THE PRESIDENT HAS SEEN
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THE WHITE HOUSE

WASHINGTON

October 18, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: GENE SPERLING
KATHLEEN McGINTY
DANIEL TARULLO
JIM STEINBERG
TODD STERN

SUBJECT: **Climate change decision memorandum**

This memorandum follows up on our earlier climate change memoranda and meetings with you. It requests specific decisions from you on various elements of our overall climate change policy. We are not looking for final decisions on the precise details of all the elements, but rather for key decisions that could form the basis for a five-point or ten-point plan. Your responses will allow us to put together a climate change policy package that you are scheduled to announce on Wednesday, October 22, while the penultimate negotiations take place in Bonn.

The decisions identified in this memo may be some of the most important and difficult of your Presidency. There does not appear to be any way fully to reconcile four constraints we have previously identified to you -- the environmental imperative, diplomatic realities, economic costs, and political opposition from business, labor and the Hill.

We think it is imperative to think beyond next week's announcement, to the management of this issue for Kyoto and beyond. In the short-term, any decision you make will draw more censure than praise. We can modulate the criticism from different quarters by moving to different points on the policy spectrum, but there is no package that wins universal acclaim. It is important, therefore, to sketch a vision of how your policy will play out in the months and years ahead.

The package we present to you today rests on several premises. First, we understand that you wish to position the United States as a leader on this issue. We present a set of policies that show that the United States is taking this problem seriously and that you are working to build the domestic consensus necessary to address this problem. Second, we recommend that an agreement in Kyoto, while desirable, should not become the measure of success of our policy. The concessions required to reach agreement there could endanger the long-term management of this issue at home. Finally, we believe that our policy can unfold with time. We should advance a framework that is sufficiently supple to adjust to political, diplomatic, economic, and scientific developments as they occur.

I. Confirmation of your instructions on several elements

Based on your reactions to our previous memos and our meetings with you, we understand that you support the following items as components of an overall climate change policy. The purpose of this section is to confirm that our understanding is correct.

- **Tax cuts and R&D:** We held a very productive meeting on Thursday with Secretary Rubin, Director Raines, Deputy Secretary Summers, Chair Yellen, and others to discuss the budget and our climate change proposal. The focus of the meeting was how to structure a package of carbon-reducing tax incentives and other programs that would amount to perhaps $5 billion over 5 years. Given the constraints on discretionary spending, we decided to explore how to move as many of the initiatives as possible on to the tax side. Treasury is working intensively with DOE, EPA, and other agencies on this front. Some of the *preliminary* ideas include: a tax credit for the purchase of certain highly efficient equipment for buildings; a tax credit for high fuel economy vehicles; a tax credit for photovoltaic rooftop systems; a tax credit for retiring inefficient electric generating capacity; and a tax credit for industrial cogeneration. The specific proposals could be more fully developed, and final decisions about which activities to encourage through spending or which through tax incentives, as part of the budget process. The offsets for the tax cuts could take the form of reducing current tax preferences for fossil fuels; such offsets would ensure that both the tax cuts and their "pay-fors" advance the effort to reduce carbon emissions.

• Test Gore

- **Federal energy efficiency:** The federal government spends more than $7 billion per year on energy. A Federal government energy efficiency initiative is being developed by DOE staff, in conjunction with Defense and other relevant agencies. It would include expanding the use of Energy Savings Performance Contracts, reinventing federal procurement, taking a "sustainable design" approach to federal facilities, and developing more efficient military propulsion systems. The effort would also include a review of existing Executive Orders on purchases, preparation of a new Executive Order to fill any gaps, a directive to federal agencies to prepare greenhouse gas reductions plans and a requirement that all federal agencies assess the greenhouse gas impacts of major federal actions.

- **Industry out-reach:** Although we are committed to a binding, rather than voluntary target, it would still make sense to encourage businesses, on an industry by industry basis, to prepare plans in which they tell us what reductions they believe they could achieve on their own and how they could best achieve them. We would ask each relevant industry to prepare a plan over the next 6-12 months and would work cooperatively with industries where appropriate. (For example, the cement industry claims it could reduce CO2 emissions by 10 million tons/year -- over 2 percent of the total national reduction needed to reach 1990 levels by 2010 -- with a regulatory change in how the industry is permitted to mix cement. We would work with the industry to facilitate such a change, if it proved to be appropriate.)

Credit for early action: We would declare that it was crucial that there be no discrimination against firms that take early action to reduce emissions (e.g., that any baseline that might be established would be set prior to any early action -- so that they would not suffer from taking early action and then seeing the baseline moved). Furthermore, we would declare that we would strongly favor appropriately rewarding those who promptly take early action. The details of how such an early credit system would operate, however, are complex and can't be fully articulated until the details of an overall permit trading system are worked out. We should state our support for early action and indicate that early actors will be appropriately rewarded.

5-year science reviews: Under the existing climate treaty, the Intergovernmental Panel on Climate Change is charged with reviewing the state of the science every five years. Several corporate and Congressional leaders have suggested supplementing these reviews with additional studies by the National Academy of Sciences or your Committee of Advisors on Science and Technology (PCAST), on a similar 5-year cycle.

Emphasize long-term goal of stabilizing concentrations. The goal of the existing climate treaty is "to stabilize concentrations of greenhouse gases in the atmosphere at levels that avoid dangerous anthropogenic interference with the climate system." However, the Parties to the climate treaty have never defined precisely what levels are dangerous. Your advisers believe the United States should announce support for developing a specific, long-term goal. The U.S. would urge the Intergovernmental Panel on Climate Change, as well as the National Academy of Sciences, to undertake this task.

Global Environmental Facility. The United States is significantly in arrears to the Global Environmental Facility, which assists developing countries in reducing greenhouse gas emissions. (Of the $430 million pledged for FY93-FY97, we have been able to contribute roughly $185 million.) These arrears reduce our leverage with developing countries in negotiations under the climate treaty. Your advisers recommend you reemphasize your strong commitment to the Global Environment Facility and support clearing U.S. arrears at the earliest practical date. Funding for the Global Environment Facility should be pursued as a top priority.

International Financial Institutions. We would work with the international financial institutions (e.g., World Bank and IMF) to boost the importance of carbon reduction efforts in the context of both concessional and non-concessional lending decisions. The purpose would be to ensure that the activities of the international financial institutions provide the proper incentives for countries to undertake efforts to address climate change.

Bilateral Dialogues. We are pursuing bilateral dialogues with key developing countries (including China, Brazil and India) to promote clean energy. Often, interest in energy efficiency and renewable energy is greater in these settings than in the politicized, multilateral setting of the Climate Convention. Discussions focus on regulatory structures for clean energy development, technical assistance, export credit and related items. Work is underway in this area in connection with the Jiang Zemin state visit later this month. Your advisers recommend that we pursue these dialogues with increased effort in the years ahead.

Transition Assistance. While we should not dwell on transition assistance as a major focus of your plan, you should nonetheless state as one of your principles that we will work cooperatively with labor and Congress to insure that we give proper assistance to any workers who are dislocated by the changes in energy usage inherent in any climate change plan. This both makes sense and is very important to labor.

__________ Approve the above components

__________ Do not approve

__________ Discuss further

II. Overall policy approach, including targets and timetables

The most difficult decisions you must make involve targets and timetables under the climate treaty, and how explicit to make the protections against excessive economic costs as part of your announcement. You have already heard the pros and cons of different courses of action.

To put the target, timetable, and safety valve discussions in context, it may be helpful to examine the overall vision that we have for your policy package. The sections below then describe possible variations on this basic package.

The plan involves three stages. Only after we had accumulated experience during the first stage (of tax cuts, R&D, and industry out-reach) and accumulated more experience during the second stage (of a trial trading program), would we enter the period under which we would be bound by the international treaty to reaching 1990 levels. Possible budget periods are explored below.

Our approach recognizes the novelty of the task that we are undertaking, and the uncertainty surrounding its potential impact, by creating regular reviews of how effectively the economy was responding to the carbon emissions reduction effort, and how effectively other countries were responding. Such a review would include the impact of the effort on overall energy prices, an analysis of how technology was developing to meet the need for low-cost carbon reductions, an evaluation of progress toward an international permit trading regime, an assessment of the Federal government's own efforts to conserve energy, an evaluation of the efforts undertaken by other countries to meet their targets, and a recommendation on how best to proceed. The review could be conducted every four years, starting with one in 2004 and another in 2008.

In addition to these regular reviews, the basic vision involves three stages:

- Beginning as soon as possible: Tax cuts, R&D, and industry outreach. Before 2005, we would start with the policies that we have outlined above: tax cuts, R&D, federal energy efficiency, industry out-reach, and a commitment to rewarding early action.

Why wait

- 2005-2008 or 2005-2010: Trial emissions trading program. The emissions trading system would start in 2005, as a trial project that would allow us to learn how the system operates before entering the period in which our binding international obligations would hold. Gene would prefer that we include an explicit ceiling in this period, to ensure that the permit price does not rise above $25 per ton. Katie opposes naming a specific ceiling price. This issue is explored in more detail below.

- 2008-2014 or 2010-2015: Return to 1990 emissions levels. Only after we had accumulated experience during the first stage (of tax cuts, R&D, and industry out-reach) and accumulated more experience during the second stage (of a trial trading program), would we enter the period under which we would be bound by the international treaty to reaching 1990 levels. Possible budget periods are explored below. We would also commit to further reductions, to levels below 1990, after the end of the first budget period.

This structure is designed to phase-in implementation of the program, thereby minimizing costs. We thus start with two periods – amounting to a decade's worth of experience -- in which the pain is relatively low, and the economy has a chance to adapt to some of the new constraints being imposed on it. Only after reviewing our experience under these two periods would we determine precisely how we would make adjustments in the binding international period.

But it is crucial to recognize that even with this strategy, we are still very exposed to attacks about the credibility of our plan or the potential costs involved in meeting the target and timetable. The vast majority of outside, credible *economists* will predict that reaching 1990 levels by the 2010 or 2015 timeframe will involve significant economic costs – making it awkward for top Administration economists to simultaneously argue that we will meet our target and avoid significant economic costs. Other experts, such as those who look at the unused technological potential in many sectors, will be prepared to support these claims. *We* *will be forced to face very difficult questions about whether we are willing to accept the costs that most credible outside analysts believe will be necessary to reduce emissions to 1990 levels by the 2010 or 2015 timeframe. But if we try to protect ourselves against such attacks, we will expose ourselves to attacks that the target is not truly binding. Gene's view is that our best hope is to argue that future Congresses and Presidents will decide how best to proceed at the relevant point (see further discussion below).*

At the same time, we will also face strong attacks from the environmental and international community on the ground that our target and timetable are too weak. Two weeks ago, Japan proposed 0-5 percent reductions from 1990 levels by 2008-2012, and was harshly criticized. The vast majority of the environmental community expressed outrage when press reports indicated that you were not even considering reductions below 1990 levels in the 2010 timeframe.

Within this overall framework, there are several possible variations:

A. Trial emissions trading program (2005-2008 or 2005-2010)

The framework delineated above would start a domestic emissions trading system in 2005. The first few years of the system -- before any internationally binding obligation would take hold -- would involve a relatively mild constraint (i.e, only a small reduction off the business-as-usual emissions path).

The benefit of an early start is that it allows time for the system to become operational in the run-up to the internationally binding goal, and begins to deflect emissions from the business-as-usual path. The cost is that in order to affect emissions, it moves forward the time at which energy prices will rise from their business-as-usual path.

Gene would prefer to impose a ceiling price on the permit system during this trial period, to ensure that the constraint was mild. The principal benefits of this specificity are that it builds credibility and provides a way to beat back the $200 per ton (50 cents per gallon) attack. In response to such attacks, we could argue that the price increase would be limited until after the trial budget period (at least 2008) and, that after that date, we would not expect a future President or Congress to impose excessive costs on the economy. To environmental groups, we would argue that the $25 ceiling applies only to the trial trading period, before the first internationally binding period.

Katie opposes naming a ceiling price. The cost of the $25 ceiling approach is that it gives opponents a specific, Administration-approved figure to attack. Specifying the ceiling price for the trial period allows opponents to attack on that basis ($25 per ton of carbon translates into approximately almost $40 billion per year), and these figures would continue to be identified with the Administration's climate change program even if there is no agreement in Kyoto. We could argue that the figures would explicitly be a *ceiling* and that the prices could be lower. A specific price would also be opposed by some in the moderate business community at least in part because they think such a price would interfere with their ability to do lucrative joint implementation projects in developing countries. Some in the business community are already arguing that any price of this kind would, whether correctly or not, be perceived as a *floor.*

During the last several days, opposition to a trial program has begun to emerge from utilities and others. We are consulting and will pass along further information as soon as we receive it.

__________ Approve starting the permit system in 2005

    ______________ With $25 ceiling on permit price

    ______________ Without specific ceiling on permit price

__________ Do not approve

__________ Discuss further

B. Targets and timetables under the climate treaty

It is vital to keep in mind that we should discuss targets and timetables as <u>only one part</u> of a three-piece international agreement that must also include provisions for international emissions trading and joint implementation, as well as clear obligations for developing countries. Arguing for this three-part framework allows you to take the high ground by calling for a truly global approach to the problem.

The integrity of this framework is also critical to the economic and political defense of our position. For one, the flexibility for low-cost reductions that trading and JI afford is key to our ability to defend as achievable any target that seeks to reduce emissions to 1990 levels in the 2010 timeframe. As for developing countries, insisting on their meaningful participation deflects the criticism that U.S. competitiveness is at risk and also makes the strong environmental point that the problem cannot be solved without all major greenhouse gas emitters doing their fair share.

The targets and timetables will inevitably remain the focus of enormous attention at home and abroad. Constituencies and other countries will pay more attention to this piece of our policy package than to any other. Based on our meeting with you, we understand that you would like to support a position within the current international mainstream, that you are inclined toward a first target of 1990 levels by roughly 2010 or 2015, and that you would support additional reductions in roughly the 2020 or 2025 timeframe. Based on this understanding, we suggest two possible approaches. (There are, of course, many variations that would accomplish similar goals.) Both approaches reflect the U.S. position in support of multi-year targets, intended to smooth out annual variations in emissions caused by weather, business cycle, and other factors.

- 1990 levels by 2008-2014; reductions below 1990 levels in the next budget period

- 1990 levels by 2010-2015; reductions below 1990 levels in the next budget period

The basic dynamic is that an earlier timetable would please the environmental and international communities more, while a more gradual timetable would be less opposed by business and labor. Neither of these approaches is likely to win actual praise from the environmental groups or your negotiating partners.

Internationally, the EU and much of the rest of the world will criticize either of these options, since neither calls for reductions below 1990 in the first budget period. (The Japanese were criticized for their plan by much of the international community; we could expect even stronger criticism.) 2008-2014 would be received better than 2010-2015. Similarly, environmentalists will be very disappointed by the absence of reductions below 1990 in the first budget. The commitment to reductions below 1990 levels during the second budget period could help somewhat.

Most business and labor will not be happy with either of these options. The hard-core business opposition will attack either of them with great vigor, but more moderate companies and utilities, of the kind you hosted in the Cabinet Room in August, would feel much better about a more gradual approach (e.g., 2010-2020), but could probably live with 2010-2015 -- *if* we made clear that we were insisting on a full international package as part of the deal: joint implementation, international trading and developing country participation. The AFL-CIO has argued for a 2020 timetable.

Some of your advisers -- including Gene, Dan, and Todd -- would prefer to see a target and timetable more in the 2015 or 2020 range, and the economic agencies would prefer something beyond that. Others -- including Katie, Jim Steinberg, Jack Gibbons and Madeleine Albright -- are inclined toward an earlier target, closer to the 2010 timeframe. It is our understanding that you would prefer something closer to 2010. We have therefore presented two options in that range. Not surprisingly, those who favor something in the 2015-2020 range or beyond would prefer the option below that is less stringent.

Over the weekend, Katie has been engaged in intensive efforts to shape a coalition of business and environmental concerns that might stand up to support your policy next week. Key players are BP, several utilities, and the Environmental Defense Fund. The key components of a policy that might win support from these groups and companies appears to be: (1) 1990 levels by 2008-2014; 1990 levels minus 5 percent by 2015-2021; (2) strong commitment to credits for early action (i.e., before 2008); (3) strong support for existing elements of the U.S. position (flexibility in meeting targets and participation of developing countries), (4) no "safety valve" or "escape clause", and (5) no trial permit period as above. At this writing, the results are uncertain. We will keep you closely apprised.

Gene notes that while initial validation is important, we must carefully weigh any possible benefits from policy changes intended to capture initial validation against possible cons from those changes if they might expose us to attacks in a larger political arena.

__________ 1990 levels by 2008-2014; reductions below 1990 levels in the next budget period

__________ 1990 levels by 2010-2015; reductions below 1990 levels in the next budget period

__________ Discuss further

C. Protecting against excessive costs during the international target period

At a minimum, we would announce a general principle that it would be unreasonable to expect you or any future President to impose excessive costs on the economy in implementing this program. The question is whether we go beyond a statement of principle, by announcing some mechanism for protecting the economy against significant damage. *The fundamental tension involved is how to balance the need for protection against charges of high economic costs against the "binding" nature of the international target.* The statement of principle provides the least protection against charges of high economic costs, and the most protection against charges that the target is not binding. In addition to that approach, there are three different visions that build upon a simple statement of principle to provide somewhat more protection against the economic damages argument; the visions vary in trading off protection against charges of substantial costs versus protection against charges that the obligation is not truly binding. You should also keep in mind how any of these approaches influence the effectiveness of your economic team in advocating our policy package.

- Announcing support for a ceiling price in the internationally binding period (e.g., 2008-2014 or 2010-2015). The ceiling price could be defined now or decided in the future following consultation with Congress and other interested parties.

- Announce support for a discretionary safety valve, which would be invoked if costs are judged to be excessive or other countries were not meeting their obligations. This discretionary safety valve would not explicitly specify the criteria (e.g., permit price, GDP growth, unemployment, international trade in permits, other countries' performance, etc.) that would be used in evaluating the costs of the program.

- Announce support for having the Congress and the President review the program immediately before the binding international period, and decide how to proceed at that point. This approach reflects the reality that future Congresses will always have the option to protect the economy or undertake more environmental action -- and thus recognizes that decisions about whether the United States was willing to bear the costs that could be necessary to meet the target and timetable goal will have to be made at that time.

Approach 1: Ceiling price in internationally binding period

The first approach would involve a statement to the effect that even during the internationally binding period (2008-2014, or 2010-2015), the government would stand ready to sell additional permits at some price, which could be specified now or set after appropriate consultation with Congress and other interested parties. Such a ceiling price would provide the most protection against charges that the costs involved would be excessive, but it would also provide the most ammunition for those who want to charge that the target is not truly binding.

This idea has emerged in the public dialogue on this issue very recently. Last week, due in part to a general discussion of this issue at the White House conference, there was a flood of constituency interest. Environmental groups wrote criticizing the idea in very strong terms. Several corporate leaders (including Tom Casten of Trigen, BP, and several leading utilities) voiced *opposition*. On the other hand, Gene and others believe that it is reasonable to surmise that as many business groups evaluate a specific safety valve proposal, they will be supportive to the extent that such a proposal caps overall costs.

Approach 2: Discretionary approach which would be invoked if costs are judged to be excessive or other countries are not performing

This discretionary safety valve would not explicitly specify the criteria (e.g., permit price, GDP growth, unemployment, international trade in permits, etc.) that would be used in evaluating the costs of the program. Instead, we would announce now that protective steps would be taken under either of two conditions:

- First, if the effort were imposing substantial economic damage on the country.
- Second, if some percentage of other countries were not meeting their obligations.

The principal benefit of this approach is that it would allow us to fend off the high cost estimates of our opponents, without creating a specific Administration figure to attack. In a related vein, this approach frustrates efforts to plug official Administration figures into conventional economic models, in an attempt to show that our policies are unlikely to achieve their objectives. It also offers the most protection against the concern that non-market mandates will be used to fill the gap between a specific ceiling price and the target and timetable.

On the other hand, it could allow all sides to assume the worst: Corporate groups would worry that the safety valve would never be triggered, and environmental groups (which strongly dislike the idea to begin with) would worry that it would be triggered too easily. We are also likely to be faced with a barrage of questions, from those armed with credible outside analysis, about how we expect to meet the target for a price that was not "excessive." We could be forced into reacting to specific model results -- and thus quickly pressed into specifying the precise conditions under which the safety valve would be used. For example, we would likely face questions such as: "Is a $100 increase in carbon prices 'excessive'?" If we responded that $100 was excessive, we could soon fall into the trap of defining the boundary of "excessive."

Approach 3: Announce support for having the Congress and the President review the program immediately before the binding international period

This approach reflects the reality that future Congresses will always have the option to protect the economy -- and thus recognizes that decisions about whether the United States was willing to bear the costs that could be necessary to meet the target and timetable goal will have to be made at that time.

The benefit of this approach is that it provides some protection against the likely attacks, but still allows us to underscore our commitment to the target. But we could be criticized for avoiding the difficult choices involved, and it could allow all sides to assume the worst: Corporate groups that we had commited to the target and timetable, and that the momentum behind the internationally binding treaty would allow environmentalists to win the debate in a decade; and environmental groups that we were not truly binding the country now.

Katie supports announcing a general principle. Larry Summers supports approach 2 and Gene and Todd support approach 3.

__________ Announce general principle

__________ Approach 1: Ceiling price in internationally binding period

__________ Approach 2: Discretionary approach which would be invoked if costs are judged to be excessive or other countries were not performing

__________ Approach 3: Announce support for having the Congress and the President review the program immediately before the binding international period

__________ Discuss further

<u>How to define the safety valve</u>

Another question that you had about the safety valve was whether it could be triggered if the economic performance suffered because of the carbon emissions reduction effort. In response to this question, NEC staff have worked with Treasury and CEA to explore different possibilities. They have concluded that it is not technically possible to construct a credible safety valve that triggers only if the carbon emissions reductions adversely affect economic growth: the baseline issues are simply too complicated. For example, suppose that such a policy reduces GDP growth by 0.25 percentage points in each year. If the economy is otherwise booming, so that growth in the absence of this policy would have been 3.5 percent, then the result of the policy will still be a 3.25 percent growth rate. Given the enormous uncertainties, even after the fact, regarding the effects of environmental regulation on the economy, CEA and Treasury believe that it would be impossible to separate out the role of climate change policies on the economy's growth rate with any degree of confidence.

Including a safety valve in the climate treaty

A final question is whether to reflect a safety valve in the climate treaty. Any attempt to do so would meet with fierce resistance and charges that the United States was backtracking from its call for "binding commitments." But if we fail to seek a safety valve under the treaty, there is a risk that our domestic mechanism would put us out of compliance with our international obligations -- thus causing business leaders to fear that we would not invoke our safety valve if necessary.

Gene, Katie, Dan, Jim, and Todd do not recommend seeking a safety valve under the treaty. The costs of doing so would be high and the need is unclear. In the event a domestic safety valve appears likely to cause the United States to exceed emissions limits under the treaty, the United States could adjust domestic programs, renegotiate the treaty or accept the treaty's non-compliance provisions (which are unlikely to be severe).

__________ Negotiate a safety valve under the climate treaty

__________ Do not negotiate a safety valve under the climate treaty

__________ Discuss further

III. Grandfathering and auctioning

Another issue related to a permit system, and one we touched upon in our meeting, is whether the permits should be auctioned or grandfathered. Your advisers suggest that we not declare at this point our position on auctioning or grandfathering. Announcing either approach could entail considerable costs, and there is little to be gained from taking a position at this time. We would state that the structure of the domestic emissions trading program is important, and that we will work with Congress and other interested parties as we developed our domestic implementing legislation.

__________ Agree: announce that we will develop approach in consultation with key constituencies.

__________ Discuss further

IV. Developing country stance

As we have noted before, your advisers favor a tougher line on developing countries than we have taken to date. In particular, your advisers favor a linkage between the United States' willingness to make commitments and the willingness of key developing countries to do the same. Under the "two-step" approach, we would make a strong statement that the United States would not assume binding obligations under the climate treaty until key developing countries assume adequate obligations in terms of their commitments. This linkage with developing country commitments might be reflected in a "Kyoto Mandate," establishing a new round of negotiations under the treaty.

The position recommended by your advisers on this issue could very well endanger an agreement being signed this December in Kyoto. Even the current U.S. position on developing countries, which seeks additional commitments but does not draw this linkage, has won little if any support abroad. State Department negotiators believe that developing countries are unlikely to agree to a "Kyoto Mandate," and that the odds of such a mandate are close to zero unless the United States accepts targets with *reductions* below 1990 levels in roughly the 2010 timeframe.

__________ Approve linkage of U.S. commitments to developing country commitments

__________ Do not approve linkage

__________ Discuss further

V. Electricity restructuring

We have held two NEC principals meetings on electricity restructuring. Our recommendation is that one of the elements of your climate change proposal should be the announcement of support for electricity restructuring, which if properly structured, could reduce carbon emissions. It is the unanimous opinion of your advisers, however, that it would not make sense to announce your entire restructuring package in the context of climate change -- because it would be drowned out by other aspects of the package, because the Hill is consumed with Fast Track, and because we have not worked out all the details of our proposal.

One remaining issue is whether you would announce some specific examples of restructuring provisions in your climate speech. There is internal consensus in support of several provisions that could help reduce emissions, such as a "renewables portfolio standard" to promote wind, solar, geothermal and biomass and "green labeling" to provide consumers with the information to evaluate the environmental consequences of various sources of electricity. The principal benefit of mentioning these specific examples is that it provides more connection to the climate change issue. However, outsiders following the electricity restructuring issue may wonder why other environmental provisions were *not* mentioned. We are working to resolve this issue.

__________ Approve statement of environmentally-friendly program for electricity restructuring

__________ Do not approve

__________ Discuss further

VI. National Security Exemption

You should be aware that the Defense Department is seeking a "national security exemption" under the climate treaty. The Pentagon puts a high priority on this issue, due to concerns that fuel reduction requirements could hamper military operations. The issue has attracted attention on the Hill.

There is consensus among your advisers that some form of "national security exemption" is warranted. However, there may be disagreement concerning the scope of the exemption. We are working to clarify issues and resolve differences, and expect to provide additional information on this issue early next week.