President's Trip – "Delta Queen", Camp David, Georgia and Florida 8/17/79-9/3/79 [No. 1] [2]

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THE WHITE HOUSE

WASHINGTON

29 ug 79

Gene Eidenberg

The attached was returned in the President's outbox today and is forwarded to you for appropriate handling.

Rick Hutcheson

	FOR STAFFING
	FOR INFORMATION
	FROM PRESIDENT'S OUTBOX
	LOG IN/TO PRESIDENT TODAY
	IMMEDIATE TURNAROUND
	NO DEADLINE
	LAST DAY FOR ACTION -

	ADMIN CONFID
	CONFIDENTIAL
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		VICE PRESIDENT
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		CALIFANO
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		KREPS
		MARSHALL
		SCHLESINGER
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		FALLOWS
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		GAMMILL
		HARDEN
		HUTCHESON
		JAGODA
		LINDER
		MITCHELL
		MOE
		PETERSON
		PETTIGREW
		PRESS
		RAFSHOON
		SCHNEIDERS
		VOORDE
		WARREN
		WISE

done

THE WHITE HOUSE

WASHINGTON

August 24, 1979

MEMORANDUM FOR THE PRESIDENT

FROM: GENE EIDENBERG Gene

SUBJECT: Proposed Phone Call to Governor Jim Hunt (North Carolina)

Jim Hunt called to ask that he have the opportunity to speak briefly to you on the phone. He wants to urge your serious consideration of North Carolina Judge Heman Clark to be Federal District Judge for the Eastern District of North Carolina.

Jim has been asked to speak with you by former governor Terry Sanford. The opportunity to speak with you on this matter is of great personal consequence to Jim. He wants to be able to say to Governor Sanford and other important leaders in North Carolina that he has spoken personally to you.

I have talked with Jack Watson, who is out of town, and he joins me in recommending that you make this call to Jim Hunt. Jim Hunt has been such a good and loyal friend that this personal request should be honored. Obviously, Jim does not expect you to do anything but listen to his representation.

If you decide to call Jim, you should know the following about the potential Clark appointment:

-- Judge Clark is 63 years old and will turn 64 in September;

-- Jack has talked with Bob Lipshutz about Heman Clark, and Clark is under serious consideration;

-- It has been agreed that the decision regarding the appointment will be made before the age factor determines the outcome.

Jim can be reached this evening at 704/252-2711.

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PRECEDENCE

Unclas
CLASSIFICATION

FROM: Rick Hutcheson

TO: Phil Wise for the President

INFO:

RELEASED BY: [signature]

FOR COMMCENTER USE ONLY

DEX

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PAGES 1

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DTG: 242214Z Aug 79

TOR: 242220Z

SPECIAL INSTRUCTIONS:

Pls call upon receipt

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WHITE HOUSE
SITUATION ROOM

THE WHITE HOUSE

WASHINGTON

August 24, 1979

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THE WHITE HOUSE
WASHINGTON

29 Aug 79

Sarah Weddington

The attached was returned in the President's outbox today and is forwarded to you for appropriate handling

Rick Hutcheson

ACTION

X

3574

done
J

MEMORANDUM

THE WHITE HOUSE

WASHINGTON

August 25, 1979

MEMORANDUM FOR: THE PRESIDENT

FROM: SARAH WEDDINGTON SW

SUBJECT: Proposed Call from Bob Armstrong, Land Commissioner of Texas

I. PROPOSED CALL

I recommend that you receive a call from Land Commissioner Bob Armstrong tomorrow regarding the impact of the oil spill on Texas beaches. If someone lets him know of your availability, he will call. The White House operator knows where to locate him.

II. TALKING POINTS

Two items for discussion would be:

A) Your personal sense of the tragedy of the impact of the oil spill on the Texas beaches

B) Information about all that the federal government is now doing, including;

Cleanup operations by the Coast Guard continues, particularly in the Port Isobel area. The cleanup crews are using hand tools rather than machines to avoid causing unnecessary damage to the fragile beachfront. Coast Guard costs to date are estimated at about $2 million.

EPA and NOAA continue to study and monitor the situation and have proposed a damage assessment study which will relate the physical, environmental and economic impact of the incident.

The National Marine Fisheries Service is working with the State, the Coast Guard and the University of Texas to determine what toxicity is retained by the oil after it has weathered at sea and traveled several hundred miles. Up to this time, there has been no apparent damage to the fishing industry, charter boats are still operating.

EDA is prepared to evaluate and respond to the undetermined but potential damage suffered by the tourist and resort industry.

Mexico and the U.S. are coordinating efforts to minimize the damage. The U.S. has provided aerial surveillance and Mexico has authorized U.S. planes to use Mexican airports. The U.S. National Response Team sent scientific observers to Mexico with expertise in the area of ecology. Mexico is paying the U.S. for two American skimmers that are now operating at the well site gathering approximately 5,000 barrels of emulsified oil each day that is then pumped into Mexican ships.

III. BACKGROUND

Texans are particularly proud of their beaches and the current oil spill situation is the key focus of news and discussion in Texas.

Governor Clements has toured the area by helicopter. He first said it was "much to do about nothing" but now is taking it more seriously. He owns SEDCO, the company that built the oil rig responsible for the spill, a rig leased to Mexico. The legislature is holding special hearings about it.

There has been no public awareness of federal concern and federal action. Doug Costle, Administor of EPA, was in the area Thursday but I have been unable to find anyone who saw any publicity about it.

Bob Krueger has been working with the Mexican Government to clean up the oil spill. An official request was made on Wednesday to Mexico to help pay for the cleanup operation. Yesterday, Mexico refused this request.

IV. OTHER INFORMATION

NBC is planning to do a piece on the oil spill on its Sunday night television show "Prime Time." They have not decided whom to interview yet, but have contacted Clements, White, and Armstrong about the possibility of doing a live remote interview on Sunday night.

Governor Clements, Republican, is vacationing in Mexico and is due back tomorrow.

Lt. Gov. Hobby, top-ranking Democrat, is in Wyoming at the Lt. Governors Conference.

Billy Clayton, Speaker of the House, is Acting Governor until Sunday. He is openly planning to run for Governor in 1982.

Attorney General Mark White has become very involved in this issue.

Bob Armstrong is the Land Commissioner and the State official most substantively involved. He is the longest tenured statewide Democrat and was the Texas coordinator for the Carter campaign.

Bob Strauss concurs in my choice of Armstrong as the best person to talk to.

I spoke with Bob Krueger and his feeling was that the situation merited more than a phone call.

8/21/79

C

Administrator

Dear Mr President:

This is in response to your note of August 17th, 1979, regarding the modernization of the Washington Federal Telephone System.

Our plan for the modernization of the system is more than a procurement plan as cited in the Business Week article. We plan to take control of the Government telephone services out of the hands of Chesapeake and Potomac. The plan provides for an opportunity to reduce the cost of service by as much as 5 to 10 million dollars annually. It also promotes competition between the C&P and the communications equipment suppliers to the maximum extent possible not only in the long range system planned for procurement in 1983 but also during the earlier interim phase of the plan.

It is my intent our efforts support competitive procurement wherever possible.

Very respectfully

[signature]

3345

to: Adm Freeman, GSA

JC

THE WHITE HOUSE
WASHINGTON

8/17/79

Administrator Freeman

The attached was returned in the President's outbox today and is forwarded to you for appropriate handling.

Rick Hutcheson

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However, overall inventory levels are ... ained now than they were at this point in the 1974-75 recession, and this should cushion the downturn.

"Conflict Over A GSA Phone Deal"

Despite calls for more competition in the telephone business from Congress and other government agencies, the GSA has been quietly working with Chesapeake & Potomac Telephone Co. on a $400 million plan to revamp the federal telephone system in the Washington, D.C., area. The sole-source procurement plan has been in the works but under wraps for more than three years, Business Week reports. The contract is being roundly criticized by other communications equipment suppliers who fear they will be frozen out of the government market in Washington.

THE WHITE HOUSE

WASHINGTON

29 Aug 79

Frank Moore

The attached was returned in the President's outbox today and is forwarded to you for appropriate handling.

Rick Hutcheson

3577

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		MCINTYRE
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		PETERSON
		PETTIGREW
		PRESS
		RAFSHOON
		SCHNEIDERS
		VOORDE
		WARREN
		WISE

done
J

THE WHITE HOUSE

WASHINGTON

PRESIDENTIAL TELEPHONE REQUEST

TO: Congresswoman Gladys Spellman (D-Maryland)

DATE: Monday, August 27, 1979, or early Tuesday, August 28.

BACKGROUND: Congresswoman Spellman has again been hospitalized for problems relating to her gall bladder and pancreas; this condition is painful, and she has been admitted for tests.

She has, as you know, been a valuable ally; this phone call could go a long way to cement an already good relationship.

She is expected to be in Prince George's Hospital through tomorrow.

INITIAL REQUESTER: Terry Straub Terry Straub

APPROVED BY FRANK MOORE: Bob Thomson

DATE OF SUBMISSION: August 27, 1979

If you call, you might ask her advice on the federal pay increase as well.

B

No more nor less than others 7% ok?

THE WHITE HOUSE
WASHINGTON
29 Aug 79

Alfred Kahn

The attached was returned in the President's outbox today and is forwarded to you for appropriate handling.

Rick Hutcheson

3578

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		PETTIGREW
		PRESS
		RAFSHOON
		SCHNEIDERS
		VOORDE
		WARREN
		WISE

REMARKS OF ALFRED E. KAHN

BEFORE THE

AMERICAN BAR ASSOCIATION

To Fred Kahn — This is excellent. Please distribute to Cabinet & other top officials — J.C.

DALLAS, TEXAS
August 15, 1979

THE ROLE OF REGULATORY REFORM IN AN ANTI-INFLATION PROGRAM

There are a lot of reasons why you ought to be intensely interested in the job I am trying to do.

The first is purely personal. While I have no doubt that most of you are managing to make ends meet these days -- especially if we include in the measure of your real income the privilege you have of taking tax deductible vacation trips to Texas in the middle of the summer -- I'm sure that even you suffer daily on finding that you're not quite as rich at the end of the day as you thought you were at the beginning, and wonder what is happening to the value of your savings.

Second, there is the simple fact that inflation is something bad that is happening to our country.

Third and fourth, there are professional reasons why you ought to be extremely interested in the problem of inflation and in our attempts to combat it. The first of these is broadly philosophical. The law is an important part of the fabric that holds society together. It is not the entire fabric: it's not the law alone that keeps me from walking on the grass in the median on Pennsylvania Avenue that lies between my house and the Metro, or that keeps me from throwing pieces of paper out of my car on the highway. But I see inflation as a symptom of our society's failure adequately to hold the pursuit of individual and group interest in check, and this in turn raises profound questions about the proper roles of voluntarism and persuasion, on the one hand, and legal compulsion on the other in any attempt to strengthen those restraints.

Somewhat more narrowly -- and this is my fourth reason -- a very important part of the social compact we have undertaken to combat inflation is a resolution on the part of the Federal Government to reexamine and reform the intricate network of regulations with which it enmeshes the private economy; and this so-called regulatory reform effort is one that intimately involves the livelihood -- frankly, I hope it actually threatens the livelihood -- of thousands of lawyers whose claim to a share of our national income is their skill in helping clients through some portion of that regulatory mesh: that last was a deliberate mispronounciation. I hope you will not misinterpret these particular efforts of mine as being directed against you in any personal way: some of my best friends are lawyers. And you can in any event afford to be indulgent: while I have some successes, I do not any more than King Canute expect to push back all the way the regulatory ocean in which you fish with such profit.

These last observations may be somewhat mystifying to those of you who were brought up to believe that inflation is an essentially technical problem that can readily be corrected by, for example, simply restraining the growth in the month supply, or the federal budget deficit. I do not deny that surges in government spending unmatched by increases in tax rates and rapid increases in the money supply have played a major role historically -- including some very recent history -- in fueling inflation; or that, with sufficient resolution in restricting both of these sources of total spending, we could bring it under control. But our failure to do so merely restates the question: why do some countries do less well than others; why does our country do less well today than a decade or two ago in restraining aggregate spending sufficiently to hold inflation in check?

I have no simple answers to those questions. I suggest, however, that one important way of understanding this apparently endemic problem is as the outcome of a struggle over the distribution of the national income pie. Inflation is a situation in which the sum total of those real income claims that we make adds up to more than the economy is capable of satisfying in real terms. We make these claims not just by spending our incomes for goods and services, but also by borrowing to spend beyond our income -- are you aware, for example, that in 1978 consumer debt increased $50.6 billion, all mortgage debt by an additional $49 billion -- by the wages we demand, the profit margins we set, the demands we make for cheaper credit, and the demands we place on government for tax deductions, preferences, subsidies, and expenditure programs. So society passes out all those dollars we insist on having in these various ways, and then cleverly arranges to have the real value of each of them diminished sufficiently so that in the end, miraculously, all of us together get in real terms exactly what our society as a whole is capable of providing us, and no more -- except for a great deal of frustration and anger; that comes at no extra charge.

This conception of the inflation problem is what leads me to see it as a question of the adequacy of the rules by which our society sets limits to individual self-seeking. That is why I'm convinced the President is right when he sees our willingness individually and collectively to restrain our demands sufficiently to control inflation as a real test of American society.

The task of exercising and eliciting restraint has many facets, and together these make up the President's anti-inflation programs; they would be the main components of any conceivable program for a society like ours.

First, and most prominently, the government itself must lead the way by practicing monetary and fiscal restraint. Aggregate demand must be held in check; we must keep a margin of slack in the economy, in order to allow competitive pressures to help hold down prices and wages.

Second, we have to have standards of responsible wage setting and pricing. I do not want to engage you in semantic discussions about whether a program that is backed up by the threats of public disclosure and of withdrawing government contracts can be properly characterized as wholly "voluntary." There certainly <u>is</u> a very substantial admixture of voluntarism in our present program. If you don't believe this, go talk to the United Rubber Workers and Machinists.

On the other hand, I must point out that our standards have been remarkably effective. I suspect you would be surprised to learn, for example, that average hourly earnings have increased at an annual rate of 7.9 percent during these last nine months, as compared with 8.2 percent in 1978. And that, during the last six months, when the Consumer Price Index has gone up at an average rate in excess of 13 percent, if we take out energy, food, and the cost of home purchases -- all of which have soared, but none of which it makes any sense to try to subject to the price standards -- the rest of the CPI, reflecting more closely our underlying, basic rate of inflation, went up only 7 percent -- nothing to write home about, but, in my judgment, a tribute to the comparative success of the standards -- so far.

But the particular program of restraint on which I want to concentrate today is the President's promise to subject to intense scrutiny all government regulations that protect and promote special interests, that restrict competition, that interfere with the efficient functioning of markets, and that impose excessive costs on the economy -- his promise, in short, of regulatory reform.

Regulatory reform means many things to many people. Substantively, it seems to me essential at the outset to distinguish regulations that protect particular economic interests against competition, by limiting price-cutting, market entry, or the free flow of goods and services, from the ones that have as their purpose such broader social goals as protection of the environment, health, or safety.

<u>Competition and economic regulation</u>

I think there are two basic truths about the relationship of competition to regulation. The first is that they are fundamentally incompatible, and one has to make a choice between them. The second is that they must inevitably coexist, and the quest must therefore be for the ideal mixture.

As for the first of these propositions, I think it unquestionable that there is a basic difference between the regulatory mentality and the philosophical approach of relying on the competitive market to restrain people. The regulator has a very high propensity to meddle; the advocate of competition, to keep his hands off. The regulator prefers order; competition is disorderly. The regulator prefers predictability and reliability; competition has the virtue as well as the defect that its results are unpredictable. Indeed, it is precisely because of the inability of any individual, cartel or government agency to predict tomorrow's technology or market opportunities that we have a general preference for leaving the outcome to the decentralized market process, in which the probing of these opportunities is left to diffused private profit-seeking.

The regulator prefers instead to rely on selected chosen instruments, whom he offers protection from competition in exchange for the obligation to serve, as well as, often, transferring income from one group of customers to another -- that is, using the sheltered, monopoly profits from the lucrative part of the business to subsidize the provision of service to other, worthy groups of customers. No matter that the social obligations are often ill-defined, and sometimes not defined or enforced at all; the protectionist bias of regulation is unmistakable.

I wish, for example, you could look at the compendium of operating rights of each airline under the Federal Aviation Act, the huge book that describes what each may and may not do, and the sum total of the regulations to which they are all subject. Every one of these maniacally complicated sets of restrictions -- on where each carrier may fly and where it may not, by what routes, with what stopovers, what prices it may charge to which categories of customers, under what particular sadistic set of restrictions related to advance purchase, minimum length of stay, previous condition of servitude -- is there to protect somebody from competition. Every one of them, therefore, insulates some business from the healthy pressure to be efficient, enterprising, and aggressive in serving the public.

And what do we get in exchange? The usual rationalization for the similarly pervasive restrictionism and cartelization imposed upon the motor carrier industry, for example, namely that it ensures better service to small towns, proves upon examination to be a complete myth. In point of fact, we have discovered that the Interstate Commerce Commission does not know who is actually serving small towns. We have found no evidence that it enforces any obligations of certificated carriers to serve them; that it has ever refused an application by any carrier to abandon such service; and we have found absolutely no evidence of actual internal subsidization. Indeed, a moment's thought should convince you that internal subsidization is totally implausible: there are thousands of certificated trucking companies, and absolutely no evidence we have been able to find of an attempt by the Commission to see to it that the same carriers that enjoy rights on profitable routes are also required to serve small communities. Unless the same carriers provide service on both kinds of routes -- and carriers do not pool their profits -- how can there be cross subsidization?

I have had occasion elsewhere to document the inexorable tendency of regulation to spread its net ever wider and finer, in attempting to maintain order in a dynamic industry. Regulation of the railroads seemed logically to require regulation of their new competitors, the trucks; that regulation in turn encouraged the expansion of private and exempt carriage; these exempt carriers, presented with incentives to invade the protected common carriage capacity, kept opening up loopholes -- for example by leasing their trucks to certificated carriers for the return trip, often by highly circuitous routes. In each case, until quite recently, the ICC moved to curtail the exemption, to close off these competitive efforts to circumvent its restrictions.

The unedifying recent spectacle of the Department of Energy chasing gasoline and diesel fuel shortages all across the country and trying to solve them by continually modifying its allocations -- and leaving new shortages in its wake -- similarly clearly exemplifies the regulator's propensity to respond to problems with ever more intrusive interventions rather than leave them to the market.

Similarly, the discouragement of price competition among air carriers, under the protective regulation of the Civil Aeronautics Board, led them instead to compete through denser scheduling, more sumptuous meals, the offer of in-flight entertainment, and in commissions to travel agents.* And that led the regulatory authorities in turn to sanction intergovernmental or industry efforts to impose restrictions on scheduling, prescribe the size of sandwiches, dictate charges for in-flight entertainment, and fix maximum commissions to travel agents.

In short, as I have put it elsewhere, for the complete regulator, the operating principle is: whenever the regulatory dyke springs a leak, plug it with one of your fingers; and just as a dynamic industry perpetually finds ways of opening new leaks, so the complete regulator never runs out of fingers.

The obvious solution to the fundamental incompatibility between the competitive approach and the regulatory one is a principle with which I suspect most of us would not quarrel: wherever competition is feasible, deregulate. Leave the protection of the consumer to the competitive market process, to antitrust and Federal Trade Commission Act, to direct safety regulations, where the market will not provide tolerable margins

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* Remarks of Alfred E. Kahn, before the Symposium on The Changing Environment of International Air Commerce, Georgetown University, in cooperation with the Air Transport Association of America, May 4, 1978.

of safety, and even direct subsidies to service to small communities, if that is what society decides it wants to do.

One does not accomplish changes like this in a day. But the President has moved vigorously to deliver on this part of his promise.

Last year, for example, we presided over the most complete deregulation of a major industry in recent history, as we dragged the airlines, many of them screaming and kicking, into the free market -- and right to the bank.

This year, the President has sent to Congress a bill to apply similar treatment to trucking. Meanwhile, the ICC has been moving on its own to make entry easier, to remove some of the most onerous restrictions on backhauls by private carriers; and the Senate has just confirmed the appointment of three outstanding, reform-minded new commissioners, one of them, by an interesting coincidence, the man I appointed as my chief economist at the Civil Aeronautics Board.

We have already submitted to Congress a proposed bill for rail deregulation. I had the pleasure recently of strongly supporting a petition by Trailways to the ICC for an experiment in free market entry this summer, and of seeing it approved, in modified form.

In the field of communications, the FCC has already moved to eliminate some of the most burdensome restrictions on cable TV operators -- which had the purpose, of course, of protecting over-the-air broadcasters from competition. We are actively working with Congress to explore ways of making competitive entry into the common carrier field freer, and to eliminate some of the traditional regulatory boundaries, long ago rendered obsolete by the march of technology, which the several communications carriers have been prohibited from crossing.

Finally, under this heading, I must mention the President's courageous decision to deregulate the domestic price of crude oil over the next two years. This was a cruelly difficult choice: letting the domestic price move up to the world level maintained by a powerful cartel had obviously political drawbacks, and its immediate effects are probably inflationary. But deregulation is clearly the most efficient way of meeting our energy, balance of payments, and national security problems. By far the most efficient way of taking care of the unwanted effects of deregulation on the distribution of income is not to hold price below replacement cost, thereby subsidizing all consumption (and incidentally, imports) but to impose taxes on the windfall profits and distributing some of the dollars to the needy.

<u>Choosing the least anti-competitive among the available alternatives</u>

In other situations, however, total deregulation is out of the question -- either because of political resistance, or in principle: in the presence, for example of powerful externalities, such as adverse effects on the environment, or irreversibilities, as in the case of severe threats to public health, or in situations in which consumers or workers are simply incapable of making informed judgments, as in situations involving occupational or product safety. In these cases, the simple competitive prescription is infeasible.

But in these situations as well, the necessity for making efficient choices is fully as great as where we can rely on competition to make them; and we cannot afford to give up entirely, except where it is inescapable, the powerful pressures for efficiency that competition exerts.

This means, as a general proposition, that it makes good sense to instruct regulatory agencies, wherever such an assessment is pertinent, to ask themselves -- aloud -- whether some particular statutory purpose can conceivably be served by a variety of devices, of varying degrees of anti-competitiveness, and to be forced at least to explain if they fail to choose the least anti-competitive one -- something along the lines of the Svenska doctrine in the maritime field, or Local Cartage, in air transport. The agencies regulating transportation, for example, obviously should be asking themselves whether service to small communities might better be achieved by freer entry into those markets than by imposing on unwilling carriers only partially effective to totally ineffective obligations to serve them.

In communications, similarly, we satisfied ourselves at the New York Public Service Commission that the quality of telephone service could be adequately ensured -- indeed improved -- by our adopting a policy of free competitive entry into the terminal equipment field, along with a program for certifying the compatibility of customer-owned equipment with the delicate communications network.

It is not clear whether it will be possible to permit free entry into common carrier communications as well, without having to stipulate in detail the prices the Bell System may charge for competitive services, in order to prevent subsidization of that competition at the expense of captive customers of Bell's monopoly services. One less anti-competitive way might be, instead, by requiring Bell to operate in this field through an independent subsidiary, and obliging it to make its monopoly facilities available to all competitors, including its own subsidiary, on uniform terms.

The steps we have taken in liberalizing Regulation Q -- which sets maximum interest rates that banks can pay depositors -- illustrates the same principle of adopting the lesser of the available anti-competitive alternatives. One problem presented by such a reform is the squeeze that it threatens to impose on thrift institutions, who would be forced to bid higher and higher interest rates in order to retain their deposits, while their assets are tied up in long-term mortgages bearing lower interest rates fixed in the past. The solution the Administration adopted was to achieve these necessary protections, on the one side by relaxing Regulation Q only over a period of years, and on the other side relaxing the present restrictions on the lending and investing activities of these thrift institutions.

Applying market principles to environmental and safety regulation

The other major kind of regulation -- environmental, occupational and product safety -- is very different in principle. No one in his or her right mind could argue that the competitive market takes care of protecting the environment. In the presence of such externalities, and in the absence of regulation, competition becomes rivalry in the degradation of the environment; unless the government intervenes, producers and consumers will have no incentive to hold down the costs that they can slough off to others. As a result, they will refrain from making any expenditures, no matter how small, to cut down on those costs, no matter how large. Although there are some important differences in the case of occupational and product safety, the fact remains that we as a society are unwilling to leave these to the operation of the free market.

It has become commonplace to observe that the rapid spread of these regulations in recent years has imposed heavy costs on the economy, and that this has contributed to inflation. It has also been observed that it has contributed directly to the distressing decline in the rate of productivity growth.

I am not particularly interested in joining in the popular numbers game about the aggregate costs of these regulations, because these estimates are close to meaningless. Costs can intelligently be measured only in relation to the benefits they provide; the pertinent question is, therefore: what is the value of what we get in return? And are we maximizing the value in relation to costs?

The same observation applies to the alleged contribution of these regulations to diminished productivity growth. We measure productivity by putting output in the numerator and input in the denominator. You can always get high measures of productivity if you include in the denominator only the costs that a business pays and leave out other genuine costs that supplying its products or services actually imposes on society -- the costs of industrial accidents, disease, or degradation of the environment. No wonder, then, that internalization of those costs by regulation, imposing the costs of abating them specifically on the production or consumption that causes them, has in recent years resulted in some apparent damping down in the rate of labor or capital productivity growth.

None of this is to deny that these regulations have increased the money costs of doing business, and therefore contributed to higher prices. The consumer is now being asked to pay in those prices a number of real costs that all of us previously paid for in concealed ways; but we always paid for them.

Nor is this to deny that these regulations have in a real sense contributed to inflation: we can't have cleaner air and cleaner water and safer products and reduced industrial accidents while at the same time having just as much of everything else. And if we continue to demand, all of us, just as much of all those other things while now demanding additional amounts of environmental and occupational protection, then this does produce inflation.

The benefits of environmental protection and clean-up and improved occupational and consumer product safety are real; so are the costs they impose on the economy. Because they use scarce resources -- capital, labor, raw materials -- these regulations must be subjected to economic tests -- to a weighing of the costs against the benefits -- if they are to be rational.

I think there is little room for doubt that we have not consistently applied this test in the past. Nor have we consistently attempted to devise regulations that would maximize the incentive of private parties, businessmen and consumers, to minimize these costs, or to find ways of producing the benefits in the most efficient way.

The President's program quite properly involves applying such tests.

How well have we delivered on this promise?

The most general effort is the Regulatory Reform Act of 1979, which the President proposed in March, and which would codify many of the reforms he established in Executive Order No. 12044. In addition to provisions to eliminate needless legal formalities and delay, this law would require that when agencies develop major regulations, they list alternative means of accomplishing the objectives, with the costs and benefits of each, and select the least costly way of achieving a given objective or explain their failure to do so.

One very interesting embodiment of this principle is the bubble policy that the Environmental Protection Agency has established: it is an excellent example of a way of simulating a competitive market, and in this way holding down the costs of regulation. Competition serves the cause of efficiency by distributing production among the lowest-cost suppliers; more specifically, for those of you who have a taste for the jargon, it tends to minimize cost by equalizing costs at the margin from various sources of supply. The bubble policy, which would permit plants to achieve emissions limitations on a plant-wide basis, rather than equally from each of a plant's separate sources of emissions, would do the same thing. It would enable businesses to control emissions stringently where the marginal costs of doing so are low, and less stringently where they are high, and would permit them in this way to achieve the same results with very, very large possible cost-savings.

Observe, also, how well the bubble policy exemplifies another central aspect of regulatory reform: abandoning, to the greatest extent possible, detailed specifications by the regulatory agency of the precise methods of meeting a particular goal, in favor of establishing performance standards, and leaving it to the regulated industries to find the least costly ways of achieving them.

An even clearer emulation of the competitive market is EPA's policy of permitting proposed new sources of emissions to be sited in "non-attainment regions" provided they obtain offsetting reductions in the emissions from existing sources. It is also proposing the use of marketable permits for siting facilities in "attainment" areas. What this means, in effect, is that the permission to impose on society the costs of pollution would be distributed competitively, rather than rationed on the basis of who came first: it would therefore tend to maximize the social benefits achieved while holding pollution levels within specified limits.

Indeed, the most heartening recognition of the applicability of competitive principles to regulatory situations is the apparently almost universal acceptance of the notion, now, that if we ever were to institute gasoline rationing, it would be highly desirable to make the coupons freely transferable. In this way, we could achieve whatever equity goal motivated the institution of rationing in the first place: total demand would be restricted, the price of gasoline bought with coupons would therefore assure access to the lower-cost gasoline in whatever way accorded with our conception of social equity; but buyers could get all the incremental supplies they were willing to take at a free market price; and coupon holders would be rewarded for such conservation as they practiced by being able to sell their coupons at that price.

It would make this account of mine excessively long if I were to attempt to describe in any detail the many other instances in which, where it seems impossible actually to introduce something approximating a free market, the Administration has attempted at least to accomplish some approximation to a sensible balancing of costs and benefits in framing its regulations. The Regulatory Council -- an organization of the regulatory agencies themselves -- the Regulatory Analysis Review Group, composed of senior White House and Administration officials, and The Council on Wage and Price Stability, have been extremely active in attempting to introduce economic rationality into these decisions wherever feasible. The results of their efforts can be seen, among other places, in the elimination of a large number of nit-picking rules by the Occupational Safety and Health Administration; in our proposed legislation to prevent the otherwise automatic application of the Delaney Amendment and similarly peremptory restrictions to the use of nitrites in processed meats; in the regulations ultimately issued by the Department of Transportation for improving the access of the handicapped to rapid rail transportation; in the surface mining regulations recently issued by the Department of Interior, and in EPA's ozone regulations and its new source performance standards on sulfur oxide emissions from coal-fired electric generating plants, all issued this year.

<u>Hospital cost containment</u>

There is one area, in which, superficially, it might appear the Administration is going in the opposite direction. I refer to its proposal for hospital cost containment legislation, which would set specific limits on the permissible growth in total hospital expenditures each year. How does a deregulator like me justify this position?

The proper principle of regulation is that where the free market will work, for God's sake let it work! Where however the free market is inherently and seriously flawed, then regulation -- provided one takes into account also the imperfections of regulation -- is a legitimate choice.

The market for hospital services clearly fits this latter characterization. The reasonableness of hospital charges and services can not be left to the competitive marketplace, as it works now.

More than 90 percent of all hospital bills are paid by third parties -- insurance companies, Medicaid, Medicare. So, neither the consumer of hospital services nor the provider feels the pinch of rising costs in deciding what kind of facilities and care shall be provided. Moreover, about 60 percent of the reimbursements to hospitals from third parties is based on the principle of the more they spend, the more they get -- pure cost plus. The rest of the reimbursements are made on the basis of hospital-established prices -- the hospitals are paid what they ask.

There are, therefore, practically no incentives for any segment of this system, to try to keep costs down.

One of the problems that we often encounter when price competition is inadequately effective, as it is here, but the urge to compete among businessmen remains strong, it tends to take the form instead of cost-inflating improvements in product and service quality. The general economic principle is that if we prevent competition from driving price down to cost, then it will often operate by raising cost to price.

The airline industry was a perfect example of this, as I have already observed. The solution there was simply to open the market to price competition. Similarly, one important reason for the spiraling of hospital costs has been the tendency of localities to build more and more munificent hospitals, paid for largely by other people, equipping them with the latest, most costly equipment, and for doctors to provide even more thorough treatment, almost regardless of cost.

But the remedy that worked so well for the airlines is simply not available where hospitals are concerned. The normal competitive checks don't work, because the consumer does not pay the price. Here instead, it takes the imposition of a price ceiling to control the inflation of costs.

Now I recognize fully that the imposition of arbitrary caps is not the fundamental solution. That will have to be an attack on the basic inadequacies of the market for hospital services. But that will also take time. Indeed, I see hospital cost containment accelerating progress toward those fundamental solutions. It will put pressure on both hospitals and the states to find better ways of controlling the wastefully duplicative, subsidized construction and equipment of new hospitals, and to introduce reimbursement methods that provide doctors and hospitals with an incentive to economize.

* * * *

In concluding this <u>apologia</u> for an airline deregulator serving as the President's Advisor on Inflation, I would be less than frank if I did not confess how extraordinarily difficult it often seems to be to try to reshape government's regulatory interventions in an anti-inflationary direction. Consider for just a moment the way in which licensing of entry into almost any service or profession that you can think of restricts competition; consider the restrictive building codes and zoning ordinances that cumulate the costs of building new houses; consider the entire range of tariffs and quotas against foreign competition, and the welter of government activities supporting the prices, restricting the production, and cartelizing the marketing of agricultural commodities; consider them separately or consider any one of them individually, and you will quickly perceive why inflation is so intractable a problem.

The contribution of each one of these price-inflating policies to the overall inflationary result will always seem small, hardly worth fighting over; the people who are injured will ordinarily be widely dispersed, ill-organized and ill-informed, and the stake of each in each policy or action will be small. In contrast, the beneficiaries will typically be few and well-organized, and the stake of each will be large.

That unequal confrontation, repeated on thousands of small, not-very-public issues is the essence of the ways in which government regulatory interventions contribute to inflation. Entering into those individual confrontations, and tipping the balance on the side of the public interest, is the essential way of rooting it out.

I hardly have to point out to you that while everybody is in favor of competition in principle, the everybodies who count in each specific instance, who weigh in with the critical votes all too often save their pro-competitive devotionals for the day of rest. So -- as I learned to say as a boy -- what else is new?

What is new, I hope, is an emergent revolt among the American people against the consequences of an everybody-for-himself, special interest society; a recognition that inflation is something we are doing to ourselves--and that we don't <u>have</u> to keep doing it; that combatting inflation has something to do with proving we are a real country, with redeeming American society, with giving living recognition to the bonds that hold us together. With perserverance we can prevail.

meeting with hamilton jordan
hendly donovan and al mcdonald
8/29/79

THE WHITE HOUSE
WASHINGTON

8-29-79

Mtg c Ham, et al

Energy is negative issue
Our goals are legislative only
Goals
Planning mechanism
Task forces
Refocusing speech
Special Interest State
Inflation - food
Narrow Congress agenda
More media contacts

THE WHITE HOUSE
WASHINGTON

29 Aug 79

Chairman Campbell
Jim McIntyre

The attached was returned in the President's outbox today and is forwarded to you for appropriate handling.

Rick Hutcheson

Arnie Miller

	FOR STAFFING
	FOR INFORMATION
	FROM PRESIDENT'S OUTBOX
	LOG IN/TO PRESIDENT TODAY
	IMMEDIATE TURNAROUND
	NO DEADLINE
	LAST DAY FOR ACTION -

	ADMIN CONFID
	CONFIDENTIAL
	SECRET
	EYES ONLY

ACTION	FYI	
		VICE PRESIDENT
		EIZENSTAT
		JORDAN
		KRAFT
		LIPSHUTZ
		MOORE
		POWELL
		WATSON
		WEXLER
		BRZEZINSKI
X		MCINTYRE
		SCHULTZE
X		Scotty Campbell
	X	Arnie Miller

		ADAMS
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		CALIFANO
		HARRIS
		KREPS
		MARSHALL
		SCHLESINGER
		STRAUSS
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		ARAGON
		BOURNE
		BUTLER
		H. CARTER
		CLOUGH
		COSTANZA
		CRUIKSHANK
		FALLOWS
		FIRST LADY
		GAMMILL
		HARDEN
		HUTCHESON
		JAGODA
		LINDER
		MITCHELL
		MOE
		PETERSON
		PETTIGREW
		PRESS
		RAFSHOON
		SCHNEIDERS
		VOORDE
		WARREN
		WISE

THE WHITE HOUSE
WASHINGTON

8/29/79

Mr. President:

Harley Frankel of the Presidential Personnel Office concurs with the attached recommendations.

Rick/Bill

President's Management Improvement Council

1900 E Street, N.W.
Washington, D.C. 20415

AUG 24 1979

August 24, 1979

MEMORANDUM FOR THE PRESIDENT

C

FROM: James T. McIntyre, Jr., Co-Chairman Jim

Alan K. Campbell, Co-Chairman Scotty

SUBJECT: Proposed Members for the President's Management Improvement Council

On May 3, 1979 you announced the establishment of the President's Management Improvement Council, appointed us Co-Chairmen, and instructed us to take the necessary steps to bring the Council into being. The purpose of the Council will be to advise you and top Federal managers on specific management problems and issues affecting the Federal Government. By helping to generate a vigorous and effective agenda of management improvement activities, the Council will make an important contribution to your efforts to increase the efficiency and effectiveness of Federal programs.

Working with the White House Personnel Office, we have prepared a list (attached) of 19 candidates for Council membership which provides a diversity of outstanding management talent drawn from Federal, State, and local governments, private industry, organized labor, universities, and professional associations. We seek your approval of these candidates.

The Council's first meeting has been scheduled for Friday, September 14, 1979. We are working with your staff to make arrangements for a brief appearance by you at the meeting if your schedule permits.

With your approval we will proceed to complete the formal appointment process.

/ ✓ / Approved

/ / Disapproved

J

Attachment

PROPOSED MEMBERSHIP OF THE
PRESIDENT'S MANAGEMENT IMPROVEMENT COUNCIL

Federal Government

Hugh A. Carter, Jr.
Special Assistant to the President for Administration

Has been involved in management improvement efforts within his office and has a good overview of problems in the Federal Government which need attention.

W. Graham Claytor, Jr.
Deputy Secretary of Defense

Strong business background as President of Southern Railway, and very interested in improving the management and effectiveness of Government; provides valuable Department of Defense involvement.

Charles W. Duncan, Jr.
Secretary of Energy

Key Cabinet official, strong ties to the private sector, strong interest in improving the bureaucracy's ability to respond to client needs; brings the Department of Energy into this effort. Despite new responsibility, has indicated willingness to serve.

Elmer B. Staats
Comptroller General of the United States

A highly respected public administrator who has long been interested in finding ways to correct management deficiencies identified by the Government Accounting Office.

Dorothy L. Starbuck
Chief Benefits Director, Veterans Administration

Career employee who has received numerous citations and awards for superior performance, and is the first woman to head the Benefits Department; interested in resolving work process and backlog problems associated with various benefit payment areas of Government.

State and Local Government

Dolph Briscoe, Jr.
Former Governor of Texas (1973-1979)

Very supportive of management improvement efforts while Governor, valuable State/local government perspective, respected member of Southwest business community, served eight years in Texas Legislature (1949-57).

D. Robert Graham
Governor of Florida (took office - January, 1979)

Has initiated management improvement efforts in Florida and will be very helpful in identifying current Federal program delivery problems at the State level.

George R. Schrader
City Manager, Dallas, Texas (appointed 1979)

One of the Nation's outstanding professional city managers who brings a vital local perspective to the Council. Twenty-five years of involvement with city management; very concerned about how to streamline program delivery processes and how to promote more effective Federal, State and local relationships.

Private Industry

Joseph E. Connor
Senior Partner, Price Waterhouse and Company

Highly respected, senior member of the accounting and business communities; specifically requested membership on Council based on long-standing personal commitment to management improvement.

Dr. Dorothy E. Gregg
Corporate Vice President of Communications, Celanese Corporation

Honored as an outstanding and highly respected businesswoman who has substantial experience in the areas of human resources, public and governmental affairs, and communications with U.S. Steel and Celanese Corporations.

John A. Koskinen
President, Victor Palmieri and Company

Victor Palmieri and Company is an asset management company heavily involved with the real estate and home building industry. Mr. Koskinen brings outstanding managerial ability and a keen desire to help improve our asset management capability.

Russell E. Palmer
Managing Partner and Chief Executive Officer, Touche Ross and Co.

Significantly involved in American Institute of Certified Public Accountants, highly respected member of accounting community, and extremely active in New York civic, business and educational activities.

Marion O. Sandler
Vice Chairman, Golden West Financial Corporation

Strong background in the investment and financial management fields and very interested in helping to bring strong fiscal management techniques to governmental processes.

A. Dean Swift
President and Chief Administrative Officer, Sears, Roebuck and Co.

Joined Sears in 1940 and has worked through a variety of management positions to become the company's eleventh president since 1886. Civic leader, director of the National Alliance of Businessmen and a national business leader. Brings significant prestige, leadership, and a wealth of experience to the Council activities.

Wayne E. Thompson
Senior Vice President, Dayton Hudson Corporation
Chairman and CEO, Dayton Hudson Foundation

Twenty years experience in local government, member of President's Advisory Committee for Management Improvement (1970-73), strong interest in public administration and long standing commitment to management improvement efforts at the Federal, State and local levels.

Labor Organizations

John A. McCart
Executive Director, Public Employee Department, AFL-CIO

Has been associated with Government employee activities with the AFL-CIO for almost 30 years and is well respected by both management and employees. Has been an effective partner with the Federal Government in initiating many improvement efforts.

William H. Wynn
International President, United Foods and Commercial Workers International Union (also Vice President, AFL-CIO)

Has worked in a variety of union positions for past 32 years. Highly respected labor leader serving on variety of advisory committees for the Government, labor, civil rights, and civic organizations. Committed to improving effectiveness of employees, work environment, and responsiveness of Government.

Universities and Professional Associations

Dr. Robert P. Biller
Dean, School of Public Administration, University of Southern California

Nationally recognized in the field of Public Administration; has served on a variety of advisory committees to State and local governmental units; widely known in academic community; and very active leader of the American Society of Public Administration.

Alan L. Dean
Chairman of the Board of Trustees, National Academy of Public Administration

Distinguished public servant having served in a variety of key Government positions at HEW, OMB, and DOT. Most recently was a Vice President of the United States Railway Association. Long associated with public administration and very active at the national level.

THE WHITE HOUSE
WASHINGTON

Harley Frankel
called - they concur
w/ Scotty Campbell
memo
"Management Improv.
Council"

Flash

#0025

to Hamilton Jordan

From President Carter

First night (only) at Camp David is alright for Hedley and family.

witza

pls when copy + incoming to Susan Clough

[illegible]

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FM PRESIDENT CARTER
TO HAMILTON JORDON
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TRANSMITTED FROM DELTA QUEEN COMM CENTER
AT 3:53 PM CDT 22 AUGUST 1979

FIRST NIGHT (ONLY) AT CAMP DAVID IS ALRIGHT
FOR HEDLEY AND FAMILY.
BT
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EYES ONLY

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RECEIVED AT DELTA QUEEN COMM CENTER
AT 1:39 PM CDT 22 AUGUST 1979

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TO SUSAN CLOUGH FOR THE PRESIDENT
ZEM
UNCLAS EYES ONLY WH91694

SITTO 019

FOR IMMEDIATE DELIVERY

AUGUST 22, 1979

TO: PRESIDENT CARTER

FROM: HAMILTON JORDAN

HEDLEY DONOVAN HAS ASKED ME TO DETERMINE WHEN AND IF YOU WANT HIM AND HIS FAMILY TO VISIT WITH YOU AT CAMP DAVID. HE LEAVES TOWN TOMORROW AFTERNOON AND NEEDS TO MAKE PLANS IF HE IS TO COME BACK OVER THE WEEKEND. HIS SCHEDULE IS FLEXIBLE, BUT HE DOES NEED AN INDICATION AS TO WHEN WOULD BE MOST CONVENIENT FOR YOU.

PLEASE ADVISE.
0106
7017

NNNN

EYES ONLY

ID 793559

THE WHITE HOUSE

WASHINGTON

DATE: 27 AUG 79

FOR ACTION: ARNIE MILLER

INFO ONLY: JACK WATSON | ANNE WEXLER
FRAN VOORDE | PHIL WISE

SUBJECT: CAMPBELL MEMO RE PROPOSED MEMBERS FOR THE PRESIDENT'S MANAGEMENT IMPROVEMENT COUNCIL

+++

\+ RESPONSE DUE TO RICK HUTCHESON STAFF SECRETARY (456-7052) +

\+ BY: 1200 PM WEDNESDAY 29 AUG 79 +

+++

ACTION REQUESTED: YOUR COMMENTS

STAFF RESPONSE: ( ) I CONCUR. ( ) NO COMMENT. ( ) HOLD.

PLEASE NOTE OTHER COMMENTS BELOW:

ID 793559

THE WHITE HOUSE

WASHINGTON

29

DATE: 27 AUG 79

FOR ACTION: ARNIE MILLER

INFO ONLY: JACK WATSON ANNE WEXLER

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ACTION REQUESTED: YOUR COMMENTS

STAFF RESPONSE: ( ) I CONCUR. ( ) NO COMMENT. ( ) HOLD.

PLEASE NOTE OTHER COMMENTS BELOW:

not possible for P to take part Phil

THE WHITE HOUSE
WASHINGTON

8/29/79

rick hutcheson --

after copies are distributed, please either return original to central files, or copy thereof.

thanks--susan clough

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

August 27, 1979

C

EYES ONLY

MEMORANDUM TO THE PRESIDENT

FROM: Charlie Schultze CLS

SUBJECT: July Trade Deficit (Data to be released at 2:30 p.m.; Tuesday, August 28)

I returned to work today, and -- contrary to my usual custom -- I can start in by bringing you good news. The merchandise trade deficit fell sharply in July to $1.1 billion, from a $1.9 billion level in June and $2.5 billion in May. Exports rose by over $600 million in July while imports fell $150 million.

(billions of dollars, monthly average)

		Exports	Imports	Balance
1978		12.0	14.3	-2.4
1979	1Q	13.7	15.4	-1.7
	2Q	14.3	16.4	-2.2
	May	13.9	16.3	-2.5
	June	15.0	16.9	-1.9
	July	15.7	16.8	-1.1

The reduction in imports occurred in the face of a sharp rise of oil imports (up $550 million). Virtually every other category of imports registered a decline.

a

THE WHITE HOUSE
WASHINGTON

8/28/79

Mr. President:

A message from Bob Strauss: While I know little or nothing about the background, there seems to be some pressure building against the re-appointment of Adm. Rickover. Politically, it would be bad not to reappoint hom and positive to do so. The public and congress is behind him as well as the CNO. It would be best to focus on this and reappoint him now before any of the opposition has a chance to grow stronger or visible.

Bob Strauss

C

The State Senate

Atlanta

J. BEVERLY LANGFORD
SENATOR
51ST DISTRICT

P. O. BOX 277
CALHOUN, GEORGIA 30701

August 16, 1979

The President
The White House
Washington, D. C. 20510

Re: Mary Fitzpatrick

Dear Jimmy:

I contacted Mobley Howell, who is on the Pardons and Parole Board, about Mary's case. She was paroled in April of 1977 and normally must serve four years on parole; however, in unusual cases the Board might consider three years parole service with restoration of rights at that time.

Mobley has suggested that I flag this request for April of 1980 which I will do.

Thank you for a most interesting and enjoyable visit to Camp David.

With kindest regards, I am

Sincerely,

Beverly

James B. Langford

JBL:ds

THE WHITE HOUSE
WASHINGTON

8/29/79

rick hutcheson --

f.y.i., and then please either send original or copy thereof to central files

thanks--susan clough

Copy to Central Files.

THE WHITE HOUSE

WASHINGTON

29 Aug 79

Jody Powell
Rick Hertzberg

The attached was returned in the President's outbox today and is forwarded to you for appropriate handling.

Rick Hutcheson

cc to Central Files per Susan Clough's request.

3576

	FOR STAFFING
	FOR INFORMATION
	FROM PRESIDENT'S OUTBOX
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	IMMEDIATE TURNAROUND
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	LAST DAY FOR ACTION -

	ADMIN CONFID
	CONFIDENTIAL
	SECRET
	EYES ONLY

ACTION	FYI	
		VICE PRESIDENT
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		JORDAN
		KRAFT
		LIPSHUTZ
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		WATSON
		WEXLER
		BRZEZINSKI
		MCINTYRE
		SCHULTZE
		ADAMS
		ANDRUS
		BELL
		BERGLAND
		BLUMENTHAL
		BROWN
		CALIFANO
		HARRIS
		KREPS
		MARSHALL
		SCHLESINGER
		STRAUSS
		VANCE

ACTION	FYI	
		ARAGON
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		H. CARTER
		CLOUGH
		COSTANZA
		CRUIKSHANK
X		~~FALLOWS~~ Hertzberg
		FIRST LADY
		GAMMILL
		HARDEN
		HUTCHESON
		JAGODA
		LINDER
		MITCHELL
		MOE
		PETERSON
		PETTIGREW
		PRESS
		RAFSHOON
		SCHNEIDERS
		VOORDE
		WARREN
		WISE

CONSERVATION OF HUMAN RESOURCES
COLUMBIA UNIVERSITY
NEW YORK, N.Y. 10027

ELI GINZBERG, DIRECTOR

cc Jody
Rick
J

August 20, 1979

The President
The White House
Washington, D.C. 20500

My dear Mr. President:

Based on a conversation with a visiting MIT professor, I have the following suggestion.

In addition to the two themes in your energy speech--the nation's loss of spirit and nerve and the need to move quickly to lower our oil imports--you may want to add the following third theme:

The U. S. has made some important gains in recent years: it has reduced income poverty; it has eliminated racism from the political arena; it has absorbed many of its losses in Vietnam.

I think it would be good if you could link back to the Kennedy-Johnson era and indicate that they got the country "moving again" and that is what you are trying to do.

Americans feel better if they are "moving ahead."

In high esteem,

Sincerely,

Eli Ginzberg

THE WHITE HOUSE
WASHINGTON

29 Aug 79

Secretary Miller

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Rick Hutcheson

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		MCINTYRE
		SCHULTZE

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		MARSHALL
		SCHLESINGER
		STRAUSS
		VANCE

		ARAGON
		BOURNE
		BUTLER
		H. CARTER
		CLOUGH
		COSTANZA
		CRUIKSHANK
		FALLOWS
		FIRST LADY
		GAMMILL
		HARDEN
		HUTCHESON
		JAGODA
		LINDER
		MITCHELL
		MOE
		PETERSON
		PETTIGREW
		PRESS
		RAFSHOON
		SCHNEIDERS
		VOORDE
		WARREN
		WISE

THE SECRETARY OF THE TREASURY
WASHINGTON

INFORMATION

To B.H. Move Friday

MEMORANDUM FOR THE PRESIDENT

Subject: Subterranean Economy

During the last three years, a number of press articles have appeared, and the Rosenthal subcommittee has held hearings on aspects of, the so-called subterranean or non-reported cash economy in the United States. Estimates of its size have ranged to $225 billion or higher and with estimated losses in uncollected taxes going to $50 billion or higher annually.

Subterranean economy is a code word covering unreported types of income ranging from babysitting and barter to unreported stock dividends and capital gains, from racetrack winnings to proceeds from illegal drug traffic.

The Internal Revenue Service for some time has been developing its own estimates of the situation and recommendations for improvement.

The IRS commenced a formal study about a year and a half ago. That has now been completed and will soon be released, possibly this week. The IRS study estimates aggregate annual unreported income of individuals from legal sources in 1976 at $75 to $100 billion and uncollected taxes on that amount of from $13 to $16 billion. From illegal sources, the 1976 amounts of unreported income are estimated at $25 to $35 billion and uncollected taxes at $6 to $9 billion.

In summary, this means that if the estimates are accurate and the levels in 1979 are the same, we are not collecting about $1 in each $10 of taxes due. Tables 1 and 3 from the report (attached) contain breakdowns.

The study details various administrative steps that will be taken or are in the process of being taken, to improve the situation. It also reiterates two legislative proposals already under consideration but currently in trouble in the Congress, namely 10% withholding by employers on independent contractors, and withholding by employers on tip income. It indicates we are considering additional proposals concerning withholding or reporting. You may recall that such proposals were considered as part of your 1977 tax reform proposal but ultimately not included on the basis of unanimous advice from the Hill--in which we concurred--that they had no chance of passage. It is possible that publicity from this report could alter perceptions on the Hill and make it feasible to introduce such proposals.

You should be aware, however, that the administrative changes being made and all the proposed or possible legislative changes even if enacted, may not in themselves materially improve the situation. Real improvement will come basically from (i) significant changes in attitude by those who fail to report or underreport taxable income and/or (ii) dedication of material additional resources to the tax administration functions of the IRS. Actually, in the last two budget cycles, increases in IRS resources have been rejected by OMB and audit coverage has fallen from around 2.29% in FY 1977 (one of the highest in recent history) to a projected 2.00% in FY 1980 (about the average level over the last ten years).

You may want personally to review this situation again in the 1981 budget cycle.

I should also mention that on its own motion the Senate Appropriations Committee, possibly responding to rumors about what the IRS subterranean economy report would show, has added $30 million to the IRS FY 1980 appropriation. That is about all IRS could usefully spend to increase audit activities in FY 1980.

It is difficult to predict the impact of the report, except that it is likely to get wide attention in the media. Estimates in these ranges already have been made and published by others, but these are the first official estimates and in gross they are very large. Two hearings, one by Representative Rosenthal and one by Representative Gibbons, have already been scheduled. Attached is a suggested statement for you to make in response to inquiries. It would be misleading to suggest at this time that IRS is in a position to take any drastic measures to recapture any substantial portion of the $19 to $25 billion in revenue. Basically, this is a situation that has developed--or perhaps simply persisted--over many years, about which demagoguery is possible and the solutions to which are not appealing. No one wants to be harassed by the tax collector even though everyone wants the other fellow to pay his taxes. Also, since this is the first IRS report, we have no benchmark from which to measure whether the situation is improving or getting worse. I doubt that your personal involvement would be productive at this time.

Next week Treasury will also release a report on some unusual currency patterns that have recently appeared, involving $20, $50 and $100 bills in circulation. The major finding is that during 1978 net currency deposits in the Miami and Jacksonville areas increased by $3.2 billion. The pattern seems to be continuing. This is extraordinary by any standards, and the suspicion is that some significant portion of the increase represents the proceeds from illegal drug traffic. We have taken prompt action to disseminate to DEA, IRS and others all information available from currency transaction reports filed by the banks. There is some evidence, however, of lax reporting by the banks, and it seems clear that the required reporting forms and regulations do not deal adequately with a problem of this apparent magnitude. We are therefore proposing amendments to the regulations and have requested the bank supervisory agencies to devote additional resources to ensure that the banks file prompt and accurate forms. It is only through analysis of these forms that we and other law enforcement agencies can evaluate what these extraordinary increases mean.

Action in this area may produce some future dividends in tax collections from the illegal income described in the IRS subterranean income report, and we expect to pursue it vigorously. This report may also attract considerable press coverage and Congressional attention.

Bill

G. William Miller

Attachments

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Table 1.
Estimates of Unreported Income for 1976, by Type of Income
(In Billion Dollars)

Type of Income	Lower Estimates: Underreporting Based on: TCMP*	Lower Estimates: Underreporting Based on: Other Sources	Lower Estimates: Nonfiling	Lower Estimates: Total	Higher Estimates
Legal sector incomes:					
Self-employment[1, 2]	19.8	3.5	9.7	33.0	39.5
Wages and salaries[2]	3.5	5.0	12.8	21.3	26.8
Interest	1.4	1.9	2.2	5.5	9.4[3]
Dividends	1.4	--	0.7	2.1	4.7
Rents and royalties	2.6	--	0.6	3.2	5.9
Pensions, annuities, estates, and trusts	2.1	--	1.5	3.6	5.4
Capital gains[4]	2.9	1.0	--	3.9	5.1
Other[5]	1.7	0.6	--	2.3	2.9
Total	35.4	12.0	27.5	74.9	99.7

[1]Self-employment income covers net earnings of farm and nonfarm proprietorships and partnerships (at times referred to as unincorporated business income) as well as net earnings of self-employed individuals working outside the context of regularly established businesses in the legal sector (see Appendix G).

[2]See footnotes 16 and 21 to the text.

[3]This is the sum of Line (15), Table E-3, and $0.3 billion of informal payments mentioned in the last page of Appendix G.

[4]Excluded from the NIPA income concept which defines income as earnings arising from the current production of goods and services.

[5]Includes alimony, lotter winnings, prizes and awards and other types of income. Most of the incomes included here are excluded from NIPA since they represent transfer payments.

* Taxpayer Compliance Measurement Program.

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Table 3.
Selected Estimates of Illegal Source Unreported Income
for 1976, By Type of Income
(In Billion Dollars)

Type of Income	Amount of Unreported Income
Bookmaking	4.0 - 5.0
Numbers	2.4 - 3.0
Other gambling	1.6 - 2.0
Illegal drugs (total)	16.2 - 23.6
Cocaine	
Heroin	
Marihuana	
Other illegal drugs	
Prostitution	1.1 - 1.6
Total	25.3 - 35.2

[Suggested Presidential response to inquiries]

Secretary Miller has informed me about the IRS report on the cash economy and its contents. I have not had an opportunity to review the report itself--which I understand is long and technical--but I am disturbed that some Americans may be failing to report significant amounts of taxable income. One of the great strengths of this country has always been that Americans do pay their taxes. The report represents the first estimates the IRS has made, so there is no way to know whether the trend is up or down. But whatever it is, ~~I am clear~~ we have to do everything possible to see that the tax system works fairly and that all due taxes ~~due~~ are in fact paid. Secretary Miller is working with the IRS to be sure that if any changes are needed, they will be made. He will have my full support.