October 6, 1997

NOT E FOR JON GRUBER

FROM: BOB RUBIN

Page 1 — Climate Change

Your work has been most useful — if nothing else, in creating some sense of realism.

Tobacco

You, Larry and I should talk about process.

Page 2 — Disaster Insurance

Correct.

Page 3

What is the likelihood that productivity is 1/2 of a percent or even a whole percent higher than the statistics show, and that the full employment rate of growth of the economy is 3 to 3-1/2, and that all this justifies the stock market to a greater extent than some might have thought.

Attachment ✓
September 17, 1997

To: The Secretary  
The Deputy Secretary

From: Jon Gruber

Re: Economic Policy Weekly Report

Work on Presidential Initiatives

Electricity Restructuring: At last week's Deputies meeting, Treasury presented the case against the proposed earmarked tax on electricity through the Public Benefits Fund. DoE did not agree, and it was decided to raise the issue to the Principals' level. We now have consensus among the economic agencies to replace this proposal with a mandated "maintenance of effort" requirement on the states, which will (a) not be a tax, and (b) will not raise unfunded mandates issues since it will not require new spending. This will be presented as an alternative to DoE's proposal. The Principals' meeting will be next week, and it will deal with this issue, as well as (a) the Renewable Portfolio Standard (a requirement that distributors buy a certain share of generation power from renewable energy sources — we support this as a low cost way to address environmental concerns with the bill, but only if the costs are limited to a reasonable level), (b) Rural price ceiling (we oppose, unless rural advocates are willing to pay for this from their other existing set of subsidies for electricity consumption), c) Tax-exempt debt (we have reached consensus with DoE on limiting the use of tax-exempt debt in a deregulated environment), and (d) Clean Air concerns (we, and DoE, are deeply opposed to EPA's proposal to tie to this bill unlimited powers for them to regulate a host of new pollutants).

Climate Change: We continue to work with the Climate Change Steering Group on policy development. We sent a memo to the President this week that illustrated the tradeoff between more and less aggressive approaches, highlighting that more aggressive approaches (1990 by 2010) result in essentially no different effect on the climate than less aggressive approaches (1990 by 2040), but that they cost at least three times as much. We also discussed strategies for bridging this gap. We are now considering policies on developing country commitments and on a technology investments strategy.

Tobacco: We worked closely with the DPC to craft the language of the President's announcement on the tobacco settlement. This announcement will reflect to a large extent our input into the process, in particular requesting significantly steeper payments from the companies. The next step appears to be to begin working with the Hill to put these concepts into legislation.
Disaster Insurance: Legislative interest in this area is increasing, and the Hill is looking to Treasury for guidance. We are working on an options paper for the Deputy Secretary that will lay out in detail the range of possible choices in this area.

Higher Education Financial Aid: As noted previously, the Department of Education has chosen to reduce the taxation of assets under their financial aid formula, which we support. We are now working through the NEC on strategies for supporting this policy, which has drawn substantial criticism from the financial aid community. We are also providing support for the Department of Education as it considers implementing new regulations on the interest rate to be paid on student loans. The Department has proposed that the interest rate paid be changed from the short rate plus 3% to the long rate plus 1%. Banks are complaining that this will substantially reduce their profit margins from student loans, and their complaints appear to be warranted, largely because the costs to banks of hedging the differential between their short-term borrowing costs and the long-term rate at which they will be repaid. We will work with the Department to consider alternatives.

Medicare Income Related Premiums: We are working with Tax Policy and the White House to develop a policy for income-relating the Part B premiums of Medicare beneficiaries. This may be part of our FY ’99 budget proposal; if not, it will definitely be an issue for the Medicare Commission.

Major Economic Indicators Released in the Past Week (Through September 16)

Strong forward momentum continues into the third quarter while prices, especially at the core level (excluding food and energy), remain very well-behaved. Final sales appear to be headed for a large gain in the current quarter but early data on inventories suggest that production will register a smaller gain.

The consumer price index increased by 0.2 percent in August and the core rate rose by 0.1 percent. Both increases were less than expected and continued the string of very moderate price growth so far this year. Over the past twelve months, the total CPI is up by 2.2 percent and the core by 2.3 percent. Producer prices increased by 0.3 percent in August, the first gain all year, while core producer prices edged up just 0.1 percent over the month.

Retail sales increased by 0.4 percent in August after registering gains of 0.9 percent in July and 0.7 percent in June. The retail sales results and other data currently available point to an increase of almost 4 percent at an annual rate in real consumer spending in the current quarter.

Confidence indicators rose in September, with the Michigan index moving close to its record high set in July.
Industrial production grew by 0.7 percent in August as a rebound in auto production following the model changeover and the end of strike activity boosted results. Other sectors within durable manufacturing also showed large increases in output. Capacity utilization rose to 83.9 percent, only 1 percentage point below the expansion high set in January 1995.

Business inventories registered a modest 0.2 percent increase in July following 0.7 percent growth in June, indicating that slower gains in inventory accumulation may hold down third-quarter growth. All of the restraint occurred in the wholesale sector, where inventories fell by 0.6 percent following an outsized surge of 2.0 percent in June. Retail stocks rose by 0.4 percent in July and factory stocks were up by 0.5 percent.

The summary of U.S. international transactions for the second quarter showed a current account deficit of $39 billion, little changed from the $40 billion deficit in the first quarter. The deficit on goods and services was lower than in the first quarter, principally due to continued strength in capital goods exports and a lower value of oil imports. This improvement just about offset increased negative net payments on investment income, reflecting large payments abroad of interest on U.S. Treasury securities.

Indicators Scheduled for Next Week (Through September 23)

Housing Starts, August (September 17)
Beige Book (September 17)
International Trade in Goods and Services, July (September 18)
Monthly Treasury Statement, August (September 22)
EP Schedule (Robert Gillingham and Jon Gruber)

Tuesday, September 16
• Child Care Quality Issues Meeting (@OEOB)
• Weekly Health Strategy Meeting with Chris Jennings (@OEOB)
• NEC Higher Education Act Need Analysis Meeting with Bob Shireman (@OEOB)

Wednesday, September 17
• Child Care School-Age Care Issues (@OEOB)

Thursday, September 18
• No external meetings scheduled

Friday, September 19
• Cost Benefit Study Meeting with EPA

The Week Ahead:

Monday, September 22
• Meeting with Rick Brown, American Petroleum Institute

Tuesday, September 23
• Weekly Health Strategy Meeting with Chris Jennings (@OEOB)

Wednesday, September 24
• No external meetings scheduled

Thursday, September 25
• No external meetings scheduled

Friday, September 26
• No external meetings scheduled