment Tax Credit**

I am forwarding the attached memo from Chairman Rostenkowski, for your information.

Attachment

MEMORANDUM

TO: **PRESIDENT BILL CLINTON**

FROM: Dan Rostenkowski

DATE: February 9, 1993

RE: Incremental Investment Tax Credit

Mr. President, I am reading in the newspapers much about the possibility that you may include an incremental investment tax credit in your economic stimulus package. Even though I have not been briefed about the specifics of your stimulus program, I want to share my concerns about this particular element before it is finalized by you in preparation for your State of the Union Address.

While I intend to stand behind your economic program and assist you to the best of my ability in its passage, I feel a strong responsibility to seek effective and fair modifications to the Nation's tax law. In this respect, some issues relating to a possible incremental investment tax credit are troubling to me, and I would ask you to review these issues as you make your decisions on an economic plan. Of course, I would be happy to discuss any of these issues further with you if you so desire.

First, because enacting an incremental credit requires picking some arbitrary historical ("base") period to determine if investment is "new", I fear that a lot of worthy companies will not be helped at all. Thus, the credit will be unfair. For example, say that Company A made a long-term strategic decision to plow its earnings into new equipment and has been investing steadily for several years. Company A would have a high level of investment for the base period and, therefore, may never get the benefit of the credit, even though it continues to invest a large amount each year. This will be true for all mature companies, for recent "growth" companies, and for companies whose lines of business require steady, rather than sporadic, investment.

* I have been hearing that entire industries, such as the utility industry, might not be helped by an incremental credit simply because they have been investing steadily each year, even during tough times.

* I also have been hearing that some firms might not be helped even though they will be investing as much as, or more than, other firms in the same industry. For example, Company A's main competitor may be a company that will get a tax break on almost all its future investment simply because it used its earnings in the past years to pay dividends instead of to invest in its future. I have been told that some companies, like Company A, might be driven out of business because of this competitive disadvantage.

* Because so many companies would not be helped by an incremental credit, and may even be hurt relative to their competitors, I fear that the support for an incremental credit may be fairly weak.

Second, I have some concerns that the overall economic stimulus generated by an incremental credit will be meager at best.

* A tax incentive as small as $10 billion is a drop in the bucket compared to a $6 trillion economy, like ours -- it simply isn't large enough to spur any noticeable increase in economic growth.

* Despite my joint announcement with then-Senator Bentsen and your personal support of a December 4, 1992 effective date, I hear that many companies are ignoring the prospect of an investment credit when making their investment decisions. Because of the incremental nature of the credit and the desire to limit the revenue loss, many companies think it highly uncertain -- or, worse, unlikely -- that they will benefit at all.

* If an investment credit is combined with a corporate rate increase in an overall plan, then to some degree the plan could be criticized as having given to the corporate community with one hand and taken away with the other. A corporate rate increase is likely to cancel whatever incentive an incremental credit might provide. For companies that would not get the credit, the rate increase could possibly represent a net decline in their ability to invest. It will also test their willingness to support your program.

* Because of the potential timing of a tax bill after a jobs package to stimulate growth, by the time credit legislation is actually enacted, the economic justification for it may be weakened.

Third, I fear that an investment credit, especially an incremental one, would possibly open the door to distortions that Congress worked so hard to eliminate in 1986. On some level, a targeted credit is contradictory to the broad-base, low-rate philosophy of tax reform. The narrower the credit, the worse the problem because more arbitrary policy distinctions will have been made to leave out various assets or industries. These distortions could be unjustified on policy grounds, and might provide motivation to the "losers" to avoid tax.

Fourth, it is my understanding that it would be difficult, if not impossible, to prevent companies from engaging in sophisticated tax planning that might result in abusing an incremental credit. I am informed by my staff that no matter how comprehensive anti-abuse rules are, we can be sure that sharp

BR/Bolger/sm

THE WHITE HOUSE

WASHINGTON

February 24, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: ROBERT E. RUBIN

SUBJECT: **Effective Dates for Personal and Corporate Tax Increases**

Issues

The personal and corporate tax increases in the economic plan currently have an effective date of 1/1/93, but are not payable until 4/15/94. The effect of these two proposals is to increase taxpayer liability by about $23 billion in calendar year 1993. Individual and corporate taxpayers, however, will only pay about $2 billion in fiscal year 1993. (Because of behavioral responses, moving the effective date to 1/1/94 would result in a revenue loss of a negligible amount in fiscal year 1993, about $23 billion in fiscal year 1994, and about $27 billion over the period 1993-1997.)

The problem could take one of two forms (or most likely a blend of the two), depending on whether the April 1994 tax payments affect spending in 1993 or 1994.

(1) If the economic impact is in 1993, the taxes could be viewed as offsetting the stimulus, thus eliminating the anticipated job creation; and

(2) If the economic impact is in 1994, the fiscal deficit reduction in 1994 may have too large an impact on the GDP (i.e., the phasing of deficit reduction may have been too heavily weighted to 1994, which has a substantially larger change in the deficit as a percentage of GDP than any other year in our program).

An answer to our first problem is the drop in long-term interest rates since the election, which should provide more than enough stimulus to offset the tax increase, thereby leaving our stimulus program as a net impact for job generation. (A substantial decline in long-term interest rates generates business investment, increased housing starts, exports through a lower dollar, consumption via lower consumer credit costs and mortgage refinancing, and perhaps a greater sense of general confidence.

Macroeconomic monitoring organizations like DRI and Lawrence Meyers will give us limited credit for the interest rate decline, and thus will be reporting that our program is deflationary for 1993. (Personally, I think we are right in claiming credit for the full interest rate drop, and thus for a more than offsetting impact on interest rates.)

Some members of our own economic team, including CEA, feel that there is an internal inconsistency in asking simultaneously for stimulus and a tax increase in the same year. That would mean that the fiscal impact on GDP -- the only part of the impact on GDP that we can control directly -- would be canceled out, or, even worse, contractionary.

If you take that as the starting point, it would follow that your claim of a stimulus and job creation were not valid. (On the other hand, if you take into account the full interest rate drop, the total stimulative impact includes the stimulus plus some extra effect from the net of the interest rate reduction and the tax increase.)

Some press seems willing to give us credit for the full interest rate decline, but economists seem to argue that we should get credit for only part of it.

As to the second problem, the aggregate GDP impact of lower interest rates over the 1993 and 1994 period needs to be measured against the negative impact of the deficit reduction program during that period.

I have discussed this at some length with the CEA, and I think a fair summary would be that the unexpectedly large move in long-term rates should largely offset the heavy deficit reduction in 1994, although there might be slightly lower growth than they had projected (but most likely still higher than the CBO projection). Here, there is no issue of whether or not we should get credit for the lower rates. It is simply a matter of projecting effects on GDP.

Decision

The choice now is whether to stay with our 1/1/93 date or move toward some later date, e.g., the date of signing, or 1/1/94. After lengthy conference calls over the weekend, we all agreed that a later starting date would have been better on purely economic grounds. However, given where we are, we all agreed to have a public posture that the effective date would have to be worked out with Congress, and not to fuel expectations one way or the other, thus preserving our options.

There are three possible choices at this point: retain the present date; change the dates now; or take the position that we will work with Congress and then postpone the decision until some later time, depending on what's happening in the economy. Some of the economic and political pros and cons for changing the date are laid out above. Others are as follows:

Con - Could make us look soft in the face of Congressional and other pressures on taxes, and so hurt us in the bond market by raising questions about the strength of our commitment to the deficit reduction program (if we make the change, it must be with the strongest reaffirmation on our 1997 commitment, although with recognition that our four-year reduction will be less).

Con - Could look as if we had miscalculated initially.

Con - Would there be any Fed reaction to the change?

Pro - Elimination of the argument that our stimulus is vitiated by tax increases.

Pro - Reduces possible unduly heavy deficit reduction in 1994.

Pro - Improves spending cut/tax increase ratio.

Until a decision is made, we are sticking to the position we all agreed upon and Secretary Bentsen used on the Brinkley show, to wit, the effective date will have to be worked out with Congress, but we are totally committed to our 1997 deficit reduction objectives.

Recommendation

There are very different views within your economic team. Secretary Bentsen and I both would wait and see what happens. We would not change unless led to because of economic or political developments. Secretary Bentsen has spoken with both Senator Moynihan and Congressman Rostenkowski, who will work with us if a change in the date begins to seem desirable.

The CEA and Gene Sperling believe that our claim of a stimulus is hollow because of the tax offset, and so would change to a later date as quickly as possible, in cooperation with Congress.

The reasons for my view are:

(A) I believe that we may have enough positive GDP impact to serve our purposes in 1993 and 1994, and that our argument as to the validity of your claims concerning stimulus is strong even if not recognized by the macroeconomic services (since they won't give us credit for much of the interest rate decline). Also, I am concerned about the possible impact of change on the bond market (not because of the numbers because there I think we have a strong argument, but we are still totally committed to our 1997 plan), but rather because of the concern that it will indicate weakness and a willingness to change in the face of pressure.

(B) I am concerned about the possible impact of change on the bond market, if interpreted as indicating weakness and a willingness to change in the face of pressure.

BR

File: Economic Plan

MEMORANDUM FOR THE PRESIDENT

FROM: GENE SPERLING AND SYLVIA MATHEWS

SUBJECT: Organizing the Cuts

Here are the challenges we feel you face in discussing and organizing the spending cuts.

1. The biggest issue you face is that as you go out to the nation to discuss spending cuts, every single cut affects something that is important to some people -- including their job in some cases. You have to find a way to explain how tough you are on cuts, while treating all of the people who will be affected with dignity. It is one thing to be told you must lose your job eventually because of the need for national imperatives, it is another thing to be told your job was just a boondoggle anyway.

2. You must convince the nation that the cuts are real and substantial. This requires specificity to overcome the skepticism that people have toward government generally, but toward promises of deficit reduction specifically.

3. Because you have such a wide array of specific cuts, some may unfairly characterize them as being random. You need to be able to organize to both allow you to speak in short hand to people and demonstrate a philosophy or criteria that organizes the specific cuts.

Based on meeting these goals, we would recommend organizing the cuts in the following four categories that are similar to the OMB categories, with one major difference. We have created a category of cuts which you should simply admit are cuts that you would not like to make under normal circumstances, but because "of the hand we have been dealt" we have to cut because there are more pressing national priorities. When addressing groups affected by our cuts, you should say that their contributions were valuable, but in light of our pressing needs to invest in people, put cops on the street, and educate our children, we make tough choices.

A. **Does this program not work or is it no longer needed?** To restore public confidence we need to show people we are as good at ending outdated programs as starting them. Making government work for the next century means ending funding in programs that don't work and updating policies and programs that were designed to meet the needs of an earlier era.

Examples

- Termination of Commissions especially the Bicentennial of the U.S. Constitution Commission
- Elimination of most loan subsidies for the Rural Electrification Administration
- Eliminate unnecessary nuclear reactor research
- TVA termination of the TVA's fertilizer research activities
- Consolidating overseas broadcasting programs
- Terminating State Justice Institute

B. **Does the program provide unnecessary or excessive subsidies to narrow groups at the expense of society at large?** It is important when describing increased fees and reduced subsidies to stress the distributional impact: can we continue to ask a cab driver in Chicago to subsidize the registration fees of private plane owners. The nation can no longer afford subsidies and giveaways to those who don't need them, and we must assure that the taxpayer is fairly compensated for services or resources provided by the government.

Examples

- Enstating Bureau of Alcohol, Tobacco and Firearms (BATF) user fees.
- Improve enforcement of harbor maintenance fees.
- Target CCC farm subsidy payments to farmers with off-farm incomes above $100,000
- Limit payments on wool and mohair to $50,000
- Permanently extend patent and trademark fees
- Auctioning spectrum for new communications services to end windfalls
- Reducing export promotion support for large companies
- New or increased user fees for SEC registration
- Increase fees on general aviation aircraft.

C. **Could we improve the efficiency of the program or Department?** You should continue to talk about your cuts in government not in an anti-government manner, but because you can believe that government can often be run with the efficiency of our best businesses if we are willing to reinvent government. It is also your way of showing that this effort starts at the top.

Examples

- White House Staff reductions
- Department cost cutting
- Reducing Foreign Agriculture services
- Streamlining USDA offices
- Strengthening child support enforcement mechanisms
- Phasing out Impact Aid "b" payments

D. **Programs that must be slowed or stopped simply to meet our priorities. We must make tough cuts we would prefer not to meet the extreme economic and investment challenges that we face?** (This is not a category from the OMB document) Here you can stress to the people you speak to that many cuts are tough, but simply have to be done because we need new priorities. You can stress it is not fun to freeze the wages of hundreds of thousands of working people who are trying to raise a family, but we all have to make the tough government cuts if we want to get the deficit down. This both shows that you realize the people behind the cuts, while letting those who want more to recognize how tough and significant what you have already done is.

Examples

- Freezing federal wages (moved from the efficiency section in the OMB document)
- Setting laboratory and durable medical equipment rates at market levels
- Ending lump-sum benefits for Federal retirees
- Increasing the tax on Social Security benefits of those already taxed

(Many others could fit in this category)

The OMB has two other sections, one on "Health Care Costs" and the other on "Shared Contribution." Examples from these sections have been folded into the category of those things we don't want to do, but when forced to triage we must do.

THE WHITE HOUSE

WASHINGTON

February 5, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: ROBERT E. RUBIN

SUBJECT: Energy Tax Decision Memorandum

Energy taxation can play an integral part in your strategy to make the U.S. economy more efficient and competitive. Revenues raised can reduce the deficit, put the government on a more appropriate pay-as-you-go basis for needed public programs, and encourage energy efficiency and fuel mix choices better reflecting the true environmental and security costs of energy use. An energy tax can help move the U.S. economy from income-based to consumption-based taxation, with attendant benefits to saving, investment and returns to work effort. Introduced in a phased manner, it can mesh with the desired time profile of stimulus - deficit reduction and send an important signal up front: that to become a more competitive nation we must fully recognize the costs of high energy use in our workplaces and lifestyles; shocks to the system will be avoided, time for adjustment will be provided, but a change must come.

However enlightened this message may be as policy, politically it will be extremely difficult. While an organized constituency for energy taxation is beginning to form, principally among the environmental community, the public debate is still characterized by broad consumer antipathy and powerful, focussed opposition from particularly-affected parties, notably producer industries and states. Their arguments include regional hardship, regressivity, and international competitive disadvantage. Any energy tax proposal will raise taxes on average families and thus will likely encounter political difficulty on this ground alone, particularly when campaign statements on this issue are taken into account.

Decisions you make on energy taxation can help address these concerns. Those decisions are presented here as (1) the form of energy tax, (2) the amount of tax and (3) the adjustments, if any, for adverse regional, sectoral or income distributional impacts. The focus here is on question (1), which tax. The other questions are integral to formulating an energy tax proposal, but require more work to present and evaluate specific options. They are included here for completeness and to get a signal from you about where to concentrate further work. While these materials focus on the choice among energy tax options, they should also be useful on deciding the more fundamental

question of whether the economic package should include a large energy tax component.

Within question (1), the focus is on ad valorem and BTU taxes. These are broad-based taxes which permit relatively low tax rates for any given revenue target. This both limits impacts on the real economy and spreads them broadly across sectors and regions. For comparison purposes, other energy tax options -- carbon tax, motor fuels tax and oil import fee -- have also been evaluated. A carbon tax is more heavily weighted toward coal. The motor fuels tax requires a higher, and highly visible, tax on a narrower base, and runs counter to a campaign pledge. An import fee requires the highest rate of all on the narrowest, least stable base and, absent countervailing taxation, produces large income windfalls to domestic producers. More detailed information on all the taxes considered is found in the attached tabs.

1. **Which tax?**

With a common broad tax base (See Tab A for tax specifications) and a common revenue target, ad valorem and BTU taxes have similar overall economic effects (See Table 1 at the end of this memo and Tab B for comparison of the impacts of alternative taxes.) They do have differential effects on the prices of different fuels, as seen in the following chart for a $22 billion tax:

	AVERAGE PRICE		Year 2000 % change from base case		
	1990 Actual	2000 Before Tax	BTU	Ad Valorem (source)	Ad Valorem (end use)
Coal (short ton)	31.57	35.62	17.6%	12.4%	0.7%
Petroleum Products (gallon)	1.02	1.05	2.5%	6.2%	4.3%
Natural Gas (mcf)	4.02	4.77	6.9%	9.7%	4.2%
Electricity (kWh)	0.068	0.069	6.1%	4.2%	5.0%

However, because user demands are only moderately responsive to these price changes, fuel consumption will change much less:

	AVERAGE PRICE		Year 2000 % change from base case		
	1990 Actual	2000 Before Tax	BTU	Ad Valorem (source)	Ad Valorem (end use)
Coal (million ton)	897	959	-2.3%	-0.9%	-1.3%
Oil (mmb/d)	17.3	19.0	-0.9%	-2.1%	-1.1%
Natural Gas (tcf)	18.8	22.8	-0.8 to -3.7%	-2.1%	-1.2%

Changes in production are correspondingly small. Thus, these tax alternatives differ somewhat as to who will pay greater taxes -- e.g. coal users or oil users -- but little as to which fuels will be produced or consumed. Increases over the period due to economic growth are forecast for both consumption and production. These increases substantially exceed any absolute or differential effects of these taxes, leaving aggregate levels well above those of today and fuel shares virtually unchanged.

The three alternatives reduce carbon dioxide emissions 1-2% in the year 2000. While this is a small absolute reduction, it is significant in the context of meeting the U.S. goal under the Global Climate Convention of returning its greenhouse gas emissions to 1990 levels. The environment benefits from energy taxation both because of conservation and because tax differences among fuels may cause cleaner fuels to substitute for dirtier fuels. More natural gas is conserved for the same percentage price increase than either oil or coal. Conservation tends to be more important than fuel substitution in producing carbon dioxide emission reductions for the three taxes under consideration. The BTU tax is the most efficient reducer of carbon dioxide emissions, but its long run effect is lessened since it is not indexed to inflation. Ad valorem tax receipts will increase over time with energy price inflation, but a BTU tax will erode in real terms unless it is indexed.

Regional impacts of the three taxes are quite similar (Tab C.) Across all regions, taxes are increased an average of $88 per capita, which varies from $96-103 in New England to $79-81 in Mississippi, Alabama, Tennessee and Kentucky. With the limited changes in production cited above, producer-industry and producer-state impacts are also limited. However, an ad valorem (source) tax, unless based on a national average price, would shift some production from Appalachia and the midwest to cheaper

(minemouth) western coal. This might amount to 0.5-1.0% of total production, or 15 million short tons/year, for a $22 billion tax in the year 2000.

Energy taxes are all regressive when viewed across income classes, although less so when looked at across expenditure classes. (Tab D.) While expenditure classes are a more accurate measure of well-being, income comparisons have been more influential politically, and were used by Democrats to criticize Bush Administration proposals. These three broad-based taxes have similar distributional effects, which may be more regressive than some alternative ways of reducing the budget deficit, but less regressive than many others.

The effects on U.S. industry costs vary somewhat, with an ad valorem (use) tax imposing the least burden (Tab E.) This is because the use tax strikes capital as well as fuel costs of energy generation - i.e. is less narrowly targeted to fuel. Overall, the deterioration in competitive position of U.S. energy-intensive industries from these three taxes is expected to be offset by improvements to the trade balance from modestly declining oil imports and lower interest rates due to credible deficit reduction.

The Treasury Department considers these alternatives to be of comparable administrative difficulty (Tab A.)

Without major differential impacts driving the choice of tax, you are able to choose a variant based on what it is you want to accomplish. Clearly, all three alternatives raise revenues and promote energy conservation. The question is how to do that.

1. The BTU tax rationale is environmental. The BTU tax results in the highest CO_2 emission reduction per dollar of revenue collected, although it does affect natural gas consumption slightly more than oil consumption.

2. The ad valorem end-use tax is the most neutral in its effects on primary fuel prices. It also keeps rates low with a broad tax base which includes energy generation and delivery capital, particularly affecting electricity.

3. Energy security is a rationale for the ad valorem (source) tax, which shows the greatest reduction in oil consumption and imports.

Multiple objectives may be met with hybrid options. These may be combinations of taxes, such as the European Community's blended carbon/BTU tax proposal, a BTU/gasoline tax combination, or design modifications such as (1) modified tax base definitions (2) variations in imposition points or (3) differential tax rates. Up to a point, such tailoring may serve policy goals, but may be hard to present as coherent policy.

DECISION:

____BTU Tax ____Ad Valorem (Source) Tax ____Ad Valorem (Use)Tax

Hybrid _____

No energy tax_____
Other _____

2. **What amount?**

Deficit reduction targeted in the economic package can be achieved with an estimated $22 billion energy tax (See Tab A for annual revenue estimates.) This can be raised with an energy tax scaled to bring in $22 billion, or it can be accomplished with a larger tax and a give-back in other taxes. The give-back alternative:

- permits some action on middle class tax relief as promised in the campaign.

- shifts the tax structure somewhat away from returns to labor and investment and toward consumption.

- imposes a larger tax burden on energy consumers, with an attendant increase in absolute regional differences, in any regressive effects, and in the competitiveness burden on energy-intensive U.S. industries.

- increases the energy tax impacts on the real economy -- consumption, production -- with greater potential for short-term economic dislocation but concomitant conservation, environmental and security benefits.

- increases Federal outlays as a result of inflation, requiring higher tax rates to achieve any desired net budget position.

Broad give-back options include the personal income tax and the payroll tax. Particulars of such an arrangement remain to be developed and are not posed as a choice here. Of course, the

combination of energy tax and give-back could be scaled to any ratio desired.

DECISION:

_____ $22 Billion Energy Tax _____ Larger Energy Tax with Significant Give-Back through Other Taxes

Other _____

3. **What adjustments?**

The greatest policy challenge of energy taxes is not a matter of economic impact or administrative difficulty but of public acceptability, most often expressed in terms of effects on regional producers and consumers, on energy-intensive sectors (drivers, industries) and on lower-income households. Specific actions to address these concerns can be packaged with an energy tax proposal. On the other hand, as the energy tax is embedded in a much larger economic package within an even larger economic policy agenda, specific energy-tax-linked mitigation may not be appropriate. Indeed, configuring components of the economic package to be judged individually, when they have been fashioned jointly for desirable overall benefits, may facilitate their being picked off and hung separately.

Regarding regional impacts, the most-often-expressed view of potentially-affected states is "send money" -- i.e., some untied sharing of revenue. Regarding sector impacts, possible remedies include investment and R&D tax credits, enterprise zones, manufacturing extension programs -- items already on your agenda. That agenda also includes a number of proposals, e.g., defense conversion and trade, where assistance to cope with economic dislocation will be warranted, making a general approach desirable. Compared with the impacts of these other proposals, a phased-in energy tax will not be a leading source of dislocation. Thus general mitigation seems most appropriate here.

Regarding regressivity, the uniformity and strength of public opinion about this issue warrants special attention to it, even though regressivity may not be as great as generally believed (Tab D.) Mitigation may be available through personal income tax adjustments (earned income tax credit; other exemptions, deductions or credits), payroll tax reductions, or targeted assistance programs. However, a better solution would be to address regressivity of all new tax proposals at one time, as part of a comprehensive package of tax measures. Any decision to proceed with energy-tax-tied mitigation will require further specification work.

DECISION:

Develop energy-tax-specific mitigation for:

___Regional Impacts ___Sector Impacts ___Distributional Impacts

Address mitigation measures in context of overall economic package_____

Other_____

Table 1: Comparison of Alternative Energy Taxes

	Economic Growth	Fuel Markets	Environment	Competitiveness	Other
Ad Valorem At-Source	Similar effects on economy. All taxes depress short-term economic growth unless offset by expansionary monetary or fiscal policy. Ad valorem options provide constant real revenue; real revenues for other taxes fall unless indexed for inflation.	Heaviest burden on oil of three major options; lightest on coal. Accentuates price shocks.	Generally similar carbon reductions, with Btu tax most efficient per dollar of revenue raised. Other benefits include reduced environmental costs related to automobile use.	Energy intensive firms hurt. Others helped somewhat by deficit reduction. Coordination with EC and Japan could reduce competitiveness costs.	Distributionally similar, by income and region.
Ad Valorem End-Use		Has smallest effect on fuel markets, because tax base includes capital as well as energy. Accentuates price shocks.			
Btu Tax		Impact on coal falls between ad valorem taxes and carbon tax.			
Carbon Tax		Largest tax upon coal.	Most targeted at carbon emissions.		
Motor Fuels Tax		Only burdens oil.	Greatest reduction in auto use, but small carbon reductions.	Most targeted to consumption, as opposed to production, of all taxes considered. Smallest effect on U.S. industrial energy prices.	Somewhat more regressive and less uniform regionally than broad-based taxes.
Oil Import Fee	Hardest to accommodate with monetary policy.	Domestic oil producers get windfall gains. Significant drilling increase, with lesser production increase. Speeds depletion of U.S. reserves.	Largest carbon reductions in near term because of large impact on energy prices.	Potential GATT and NAFTA problems. U.K., Venezuela, Mexico, and Canada would likely seek exemptions.	

Energy Tax Alternatives:

Specifications, Revenues, and Administrative Considerations

Energy Tax Alternatives

1. **Btu Tax**. The tax is based on the average or actual heat content (measured in British thermal units) of energy consumed in the United States.

2. **Ad Valorem - at source**. The tax is based on the average or actual value of energy at the first point of sale (excluding exports).

3. **Ad Valorem - end use**. The tax is based on the average or actual value of energy sold to end users (excluding exports).

4. **Carbon Tax**. The tax is based on the average or actual carbon content of domestically consumed fossil fuels (and possibly other carbon sources, such as cement manufacturing).

5. **Gasoline Tax**. The excise tax on motor fuels (including diesel) used by highway vehicles could be increased. The base could be broadened to include diesel used by railroads, aviation fuel, and other uses of motor fuels.

6. **Oil Import Fee**. The tax is a unit tax imposed on imported crude oil and petroleum products.

Blended Tax. An energy tax could use a rate that is a blend of the above taxes. The European Community (EC) has proposed an energy tax with a rate that is based half on Btu content and half on carbon content.

Specifications for Each Tax

This section provides a more detailed description of the base, collection point, and prices (for ad valorem taxes) that were used for analyzing the first six taxes listed above. The rates required for each tax to raise $22 billion in FY 1997, and alternatively to raise $40 billion in FY 1997 are also shown. It is assumed that

each tax would be effective 1/1/94, and phased in over four years in equal stages, with the full rates in effect 1/1/97 and thereafter.[1]

1. **Btu Tax**

Base is fuel uses of fossil fuels (oil, natural gas, and coal) consumed in the United States and electricity generated from hydro and nuclear power. Base excludes nonfuel uses of fossil fuels, nonconventional fuels (solar, wind, etc.), and exported fossil fuels. For nuclear-generated electricity, the Btu content of the nuclear fuel is the base; for hydro-generated and imported electricity, the average fossil fuel Btu input that would be required to generate the electricity is the base.

Collection point is the refinery for oil, importation point for electricity and refined petroleum products, the pipeline for natural gas, minemouth for coal, and the utility for hydro- and nuclear-generated electricity. Some downstream credits for nonfuel use are required.

Rates are $0.44/million Btu for the $22 billion alternative and $0.84/million Btu for the $40 billion alternative. One barrel of oil contains 5.8 million Btu's and a tax of $2.55 would be paid. One thousand cubic feet of gas contains 1.03 million Btu's; a tax of $0.45 would be paid. One short on of coal contains 21.8 million Btu's; a tax of $9.59 would be paid.

2. **Ad valorem - at source**

Base and collection points are the same as for a Btu tax.

Prices are refinery acquisition cost (RAC) for oil, the RAC equivalent for refined petroleum products, wellhead for natural gas, minemouth for coal, and fossil fuel-generated equivalent for hydro- and nuclear-generated and imported electricity.

Rates are 16 percent of the indicated prices for the $22 billion alternative and 30 percent for the $40 billion alternative.

3. **Ad valorem - end use**

Base excludes nonfuel uses of fossil fuels, nonconventional fuels, and fossil fuels sold to electrical generating plants. All electricity delivered to customers is

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[1] The four-year phase in would make 1/4 of the full rate in effect in 1994, 1/2 in 1995, 3/4 in 1996, and the full rate in 1997 and later years.

in base (i.e., transmission losses excluded). Natural gas used in pipelines is also excluded.

Collection point is the refinery for petroleum products, the pipeline for natural gas, and the utility for electricity.

Prices are end user prices.

Rates are 4.70 percent of end user prices for the $22 billion alternative and 8.65 percent for the $40 billion alternative.

4. **Carbon Tax**

Base is confined to fuel uses of fossil fuels.

Collection point is the refinery for oil, importation point for refined petroleum products, the pipeline for natural gas, and minemouth for coal. Some downstream credits for nonfuel use are required.

Rates are $22.00/short ton of carbon for the $22 billion alternative and $42.00/short ton of carbon for the $40 billion alternative.

5. **Gasoline Tax**

Base is "Highway Trust Fund Base," which is gasoline and diesel used as a motor fuel, excluding purchases by nonprofit organizations, state and local governments, farms, aviation, inland waterway transportation, intracity and school buses, and off-highway use.

Collection point is the same as current law.

Rates are $0.237/gallon for the $22 billion alternative and $0.442/gallon for the $40 billion alternative.

6. **Oil Import Fee**

Base is all imported crude oil and refined petroleum products (measured in crude equivalents).

Collection is at the point of importation.

Rates are $9.67/barrel for the $22 billion alternative and $21.33/barrel for the $40 billion alternative.

Preliminary Revenue Estimates

Table A-1 shows preliminary revenue estimates for each of the above energy taxes and for both revenue targets in FY 1997 ($22 billion and $40 billion). All of the energy tax alternatives, by design, would reach the revenue targets in FY 1997, and all would raise similar amounts of revenue over the FY 1994-1998 period. The ad valorem taxes, however would raise more revenue in FY 1998 and subsequent years.

Table A-1: Revenue Estimates for Alternative Energy Taxes

PART I. Revenue Target of $22 billion in FY 1997

Tax	Rate	Fiscal Year					
		1994	1995	1996	1997	1998	1994-1998
		(billions of dollars)					
1. Btu Tax	$0.44/million Btu	4.1	10.0	15.9	21.8	23.6	75.5
2. Ad Valorem - at source	16.0% of first sale (1)	3.8	9.6	15.7	22.1	24.7	75.6
3. Ad Valorem - end use	4.70% of end use price	3.7	9.3	15.3	21.8	24.5	74.6
4. Carbon Tax	$22.00/short ton	4.2	10.2	16.3	22.1	23.9	76.7
5. Gasoline Tax	$0.237/gallon	4.4	10.3	16.1	22.0	23.2	76.0
6. Oil Import Fee	$9.67/barrel	4.2	10.4	16.3	22.0	23.8	76.7

PART II. Revenue Target of $40 billion in FY 1997

Tax	Rate	Fiscal Year					
		1994	1995	1996	1997	1998	1994-1998
		(billions of dollars)					
1. Btu Tax	$0.84/million Btu	7.8	18.9	29.7	39.9	42.7	139.7
2. Ad Valorem - at source	30.0% of first sale (2)	7.1	17.7	28.8	39.9	43.9	137.4
3. Ad Valorem - end use	8.65% of end use price	6.8	17.0	28.1	40.0	44.9	136.8
4. Carbon Tax	$42.00/short ton	8.0	19.3	30.1	40.1	42.6	140.1
5. Gasoline Tax	$0.442/gallon	8.2	19.0	29.7	40.0	41.9	138.8
6. Oil Import Fee	$21.33/barrel	9.1	21.8	32.6	40.0	40.7	144.2

Source: Department of Treasury, Office of Tax Analysis

(1) The product equivalent rates in 1997 are $3.67/barrel of oil, $0.32/mcf of natural gas, $3.85/short ton of coal, and $2.05/000 kWh of hydro- and nuclear-generated electricity.

(2) The product equivalent rates in 1997 are $7.50/barrel of oil, $0.62/mcf of natural gas, $7.46/short ton of coal, and $3.97/000 kWh of hydro- and nuclear-generated electricity.

Administrative Considerations

This section describes the administrative considerations affecting the design of an energy tax. In general, the administrability of a tax is enhanced by adherence to the following principles:

- Rates should be expressed on a per-unit basis and should be based on averages rather than on actual energy content, carbon content, or price.
- The number of taxpayers should be minimized.
- The tax should be imposed as far upstream as possible.

- The base should be defined so that taxability can be determined with certainty at the point of collection.
- The visibility of the tax should be minimized.
- To the extent possible, existing administrative structures that are consistent with the foregoing criteria should be used.

The considerations relating to broad based taxes (i.e., the Btu tax, both variants of the ad valorem tax, and the carbon tax) are similar and those taxes are discussed as a group. The oil import fee and the gasoline tax are each discussed separately.

BROAD BASED TAXES

Use of Average Rates. The taxes would impose significant administrative problems if imposed on the basis of actual energy or carbon content or actual price, determined on a transaction-by-transaction basis. For ease of administration, the taxes should be imposed on a per-unit basis (e.g., barrel of oil, ton of coal) at a rate based on a national average for each type of energy source. Thus, for example, the Btu tax imposed on a barrel of oil or a ton of coal would be based on the average energy content of oil or coal rather than on the actual energy content of the particular barrel of oil or ton of coal. Similarly, the ad valorem tax would be based on the average price in all transactions during a recent period (see below) rather than on the actual price in the particular transaction.

The different grades of coal vary significantly in their energy content, carbon content, and price. Thus, equity and regional balance may require that coal be treated as multiple products (e.g., bituminous, sub-bituminous, lignite), each subject to a different tax rate.

Tax rates would also be determined for the different types of refined petroleum products (e.g., gasoline, fuel oil). The end use ad valorem tax is imposed on both domestic and imported refined products at rates determined in the manner described above. The other taxes are imposed on imported (but not domestic) refined products at a rate equal to the average tax embedded in the cost of equivalent domestic products.

Except under a carbon tax, tax rates would also be determined for electricity from hydro and nuclear power. The tax per unit on electricity from these sources would be equal to the average tax embedded in the cost of electricity generated from fossil fuels.

Ad valorem taxes would be adjusted periodically to reflect changing prices for energy products. The adjustment mechanism should balance various factors including (1) the goal of reflecting current price levels as closely as possible, (2)

the advantages of stable rates, and (3) the lag time between a change in prices and a corresponding change in rates imposed by delays in data collection and the need to give reasonable advance notice to taxpayers. The rates for a Btu or carbon tax would generally remain constant over time (although some variance may occur if the mix of fuels used changes).

Minimizing Number of Taxpayers. The taxes are collected at the narrowest point in the chain of production and distribution so the IRS can focus its collection efforts on the smallest possible number of taxpayers. For example, the tax on crude oil (or, in the case of the end use ad valorem tax, refined petroleum products) is collected at the refinery.

Upstream Imposition. The taxes are generally imposed at or near the producer level (i.e., upstream) and before the point at which the product is likely to be put to a taxable use. This minimizes the potential for avoidance from the taxable use of a product before it reaches the point at which tax is imposed.

Definition of Base. The taxation of all energy sources, without exception, would simplify the administration of the tax. To the extent the base is narrowed through exemptions, it may not be possible to determine until the product is actually used whether tax should be imposed. The tax-free sale and refund mechanisms typically provided when products are purchased for or used in an exempt use increase administrative burdens and opportunities for avoidance.

The broad based taxes minimize these problems. In general, the only significant exemption under all of the taxes is for nonfuel uses. In the case of the end use ad valorem tax, however, fossil fuel (principally coal) used to produce electricity is also exempt.

Visibility. Taxes are most visible to the public when they are imposed on retail sales and are separately stated in the amount charged to customers. In addition, a tax that results in a substantial increase in the price of a product is likely to be visible even if it is not separately stated.

The broad based taxes are generally imposed before the retail sale and would not be separately stated. (Note that utilities would prefer a tax that is imposed on the customer and collected by the utility. They are concerned that otherwise there would be a significant delay in their ability to pass the tax along to the customer. Such a tax would be highly visible if separately stated on utility bills.) In addition, none of the broad based taxes should cause a noticeable increase in retail prices for any product.

Use of Existing Administrative Structures. A new tax is easiest to implement if it is imposed at the same point and collected from the same person as an existing tax on the same product. In that case, the administrative structures used for the existing tax can be extended, without significant modification, to the new tax. The existing tax on crude oil is imposed on receipt at the refinery and collected

from the refiner and the existing tax on coal is imposed at the minemouth and collected from the producer. Thus, administrative structures for these taxes could be extended to a Btu tax, carbon tax, or at source ad valorem tax.

Floor Stocks Tax. A floor stocks tax may be imposed when a tax takes effect or its rate increases. The purpose is to ensure that tax is paid on products that are already past the point at which tax is generally imposed. Floor stocks taxes involve large numbers of taxpayers and are difficult to administer. Nevertheless, they are generally considered necessary to prevent stockpiling prior to the effective date of a new tax or a higher tax rate.

Oil Import Fee

The oil import fee is a per-barrel fee on crude oil and petroleum products imported into the United States. Although there may be more importers than refiners of imported crude oil, the tax must be collected at the point of importation because, once in the United States, imported and domestic petroleum are indistinguishable. (Note that a floor stocks tax would not be imposed for this reason.) On the other hand, although the base of the tax is relatively narrow, all imported petroleum products would be taxed (with a possible exception for products that are re-exported). Thus, taxability can be determined with certainty at the time of importation, minimizing the complexity and opportunities for avoidance associated with exemptions. The oil import fee, because of its narrow base, will have a noticeable effect on retail prices of petroleum products such as heating oil and gasoline. Thus, it is likely to be much more visible than the broad based taxes. Existing administrative structures can be used to collect the oil import fee on refined petroleum products, but there are no structures in place to collect the fee on crude oil imports.

Gasoline Tax

Implementation of an increase in the tax on gasoline and other motor fuels would require no new administrative structures. It should be noted, however, that existing structures are not satisfactory. IRS enforcement efforts are hampered by the large number of taxpayers as well as the exemptions for off-highway use and a variety of other uses. As a result, evasion of the motor fuels taxes is widespread. Moreover, the gasoline tax is the most visible of all the proposed alternatives. The effect of the proposed increase on the retail price of gasoline would be as great as that of an oil import fee and would be immediately reflected in prices at the pump.

Alternative Energy Taxes: Energy Market, Environmental, and Economy-wide Impacts

Total Energy Consumption

- Total 1992 U.S. energy consumption was 87.0 Quads. In the absence of energy taxes, consumption is projected to grow by 10% to 12% by 2000 and another 9% in the following decade, leading to increased reliance on imported energy.
- While the taxes analyzed would reduce energy use from projected levels, economic growth would raise energy consumption in the U.S. above 1992 levels under all of the scenarios analyzed.
- An energy tax netting $22 billion in FY 1997 would reduce projected energy consumption by 0.5% to 2.8% in the year 2000; a tax netting $40 billion would reduce consumption by 0.8% to 5.5%. The largest impacts on energy use would come from an oil import fee, while the smallest would come from a motor fuels tax and an end-use ad valorem tax.

Table B-1: Energy Consumption In Year 2000
(percentage change from Base Case)

Net Revenue Target of $22 Billion in FY 1997 *

		1990	Base Case 2000	Btu Tax	Ad Valorem Tax (At Source)	Ad Valorem Tax (End Use)	Carbon Tax	Motor Fuel Tax	Oil Import Fee
Oil (All)	mmb/d	17.31	18.97	-0.9%	-2.1%	-1.1%	-1.1%	-1.8%	-4.5%
Oil (Imported)	mmb/d	7.58	10.72	-0.1%	-3.4%	-1.8%	-1.9%	-3.1%	-15.6%
Coal	mill. tons	897	959	-2.3%	-0.9%	-1.3%	-2.8%	0%	-0.8%
Natural Gas	tcf	18.8	22.8	-0.8% to -3.7%	-2.1%	-1.2%	0% to -3.7%	0.4%	-0.6%
Electricity	tWh	2830	3250	-1.6%	-0.9%	-1.3%	-0.9% to -2.3%	0%	-1.1%

Table B-2: Energy Consumption In Year 2010
(percentage change from Base Case)

Net Revenue Target of $22 Billion in FY 1997 *

		1990	Base Case 2010	Btu Tax	Ad Valorem Tax (At Source)	Ad Valorem Tax (End Use)	Carbon Tax	Motor Fuel Tax	Oil Import Fee
Oil (All)	mmb/d	17.31	20.66	-0.8%	-2.9% to -7.3%	-1.3%	-1.0%	-1.6%	-4.3%
Oil (Imported)	mmb/d	7.58	13.00	-1.1%	-4.4%	-1.9%	-1.4%	-2.4%	-10.6%
Coal	mill. tons	897	1094	-1.9%	+0.6% to +7.0%	+0.8%	-2.8%	+0.2%	+1.0% to +7.0%
Natural Gas	tcf	18.8	25.0	-2.2%	-2.9% to -8.9%	-1.8%	-0.5% to -3.9%	-0.2%	-5.4% to +3.6%
Electricity	tWh	2830	3960	-2.1%	+0.7% to -2.6%	-2.1%	-2.1%	+0.1%	-1.0%

* NOTE: Effects for a $40 billion revenue target are roughly double.

Energy Consumption Shares

- With the exception of oil import fees, none of the taxes analyzed has large effects on the relative market shares of coal, oil, and natural gas. These remain within percentage points of base case shares. Markets for each fuel will be larger in 2000 in absolute terms than they are today.
- At a revenue level of $22 billion, carbon and Btu taxes reduce total coal production by 2% to 3% in the year 2000; at a level of $40 billion they reduce production by 4% to 5%.
- The coal market impact of an ad valorem tax depends on where it is collected. A tax levied on the price at the source encourages switching from eastern to western coal because the latter would have a much lower price for tax purposes. This result, however, is dependent on the specification of the tax.
- The oil import fee has the greatest effect on domestic energy producers, boosting domestic oil production by as much as 11% with a $22 billion tax (approximately one million barrels per day). If natural gas prices also move upward as a result of the fee, gas could become less competitive in the market for electric utility fuels. Alternatively, increases in domestic oil exploration and production activity could increase natural gas supplies and reduce the price of natural gas.

Table B-3: Producer Prices in Year 2000 (percentage change from Base Case)

Net Revenue Target of $22 Billion in FY 1997 *

		1990	Base Case 2000	Btu Tax	Ad Valorem Tax (At Source)	Ad Valorem Tax (End Use)	Carbon Tax	Motor Fuel Tax	Oil Import Fee
World Oil - Crude	barrel	20.03	22.95	-0.0%	-1.0%	-0.5%	-0.4%	-1.1%	-4.1%
Coal - Minemouth	short ton	21.71	26.45	-0.4%	-0.1%	-0.2%	-0.4%	0.0%	-0.2%
Natural Gas - Wellhead	mcf	1.71	2.56	-0.8%	-0.5%	-0.4%	0.0%	0.4%	-4.3%

Table B-4: End-Use Prices in Year 2000 (percentage change from Base Case)

Net Revenue Target of $22 Billion in FY 1997 *

		1990	Base Case 2000	Btu Tax	Ad Valorem Tax (At Source)	Ad Valorem Tax (End Use)	Carbon Tax	Motor Fuel Tax	Oil Import Fee
Coal - Utilities	short ton	31.32	34.38	17.7%	12.2%	0.0%	20.1% to 36.7%	0.0%	1.6%
Gasoline - Retail	gallon	1.26	1.44	2.6%	6.3%	4.5%	3.4%	12.5%	11.7%
Household Oil	gallon	1.12	1.08	3.7%	8.7%	4.5%	4.4%	-0.3%	15.9%
Household Natural Gas	mcf	6.10	6.90	4.3%	6.7%	4.6%	4.2%	0.1%	-1.5% to 8.8%
Electricity -- Residential	kWh	0.08	0.08	5.8%	3.8%	5.3%	5.3%	0.0%	1.5%

* NOTE: Effects for a $40 billion revenue target are roughly double.

Primary and Secondary Fuel Prices

- The effects of taxes expressed in nominal terms (e.g., cents per gallon) are eroded over time due to inflation. Over a twenty year period, the impacts of tax rates on inflation-adjusted prices would be reduced 40% to 60%. The effects of ad valorem taxes, which are specified as a percentage of the sales price, do not erode over time.
- Ad valorem taxes will amplify any price shocks that occur in energy markets unless some alternative provision is made.
- Carbon and Btu taxes have the largest effects on the price of coal. Btu, carbon, and end-use ad valorem taxes affect electricity prices the most.
- Because of their narrower tax bases, gasoline taxes and oil import fees involve higher price increases on the fuels affected by those taxes than broader based taxes, such as those based on carbon, btu's, or value.

Table B-5: Change in CO_2 Emissions (percentage change from baseline)

Net Revenue Target of $22 Billion in FY 1997 *

Year	1990	2000
Baseline Emissions (mmtc)	1340	1497

	Percentage Change from Baseline
Btu	-1.4% to -2.1%
Ad Valorem (At Source)	-1.5% to -2.0%
Ad Valorem (End Use)	-1.1% to -1.3%
Carbon	-1.3% to -2.6%
Gasoline	-0.6% to -1.1%
Oil Import Fee	-2.3% to -3.0%

* NOTE: Effects for a $40 billion revenue target are roughly double.

Environmental Impacts

- At the Rio Summit, the U.S. signed a climate convention that included the goal of returning its greenhouse gas (GHG) emissions to 1990 levels. (GHGs include carbon dioxide (CO_2), methane, and nitrous oxide.) If all elements of the U.S. *Action Plan* are successfully implemented, GHG emissions are predicted to be 1.4% to 6% higher in the year 2000 than in 1990. The addition of energy taxes considered here could result in emission reductions that would meet this goal.
- Because energy use is likely to grow steadily in an expanding economy, CO_2 emissions in the U.S. are predicted to grow by roughly 10% over the next decade. (CO_2 is the predominant GHG.) The energy taxes designed to raise $22 billion in 1997 would reduce CO_2 emissions by up to 3% in the year 2000. With the higher revenue goal of $40 billion, CO_2 emission reductions of up to 6% could be achieved by the year 2000. Thus, by themselves, the energy taxes of the magnitude under consideration here cannot be expected to return CO_2 emissions (as opposed to all greenhouse gas emissions) to 1990 levels.
- Outside of the oil import fee, the carbon tax results in the highest CO_2 emission reduction per dollar of revenue collected, followed by the Btu and the at-source ad valorem taxes. The motor fuels tax and the end-use ad valorem tax have the lowest carbon reduction efficiency. The emission reduction benefits of the carbon and Btu taxes are roughly similar.
- Beyond the year 2000, CO_2 emissions projections are necessarily more uncertain, especially for ad valorem taxes. The carbon and Btu taxes continue to reduce the most CO_2 per dollar of revenue raised, but since their specified rates were not indexed to inflation, their CO_2 reduction benefits decline over time. It appears that the CO_2 reduction effect of the oil import fee falls dramatically after the year 2000.
- Ad valorem taxes rise with inflation. Therefore, they have an increasing effect on both conservation and fuel substitution over time. If conservation in oil and gas outweighs fuel switching towards coal in the electric utility sector, the at-source ad valorem tax has larger CO_2 reduction benefits in 2010 than the end-use tax and other taxes. Should utility fuel switching dominate, the CO_2 benefits of the at-source tax in 2010 would be substantially lower.
- The energy taxes will result in other environmental benefits including lessening of urban smog, acid rain, waste disposal problems and oil spills. These additional benefits, however, are likely to be relatively modest. For example, a gasoline tax of $0.25/gallon (approximately equivalent to the motor fuels tax associated with the $22 billion revenue target) will reduce volatile organic compounds (VOCs) that cause urban smog by roughly 20,000 tons, or 0.4% of total U.S. emissions in the year 2000.

Economy-wide Impacts

GDP Effects

- A new energy tax, like any other tax increase, if unaccompanied by accommodative monetary policy or other offsets, would reduce economic growth and aggregate employment over the short to medium term (on the order of 0.5%). Adverse GDP and employment effects could be reduced or even eliminated if accommodative monetary policy is undertaken or if the financial markets view the deficit reduction program as credible, thereby reducing interest rates and spurring growth.

- Of the taxes considered, the oil import fee is likely to have the greatest negative impact on national economic growth per unit of revenue raised. While the oil import fee will boost regional economic activity in the oil producing regions, its inflationary impacts are the largest of the taxes under consideration. As a result, monetary authorities would be more constrained in their ability to accommodate the tax package.

Industry-Specific Effects

- Energy taxes would cause specific industries to gain at the expense of others. Those most likely to gain would be non-energy intensive manufacturing concerns with a large export market. Some of these industries would be able to take advantage of the decline in the U.S. exchange rate that would follow the adoption of an energy tax by itself. These industries include: construction equipment, aircraft, industrial machinery such as metal working machinery, and copiers. Industries most negatively affected would be energy-producing and energy-intensive manufacturing industries, such as mining, electric utilities, and the chemical and pulp and paper industries.

Table C-1: Regional Impacts on Consumers of Alternative Energy Taxes

Net Revenue Target of $22 Billion in FY 1997 *

Census Region	Tax Increase Per Capita (Dollars)			Tax Increase as a Percent of Income (Percent)		
	Btu Tax	Ad Valorem At Source	Ad Valorem End Use	Btu Tax	Ad Valorem At Source	Ad Valorem End Use
New England	$96	$103	$100	0.50%	0.54%	0.52%
Middle Atlantic	92	93	94	0.50	0.50	0.51
South Atlantic	88	88	88	0.56	0.55	0.56
East North Central	90	88	89	0.56	0.55	0.56
East South Central	81	79	79	0.61	0.59	0.59
West North Central	89	87	87	0.58	0.57	0.57
West South Central	85	84	84	0.61	0.60	0.60
Mountain	84	82	83	0.58	0.57	0.57
Pacific	85	87	86	0.49	0.50	0.49

Table C-2: Relative Regional Impacts on Consumers of Alternative Energy Taxes

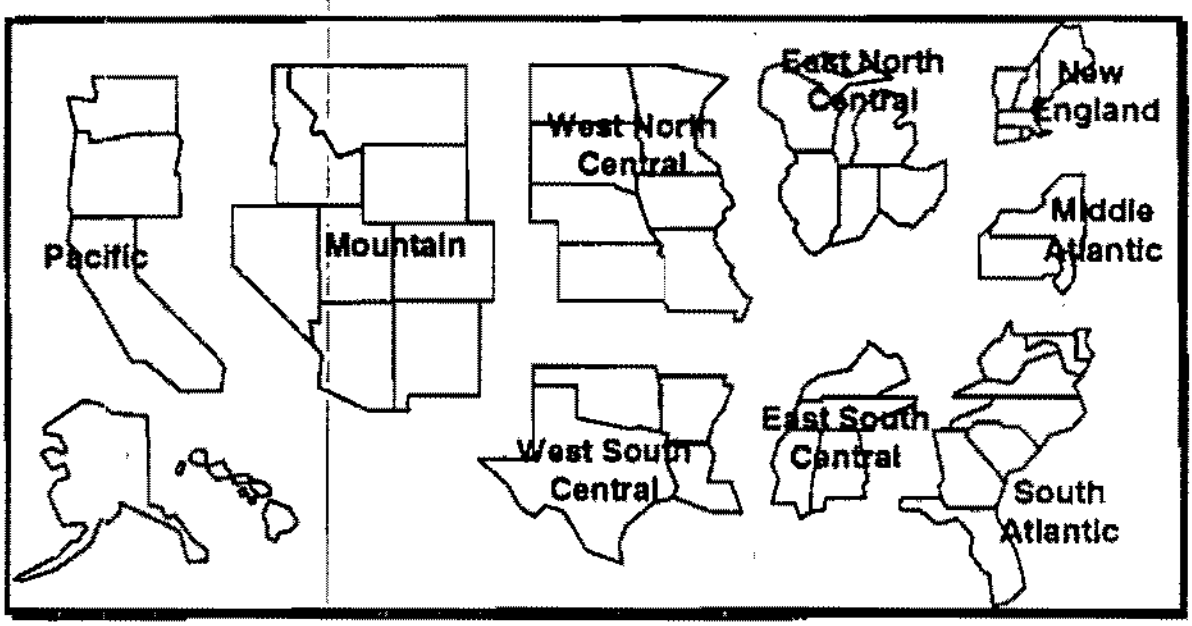
Net Revenue Target of $22 Billion in FY 1997 *

Census Region	Tax Increase Per Capita (Dollars)			Tax Increase as a Percent of Income (Percent)		
	Btu Tax	Ad Valorem At Source	Ad Valorem End Use	Btu Tax	Ad Valorem At Source	Ad Valorem End Use
New England	109	117	113	93	99	96
Middle Atlantic	104	106	107	91	93	94
South Atlantic	100	100	100	102	102	102
East North Central	102	100	101	104	102	103
East South Central	92	90	89	113	110	109
West North Central	101	99	99	108	106	106
West South Central	97	96	96	112	110	111
Mountain	95	93	94	107	105	105
Pacific	97	99	97	91	92	91

Regional Impacts on Consumers

- The above tables provide information on the regional impacts of the Btu and ad valorem energy tax alternatives, assuming a $22 billion revenue target in FY 1997. Table 1 shows by census region the dollar amount of tax that would be paid on a per capita basis. Table 1 also expresses the tax increases as a percent of disposable personal income in each region. Table 2 shows the same information as Table 1, but expressed as a percent of the national average. A map of census regions follows the tables.
- The tables indicate that the regional impacts of these three energy taxes are similar.
- Note that while the tax burden on a given region may be higher than the national average on a per capita basis, it is often lower than the national average as a percent of disposable personal income, and vice versa, for all three taxes.

Figure C-1: U.S. Census Regions and Divisions



Distributional Effects of Energy Taxes

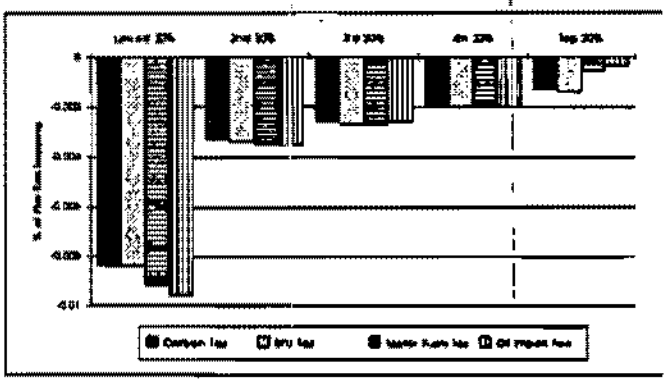


Figure D-1: Distributional Effects of Alternative Energy Taxes (average share of pre-tax income 2000-2004)

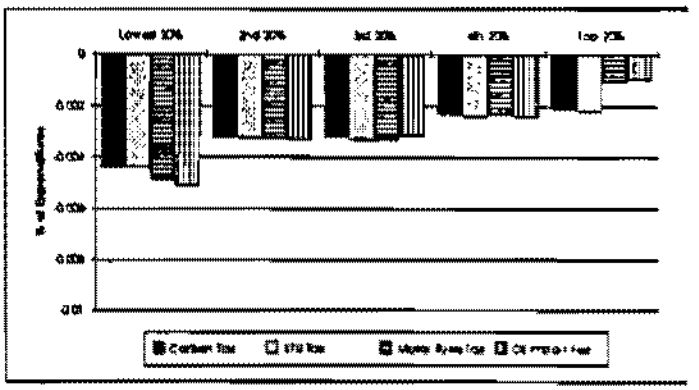


Figure D-2: Distributional Effects of Alternative Energy Taxes (average share of expenditures 2000-2004)

- Relative to annual income, the direct impact of broad-based energy taxes is regressive, although this regressivity is reduced when indirect effects — e.g., air travel price increases — are taken into account. Grouping households by annual expenditures also shows energy taxes to be much less regressive. This is a more accurate measure of well-being, especially in the lowest income quintile which exhibits the greatest regressivity effects on an income basis.
- All of the alternatives are about equal distributionally, so this feature does not provide a basis for distinguishing between taxes.
- Note that the distributions in the graphs above are *before* any possible give-back to mitigate regressivity, and do not reflect other elements of the tax package (e.g, higher rates on high-income taxpayers). Neither do they reflect any softening of the impact on low-income households through cost-of-living adjustments to transfer payments they receive.
- Distributions by annual income are the more influential politically (and were used by Democrats to criticize Bush Administration proposals).

Table E-1: Industrial Sector Fuel Prices in 2000 (percentage change from Base Case)

Net Revenue Target of $22 Billion in FY 1997 *

		Base Case 2010	Btu Tax	Ad Valorem Tax (At Source)	Ad Valorem Tax (End Use)	Carbon Tax	Motor Fuel Tax	Oil Import Fee
Oil (All)	$/gal	0.83	4.5%	11.9	4.1%	4.9%	-0.9%	19.3%
Oil (Imported)	$/mct	3.99	7.6%	11.5%	4.6%	7.3%	0.5%	-2.6%
Coal	$/ton	34.75	7.5%	12.5%	4.8%	27.2%	0%	0%
Electricity	¢/kWh	5.35	6.6%	4.3%	4.9%	6.3%	0%	1.0%

* NOTE: Effects for a $40 billion revenue target are roughly double.

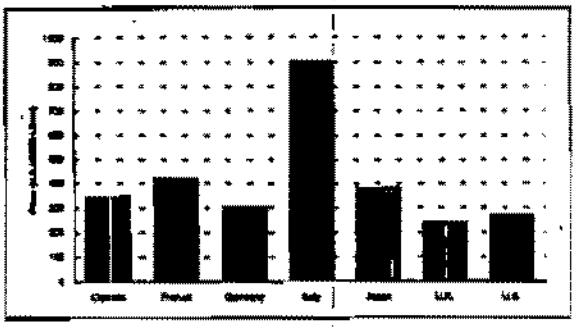
Industrial Competitiveness

- With regard to the industrial sector, the carbon and Btu taxes have similar impacts.
- The motor fuels tax has almost no affect on industrial prices.

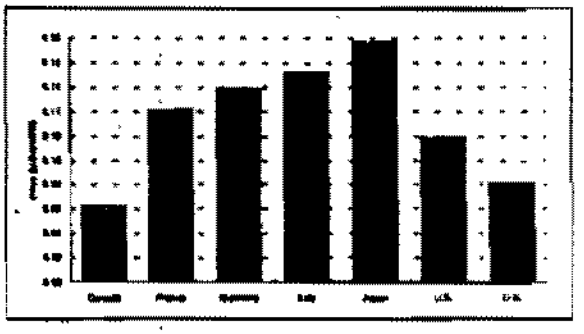
Trade and International Competitiveness Effects

- An energy tax could induce some displacement of energy-intensive industries to non-taxing countries, undercutting the revenue base and environmental benefits of the tax.
- On balance, deficit reduction financed partially through energy taxes could modestly boost U.S. international competitiveness. This is because:
  - Energy taxes would reduce slightly our dependence on imported oil (with the exception of the oil import fee which affects imports significantly), improving our trade balance
  - A credible deficit reduction package would lower interest rates, causing an outflow of capital from the U.S., lowering our exchange rates and making our exports more competitive
- Together these two factors could more than offset the loss in competitive position of U.S. energy-intensive industries, which would see a rise in their production costs *vis-a-vis* their overseas competitors.
- U.S fuel prices are generally among the lowest in the G7 (see following page). The taxes contemplated would not greatly change this situation.

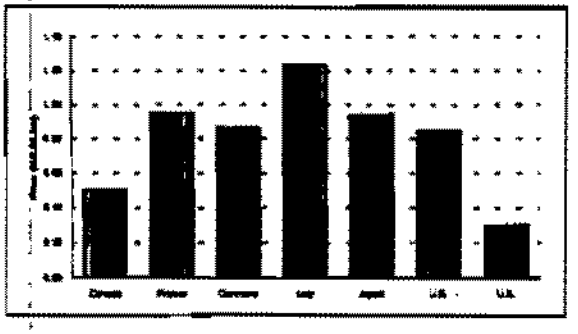
Figure E-1: Comparison of Fuel Types by G-7 Country



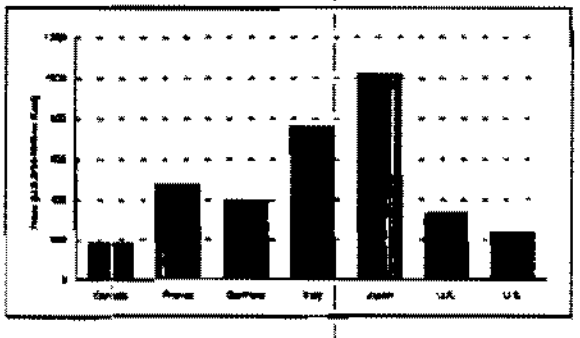
Light Fuel Oil Prices in G-7 Countries
(1991 Prices and Exchange Rates)



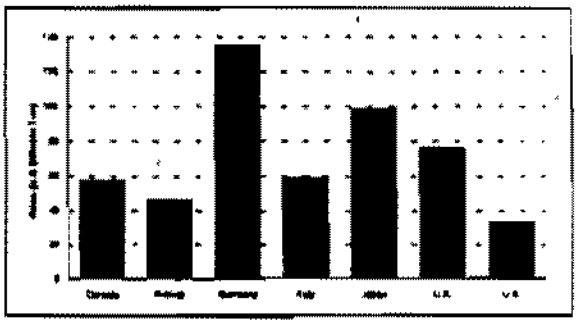
Electricity Prices in G-7 Countries
(1991 Prices and Exchange Rates)



Gasoline Prices in G-7 Countries
(1991 Prices and Exchange Rates)



Natural Gas Prices in G-7 Countries
(1991 Prices and Exchange Rates)



Coal Prices in G-7 Countries
(1991 Prices and Exchange Rates)

Import Fees/Customs Duties and International Obligations

- The tariff on crude oil can be raised (either directly or via an import fee) without violating our obligations under the General Agreement on Trade and Tariffs (GATT). However, the application of any tariff increase or import fee to imports of crude from Canada, and possibly Mexico and Venezuela, would be limited by other existing agreements (see below).

- The situation is different for petroleum products, where U.S. tariffs are bound under the GATT. Imposition of higher tariffs or import fees could make the U.S. liable to pay compensation under GATT, and subject the U.S. to retaliation.

- While the U.S. could invoke the "National Security" exception under GATT rules, the deficit reduction aim of the import fee would expose the U.S. to a challenge within GATT. A GATT panel could find the exception inapplicable and require the U.S. to pay significant compensation to the satisfaction of GATT member countries.

- Agreements with individual trading partners would impose additional constraints on the application of increased tariffs or import fees. The U.S. would likely need to:

  - Exempt Canada from the tariff, because of the U.S./Canada Free Trade Agreement (CFTA). Once the North American Free Trade Agreement (NAFTA), goes into effect, Mexico may also have to be exempted from the tariff.

  - Abrogate a U.S./Venezuela bilateral agreement that binds U.S. tariff rates on Venezuelan crude oil and petroleum products. "Most Favored Nation" obligations under GATT would not allow the U.S. to exempt Venezuela (with which the U.S. does not have a free trade agreement) from increased tariffs or import fees without extending similar benefits to all GATT members.

The European Commission's Btu/Carbon Tax Proposal

In 1991, the EC Commission suggested a Btu/carbon tax. The proposal, an element of the Commission's carbon dioxide limitation strategy, calls for a tax starting at the equivalent of $3 per barrel of oil in 1993, rising to the equivalent of $10 per barrel in 2000. Fossil fuel prices and use would be affected by both the energy and carbon components of the tax, while carbon-free energy sources, such as nuclear and hydro, would be affected only by the former. Thus, while affecting all energy, the tax offers a relative advantage to low- and no-carbon energy sources.

The formal proposal, put forward by the Commission in May 1992, provides that the application of the tax would be "conditioned on the adoption of similar measures" by other countries. The proposal also suggests that energy-intensive industries be given special treatment or exemptions from the tax to offset possible competitiveness effects. In addition, the proposal suggests that revenues be used to reduce other taxes, but leaves the decision to the individual member states since they, rather than the EC Commission, have competency in this area.

The EC Commission Btu/carbon tax must have <u>unanimous</u> approval from the EC Council of Ministers, representing the individual member state governments, before it can take effect. The Btu/carbon tax is being reviewed by three different sets of member country ministers: finance, energy, and environment. Views vary widely across both countries and ministries. To date, Council action has been in the form of a request for further analysis.

On January 28, 1993, the EC Commission issued the following statement:

The European Commission welcomes the recent declarations made in U.S. Government circles which demonstrate a willingness to seriously and efficiently tackle world energy and environment problems. The European Commission is especially pleased to see the new U.S. Administration thinking about measures regarding a possible environment and energy tax. The European Commission has already approved such measures but they are subject to a "conditionality clause."