THE WHITE HOUSE

WASHINGTON

May 17, 1991

MEMORANDUM FOR THE PRESIDENT

FROM: DAN QUAYLE

SUBJECT: Proposals To Increase The Effectiveness And Efficiency Of Regulation By Independent Agencies.

Issue: This memorandum discusses several initiatives that the Council on Competitiveness could undertake to further important policy objectives while at the same time increasing Presidential control of the so-called independent agencies. I ask your authorization to proceed with these initiatives.

Discussion: Like you, I have read with dismay various allegations that federal regulation of business has increased during this Administration. To the extent there is any substance to these allegations, it is clear that the "independent" regulatory agencies are a significant part of the problem. Perhaps more important, these agencies control significant pieces of the economic puzzle in many industries. Accordingly, the lack of effective Presidential control over these agencies means that our attempts to implement national economic and regulatory policy have major gaps.

I believe there is much the Administration can do to assist these agencies in making their regulatory systems more efficient and less costly to American society. I also believe the Council on Competitiveness in general -- and its Working Group on Deregulation in particular -- can play a substantial role in this effort. As a first step, I am seeking your approval for several Council initiatives. Three of these deal with regulation of natural gas pipelines by the Federal Energy Regulatory Commission (FERC), and can be commenced immediately.

First, I propose that the Competitiveness Council develop a proposal for improving the methodology -- or "rate design" -- by which the FERC establishes maximum transportation rates for pipelines. The FERC generally employs a two-part rate structure in which customers pay a fixed monthly fee or "demand charge" for the right to a certain amount of capacity on the pipeline, and a "commodity charge" for each unit of gas shipped. To minimize economic distortions and maximize usage, the demand charge should in general reflect the fixed costs incurred by the pipeline, while the commodity charge should reflect only the pipeline's variable operating costs.

The FERC, however, loads a substantial percentage of the pipeline's fixed costs in the commodity charge. This discourages gas usage because it makes other fuels relatively more attractive than gas for customers with the ability to switch among fuels. Moreover, because Canadian regulatory authorities use a ratemaking methodology that includes only variable costs in the commodity charge, the FERC's present rate design also discourages consumption of domestically produced gas in favor of Canadian gas.

To assist the FERC in resolving this issue in a manner that promotes greater natural gas usage as well as fairness to American producers, I propose that the Competitiveness Council develop and propose a regulation which, when adopted by the FERC, would require the FERC to employ a rate design similar to that used in Canada in most circumstances. To develop such a proposal, I recommend the formation of an interagency task force -- under the auspices of the Council -- that would include regulatory experts from the FERC itself, as well as the Department of Energy and the White House staff. Contemporaneously with the release of this proposal, I would expect to ask you to issue a direct, personal request to the Chairman of the FERC to implement the proposal.

Second, I propose that the Competitiveness Council develop a proposal for exempting from strict rate regulation those pipelines that lack any ability to exploit their customers. Currently, the FERC closely scrutinizes and regulates virtually all of the rates charged by natural gas pipelines, regardless of competitive conditions. This is both costly and inefficient. Pipelines facing substantial competition do not have monopoly power. They therefore do not need rate regulation to ensure that they charge their customers reasonable rates.

Although the Administration has proposed legislation that would require the FERC to eliminate strict price controls for pipelines without monopoly power, the FERC already has the authority to do so under the Natural Gas Act. Eliminating strict controls on pipeline rates in such circumstances could reduce by hundreds of millions of dollars the resources expended by pipelines and shippers in resolving regulatory disputes over rates.

I therefore propose that the Competitiveness Council develop, and that the Administration present to the FERC, a proposal for eliminating strict controls on rates charged by pipelines without monopoly power. I envision a procedure similar to that outlined above with respect to the rate design proposal.

Third, I propose that the Council assist the FERC in streamlining further the process by which new pipelines become "certified" in accordance with the Natural Gas Act. Current FERC policy generally subjects would-be owners of a new pipeline to a potentially lengthy and expensive administrative proceeding before the pipeline can transport gas. Competing pipelines can often use this proceeding in an effort to delay or prevent new competition. As a consequence, the certification hurdle substantially discourages the creation of new pipelines.

Although the Administration has proposed legislation that would streamline the certification process, FERC can take a number of steps without additional statutory authority. I propose that the Competitiveness Council work closely with the FERC in developing proposals that the Administration could then forward to FERC for action.

In addition to these initiatives, the Council is currently developing proposals in a number of other areas, which I would expect to present for your approval in the near future. In consultation with the Federal Communications Commission, the Council has begun preparing a white paper on ways to streamline the regulation of the telephone, broadcast, and cable industries. When this paper is complete, I will propose specific administrative (and perhaps legislative) initiatives to improve -- and reduce the burden of -- federal regulation in this important area. Similarly, in the electric energy area, the Council has begun consultations with the FERC to devise administrative and legislative initiatives to increase the availability of electric transmission capacity. Facilitating the transmission of electricity from one region to another will increase competition, reduce the price of electricity, and thereby reduce our reliance on petroleum products.

On other fronts, I intend to ask the Council to study the current regulatory schemes for transportation and financial services to determine if similar initiatives could be beneficial in those areas. I will also ask the Council to recommend ways to make the policies of the various independent agencies regarding joint ventures and mergers consistent with Administration antitrust policy. In these as in the other areas discussed above, our mission will be to reduce the economic and administrative burdens of regulation, thereby permitting our domestic enterprises to become even more competitive in world markets.

In addition to these industry-specific initiatives, I will also ask the Council to consider various generic proposals for promoting efficient and responsive regulation by all independent agencies. One possibility is to extend the OMB review process to independent agencies. Another is to require all agencies and their staffs to record certain contacts with outsiders, including members of Congress. But because these proposals will inevitably be more controversial than the initiatives outlined above, I recommend that we defer them until we have had an opportunity to implement some of our other initiatives.

Finally, I have attached a memorandum from Boyden Gray, who will be working closely with me in this overall effort. Boyden's memorandum explains in somewhat more detail why it is now necessary and appropriate to exert greater Presidential control over independent agencies.

Recommendation: I recommend that you authorize the Competitiveness Council initiatives discussed above.

__________ Approve __________ Disapprove __________ Discuss