U.S. Department of the Treasury

PRESS RELEASES

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

ADV 9:30 A.M. EDT
Remarks as prepared for delivery
June 3, 1996

REMARKS OF TREASURY SECRETARY ROBERT E. RUBIN
ATF CEASEFIRE/BOSTON POLICE AWARDS CEREMONY
BOSTON, MASSACHUSETTS

As we've heard this morning, the ATF prides itself on its working relationship with other law enforcement agencies. We're working together on the GREAT program here in Boston, which helps youngsters stay away from gangs and guns and drugs. And our office here helped bring a conviction in the death of officer Jerry Hurley who was killed defusing a bomb a few years ago. I must tell you almost always when I'm involved in a law enforcement event, local authorities make a point of telling me about their relationship with ATF.

One of the areas where there's a great deal of cooperation is working on gun-running cases. I think probably one of the better examples is the conviction of the Georgia resident who ran 32 semiautomatic pistols into Boston in three months, with a dozen later recovered in crimes up to and including murder. And just two weeks ago there was the highly publicized seizure of Chinese-made assault weapons in California by ATF and the Customs Service.

Another area where ATF has worked very closely with local authorities has already been mentioned. That's the Ceasefire program, where the ATF and the private sector have developed an important capacity to investigate firearms crimes. We've found that the Ceasefire system can have an important impact in solving crimes, and it has a ripple effect in a region if surrounding jurisdictions ask for assistance with this ballistics technology.

The technical people can get into the fine points, but the Ceasefire computer system can do in a few hours what otherwise might be undoable or take a vast amount of valuable time. Very simply put, it can help you find the ballistic equivalent of a needle in a haystack. And if you can tie bullets or shell casings from different crimes to a particular gun, and you find someone with that weapon, that significantly increases the chances you've found a criminal responsible for several crimes. I know the system here has already linked seemingly unrelated crimes together to a single weapon.

RR-1112 (more)

This is an excellent program, and we're delighted to be working together with the Boston Police Department on it.

Having said that, I want to point out that we've been seeing some very encouraging figures lately about crime -- not just here in Boston but across the country. There are a great many reasons that these numbers are coming down. First and foremost is the very good job being done by local law enforcement. But I think without question measures taken by this administration are helping provide a secure environment for raising families in America.

Since 1993 we've seen the Brady Law enacted to require a waiting period for handgun purchases. The assault weapons ban also has been enacted. And as you know, ATF has the responsibility for implementing both these laws. There is also the very tough crime bill that put additional police officers on the streets to help implement community policing. We also have the anti-terrorist bill that was just enacted. And finally, the Justice Department and the Treasury Department have implemented a policy change with respect to using the proceeds of asset and property seizures to enable local law enforcement authorities to pay for more cops on the beat.

To wind up, I'm delighted to have this opportunity to talk about Ceasefire, which is making a real contribution to fighting crime.

Thank you.

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DEPARTMENT OF THE TREASURY

TREASURY NEWS

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ADV 12:15 P.M. EDT
REMARKS AS PREPARED FOR DELIVERY
JUNE 3, 1996

REMARKS OF TREASURY SECRETARY ROBERT E. RUBIN
BOSTON COLLEGE INTERNATIONAL ECONOMIC FORUM
BOSTON, MASSACHUSETTS

You're focussing on international economic issues, and in many respects the developments in that arena are becoming among the most important factors in economic life in the United States.

I want to talk today about American leadership with respect to the global economy, and in particular, the role you can play in that leadership.

We have a very difficult situation with respect to American leadership in the international economic arena. On the one hand, America's economic self-interest and our national security interests absolutely require us to be actively and energetically engaged internationally.

In fact, one of the things that has so struck me in the course of my three and one-half years in the administration is how in so many economic and national security issues, the only country in the world able to provide leadership is the United States, and if we don't act nothing will happen. On the other hand, very large numbers of Americans have experienced wage stagnation over the past 15 years, very large numbers feel greater job insecurity, and too often they blame the global economy and view the global economy not as a source of opportunity but a threat. You and I know that is absolutely the wrong perception.

I'm not going to deal in my remarks with domestic economic policy. But clearly part of the solution to negativism is to have economic conditions that restore the belief on the part of the vast preponderance of the American people that the economy will work for them, and that forward-looking international economic policies -- like trade and open markets -- will also work for them.

RR-1113 (more)
http:\\www.ustreas.gov

I believe that achieving such conditions requires fiscal discipline, and within that context, heavy emphasis on education, training and technology, and then independently of the budget, pension and health care portability, and other reforms.

So one part of reversing the negative attitude about the global economy is a policy challenge. But there's also the challenge of explaining the importance of leadership and engagement in the global economy to Americans at a time when there are so many powerful voices of protectionism and economic isolationism.

Developing the constituency for American leadership and engagement is enormously in the interests of all Americans. You all know as well as anyone that we are now in a global economy and there can be no turning back. The Luddites couldn't stop the industrial age any more than isolationists will prevent increasing globalization. But the isolationists can make it extremely difficult to win the kind of public support and congressional support that forward-looking policies require. I can tell you having spent a great deal of time on the Hill, on broad array of economic issues, that they not only can but they are. NAFTA, GATT and the Mexico support packages are sound agreements and policies for this country. But most observers would tell you that today you couldn't get NAFTA through Congress. They'd tell you you couldn't get GATT through Congress. They'd tell you that the Mexico support program would likely be overridden in Congress today.

Let me just stop for a moment and say there is no question about the President's commitment to engagement and leadership in the international economy. He has taken action after action, very often against the current political winds. One clear example is NAFTA. Let me tell you a story that makes the same point in the context of another issue. I went into the Oval Office one Monday night in January of last year and told the President, "Mr. President, we believe that within two or three days, Mexico is likely to default, and that has enormous consequences for the United States, but the polls are running 80 percent against assisting Mexico." And his response was that we had to act because it's the right thing to do.

Having said that, I can remember someone asking me what surprised me about serving in government. My answer was the difficulty getting a message across, even when you have access to the press the way one does at the top levels of government. I can tell you that the President has used the bully pulpit powerfully, and that is absolutely critical, but we need to have more.

Those who understand our nation's self-interest is at stake in fully engaging in the international economy and in exerting the leadership of the United States in the international economy must join together in creating the support amongst the public and Congress for the kinds of forward-looking international economic policies that are required for America to succeed in the global economy of the 21st Century.

I'd like to focus now on three specific areas of our international approach. First, trade. Second, the important role that promoting development in the developing and transitional economies can play in our future. And finally, I want to discuss how the administration is actively working to strengthen the international financial system.

On trade, the President has been for free markets, reducing trade barriers, and opening markets abroad -- as evidenced by NAFTA, GATT, and the financial services agreement with Japan. His record is clear and substantial.

Going forward, we have a powerful trade agenda. We're looking at developing free trade throughout this hemisphere by 2005, and that's something I spoke with my counterparts about at a hemispheric meeting of finance ministers two weeks ago in New Orleans. We're also looking at developing a free trade regime throughout Asia and the Pacific region by 2020. While obviously we need to maintain strong trade relations with Europe, we must fully energize our public and private sector focus on the rising importance of Asia. Our exports to the region are up 65 percent in five years. We now send one-third more across the Pacific than the Atlantic, and in about 15 years there are estimates that the Asian economy could be larger than ours and Europe's combined. As we work on the broader trade agreements, in the meantime we're working bilaterally and multilaterally wherever possible to facilitate trade. However, for us to be able to move forward requires public and congressional support.

The most immediate trade issue is China. The President has now extended MFN status for China. There may well be a vigorous congressional debate over this issue. And there are many issues we need to work through where there are significant differences with China. But let me add one more word about the importance to the United States of extending MFN. While we are on the Atlantic coast today, we also are very much an Pacific nation. I was in Kyoto about two months ago for a meeting of finance ministers from throughout Asia, and it was clear from my discussions with my counterparts that the outcome of MFN is central not only to our relationship with China, but to our position throughout the whole of east Asia.

Having said that, my second point is that it is enormously in our economic and national security interests to support development and reform in the developing and transitional economies. It is unpopular, but it is not charity. We do it through our bilateral aid, but we also do it very powerfully through the international financial institutions such as the World Bank, the regional development banks, and the International Monetary Fund. Our contributions are enormously leveraged because of the contributions of all other donors and the tremendous influence we have on the policies of these institutions. I can tell you from my own involvement, both here and in visits around the world, that the World Bank and the other institutions are vital in promoting the economic growth that creates greater markets for our goods, and that contributes to democracy and political stability which furthers our national security.

However, these institutions have no natural political constituency in the United States. And at a time when they are contributing so critically to our interests, they are also subject to enormous reductions in congressional funding. Those reductions in turn are threatening both our influence in the policies of the institutions, and even the very institutions themselves because as we reduce our funding, others will tend to do the same, and switch their foreign aid to a bilateral basis. Diminishing our support for these institutions greatly diminishes out ability to shape the future economies of developing and transitional economies in ways that will benefit all Americans.

Too often even those who are focussed on supporting trade and global engagement have not focussed on the need to extend that support to these absolutely vital institutions.

The final point I would make today is to highlight the substantial accomplishments in the past two years in strengthening the global financial markets against shock.

I recall two years ago at the G-7 Summit in Naples, President Clinton outlined a vision of making the international financial institutions more reflective of the times -- making them as modern as the markets is the phrase we've used. Then, a year later at the Halifax Summit, the President proposed a series of specific measures. And now, as we go to the Lyon Summit at the end of this month, the G-7 leaders will be able to report that almost all those measures have been put into place. I might add that the President's vision at Naples was somewhat prescient because about six months later the crisis arose in Mexico, and that crisis in turn served to focus global attention on the very real need for the kinds of measures that are now being put into place.

These are programs that I believe will be of immense importance in preventing international financial crises and, if they occur, providing an effective multilateral response. They haven't received very much public attention, but I believe over time they will be vastly more important to our economy, as opposed to what does make the headlines on a day-in, day-out basis.

This includes a new disclosure regime implemented by the IMF that has the potential for effects similar to the disclosure system that is at the heart of our regulatory structure in this country. It also includes a mechanism for providing greatly increased official multilateral resources if a crisis does occur. There are reforms to improve cooperation amongst regulators to follow the activities of international financial firms. In addition, there is an approach that promotes burden sharing with the private sector in the case of financial crises. And, there are reforms affecting the World Bank and the regional development banks.

Let me close with this thought. Fifty years ago this country rose to the challenge of the post-war era and created the institutions that have seen us through to this point. At that time, people of vision, successful and respected in their communities, recognized that was the right course and worked to create public and political support.

Today, that understanding is not fully shared by the American public or the Congress. Just as people in government and business rose to the challenge then to carry the message of involvement to the American public, something the President does now at each opportunity, it must be done on a broad scale now by all of us in government and, I believe, by all of you and those like you throughout the country who understand our stakes in international engagement.

We have much to gain from that engagement, and much more to lose by staying on the sidelines.

Thank you.

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DEPARTMENT OF THE TREASURY

TREASURY NEWS

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FOR IMMEDIATE RELEASE
June 3, 1996

Contact: Jon Murchinson
(202) 622-2960

UPDATED SCHEDULE FOR MEETINGS ON INFLATION-PROTECTION SECURITIES

The following is an updated schedule for the Treasury Department's information meetings and press roundtables on plans to issue inflation-protection securities. Press wishing to attend must call the appropriate contact listed for each city. All times are local and subject to change.

DATE AND TIME	EVENT AND LOCATION	PRESS CONTACT
June 4 10 a.m.	Investor Meeting Federal Reserve Bank 600 Atlantic Avenue Boston, Massachusetts	Thomas L. Lavelle (617) 973-3647
June 5 10 a.m.	Investor Meeting Federal Reserve Bank 230 South LaSalle Street Chicago, Illinois	Suzanne Heffner (312) 322-5108
June 5 2:30 p.m.	Press Roundtable U.S. Embassy 24 Grosvenor Square London, W1A	Dennis Wolf (011) 44-171-499-5261
June 6 2 p.m. (new time)	Investor Meeting U.S. Embassy 24 Grosvenor Square London, W1A	Dennis Wolf (011) 44-171-499-5261

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DATE AND TIME	EVENT AND LOCATION	PRESS CONTACT
June 6 9 a.m. (new time)	Investor Meeting Federal Reserve Bank 101 Market Street San Francisco, California	Sandra Conlan (415) 974-3231
June 10 12:15 p.m.	Press Roundtable U.S. Embassy 10-5 Akasaka 1-chome Minato-ku, Tokyo 107	Emi Yamauchi (011) 813-3224-5271

Investors wishing to attend should call the Bureau of Public Debt, (202) 219-3350, or the U.S. Treasury Attache in London, (011) 44-171-408-8069, or Tokyo, (011) 813-3224-5486. To receive the Advance Notice of Proposed Rulemaking from Treasury's automated fax system call (202) 622-2040 and request document 1080.

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AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
June 3, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $14,555 million of 13-week bills to be issued June 6, 1996 and to mature September 5, 1996 were accepted today (CUSIP: 9127943F9).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.07%	5.21%	98.718
High	5.09%	5.23%	98.713
Average	5.09%	5.23%	98.713

Tenders at the high discount rate were allotted 44%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$55,203,906	$14,554,786
Type		
Competitive	$50,289,071	$9,639,951
Noncompetitive	1,466,880	1,466,880
Subtotal, Public	$51,755,951	$11,106,831
Federal Reserve	3,402,955	3,402,955
Foreign Official Institutions	45,000	45,000
TOTALS	$55,203,906	$14,554,786

5.08 - 98.716

RR-1115

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
June 3, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $14,694 million of 26-week bills to be issued June 6, 1996 and to mature December 5, 1996 were accepted today (CUSIP: 9127943R3).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.20%	5.41%	97.371
High	5.21%	5.43%	97.366
Average	5.21%	5.43%	97.366

$1,200,000 was accepted at lower yields.
Tenders at the high discount rate were allotted 16%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$59,820,740	$14,694,257
Type		
Competitive	$52,519,551	$7,393,068
Noncompetitive	1,271,889	1,271,889
Subtotal, Public	$53,791,440	$8,664,957
Federal Reserve	3,400,000	3,400,000
Foreign Official Institutions	2,629,300	2,629,300
TOTALS	$59,820,740	$14,694,257

5.17 -- 97.386

RR-1116

DEPARTMENT OF THE TREASURY

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EMBARGOED UNTIL 2:30 P.M.
June 4, 1996

CONTACT: Office of Financing
202/219-3350

TREASURY'S WEEKLY BILL OFFERING

The Treasury will auction two series of Treasury bills totaling approximately $31,000 million, to be issued June 13, 1996. This offering will result in a paydown for the Treasury of about $2,875 million, as the maturing bills total $33,872 million (including the 10-day cash management bill issued on June 3, 1996, in the amount of $7,011 million).

Federal Reserve Banks hold $6,745 million of the maturing bills for their own accounts, which may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders.

Federal Reserve Banks hold $3,873 million as agents for foreign and international monetary authorities, which may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders. Additional amounts may be issued for such accounts if the aggregate amount of new bids exceeds the aggregate amount of maturing bills.

Tenders for the bills will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

Details about each of the new securities are given in the attached offering highlights.

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Attachment

RR-1117

HIGHLIGHTS OF TREASURY OFFERINGS OF WEEKLY BILLS
TO BE ISSUED JUNE 13, 1996

June 4, 1996

Offering Amount	$15,500 million	$15,500 million
Description of Offering:		
Term and type of security	91-day bill	182-day bill
CUSIP number	912794 3G 7	912794 2B 9
Auction date	June 10, 1996	June 10, 1996
Issue date	June 13, 1996	June 13, 1996
Maturity date	September 12, 1996	December 12, 1996
Original issue date	March 14, 1996	December 14, 1995
Currently outstanding	$12,747 million	$18,792 million
Minimum bid amount	$10,000	$10,000
Multiples	$ 1,000	$ 1,000

The following rules apply to all securities mentioned above:

Submission of Bids:

Noncompetitive bids . . . . Accepted in full up to $1,000,000 at the average discount rate of accepted competitive bids

Competitive bids . . . .
(1) Must be expressed as a discount rate with two decimals, e.g., 7.10%.
(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position is $2 billion or greater.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Maximum Recognized Bid at a Single Yield . . . . 35% of public offering

Maximum Award . . . . 35% of public offering

Receipt of Tenders:

Noncompetitive tenders . . . . Prior to 12:00 noon Eastern Daylight Saving time on auction day

Competitive tenders . . . . Prior to 1:00 p.m. Eastern Daylight Saving time on auction day

Payment Terms . . . . Full payment with tender or by charge to a funds account at a Federal Reserve Bank on issue date

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FOR IMMEDIATE RELEASE
June 5, 1996

Contact: Calvin Mitchell
(202) 622-2920

MEDIA ADVISORY
TIME CHANGE

Treasury Secretary Robert E. Rubin, Labor Secretary Robert B. Reich, Health and Human Services Secretary Donna E. Shalala and Commissioner of Social Security Shirley S. Chater will discuss the results of the Medicare and Social Security Trustees annual meeting and annual reports at a press briefing at 2 p.m. (originally scheduled for 2:45 p.m.) today, Wednesday, June 5, in room 4121 of the Main Treasury building, 1500 Pennsylvania Avenue, N.W. Cameras should be in place by 1:30 p.m.

Media without Treasury, White House, State, Defense or Congressional press credentials planning to attend should contact the Office of Public Affairs at (202) 622-2960, with the following information: name, social security number and date of birth, by noon today, June 5. This information can be faxed to (202) 622-1999.

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RR-1118

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

ADV 2 P.M. EDT
Remarks as prepared for delivery
June 5, 1996

REMARKS OF TREASURY SECRETARY ROBERT E. RUBIN
MEDICARE/SOCIAL SECURITY TRUST FUND TRUSTEES REPORT

Today, as trustees, we are reporting again that which we have said for many years: the Medicare Hospital Insurance Trust Fund must be strengthened. We said it in 1993, in 1994, in 1995, and we're saying it again this year.

As trustees who also serve as members of the administration, we have worked with the President write an effective proposal to strengthen Medicare and balance the budget without damaging the program that delivers quality health care to elderly Americans. A year ago the President offered a plan to strengthen Medicare, and we want to work with Congress to get this job done without further delay.

Let me now deal with some of the specifics of the trustees report. With regard to the OASDI trust fund, the estimated depletion date has moved from 2030 to 2029. The trustees have again noted that the long-term deficit in these trust funds must be addressed in a timely fashion. Social Security is the most successful retirement program ever devised by the federal government. Along with Medicare, it is principally responsible for cutting the incidence of poverty among the nation's elderly in half. The trends we report today can and should be dealt with on a bipartisan basis over time.

Now, let me turn now to Medicare. The trustees have been saying for several years that we need to act to extend the Hospital Insurance Trust Fund. This information is public and has been confirmed by a variety of reputable sources including the Congressional Budget Office. The trustees report again shows rapidly rising costs for the supplementary Medical Insurance Trust Fund, which also must be addressed.

The Medicare problem must be dealt with. Both the President and Congress have made proposals to address the HI trust fund issue, and there is clearly a need for a responsible near-term solution to the issue. Today, as trustees, we are recommending the enactment at the earliest possible date of legislation that will extend the life of the trust fund while a longer-term solution is sought.

RR-1119

(more)

We are also recommending the establishment of a national advisory group to examine the Medicare program and contribute to developing a long-term solution to Medicare's financing needs.

Having said that, I want to close with just a word not as a trustee but as Treasury Secretary. The administration acted in 1993 to preserve the financial integrity of the HI fund for three additional years, and last year the President proposed measures that if adopted would extend the fund to the middle of the next decade. Congress can and should address this problem. There is, I believe, enough common ground to prudently, responsibly and cooperatively strengthen and extend Medicare on a timely basis, leaving for another forum discussion of long term changes in Medicare.

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STATEMENT OF VALERIE LAU
INSPECTOR GENERAL, U.S. DEPARTMENT OF THE TREASURY
BEFORE THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
JUNE 6, 1996

RR-1120

STATEMENT OF VALERIE LAU
INSPECTOR GENERAL, U.S. DEPARTMENT OF THE TREASURY
BEFORE THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
JUNE 6, 1996

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I AM PLEASED TO HAVE THIS OPPORTUNITY TO ASSIST IN YOUR REVIEW OF INTERNAL REVENUE SERVICE (IRS) FINANCIAL MANAGEMENT ISSUES.

AS THE INSPECTOR GENERAL FOR THE DEPARTMENT OF THE TREASURY, I HAVE GENERALLY APPROACHED IRS ISSUES THROUGH THE LENS OF THE OVERSIGHT FUNCTION. THE INSPECTOR GENERAL ACT OF 1978, AS AMENDED, ESTABLISHED A STATUTORY INSPECTOR GENERAL FOR THE DEPARTMENT OF THE TREASURY IN APRIL 1989. WITH RESPECT TO IRS, THE ACT PROVIDED MY OFFICE WITH OVERSIGHT AUTHORITY FOR THE IRS CHIEF INSPECTOR'S OFFICE, WHICH PERFORMS THE PRIMARY ROLE OF AUDITING INTERNAL IRS MATTERS. ADDITIONALLY, MY OFFICE HAS THE AUTHORITY TO DIRECTLY AUDIT IRS ISSUES THAT WARRANT OUR ATTENTION.

SO FAR, I BELIEVE THE WORK UNDERTAKEN OR IN PROCESS BY THE CHIEF INSPECTOR AND THE GENERAL ACCOUNTING OFFICE (GAO) HAVE PROVIDED EXTENSIVE COVERAGE OF IRS' FINANCIAL MANAGEMENT ACTIVITIES. I HAVE BEEN CAREFUL THEREFORE TO AVOID DUPLICATING AUDIT EFFORT. ACCORDINGLY, I HAVE DIRECTED MY OFFICE'S EFFORTS TO THOSE AREAS IN NEED OF INSPECTOR GENERAL OVERSIGHT.

TODAY I WILL DISCUSS FOUR EFFORTS. FIRST, MY OFFICE HAS VERIFIED THE RELIABILITY OF THE SELF EVALUATION PROCESS UNDER THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA) OF 1982. SECOND, WE HAVE ASSESSED THE EFFECTIVENESS OF THE DEPARTMENT'S OVERSIGHT OF THE TAX SYSTEM MODERNIZATION EFFORT (TSM). THIRD, WE HAVE REVIEWED THE CORRECTIVE ACTIONS TAKEN BY IRS TO PREVENT AND DETECT IRS EMPLOYEE BROWSING OF TAXPAYER FILES. FOURTH, I HAVE FOSTERED PARTNERSHIP ARRANGEMENTS WITH THE CHIEF INSPECTOR IN

CONDUCTING JOINT AUDITS, AND WITH GAO IN AUDITING IRS' FUTURE FINANCIAL STATEMENTS.

FIRST, FMFIA. AS YOU ARE AWARE, THE ASSURANCES PROVIDED TO THE PRESIDENT AND THE CONGRESS THROUGH THE FMFIA PROCESS ARE BASED ON MANAGEMENT'S SELF EVALUATION. THUS, I HAVE TAKEN STEPS TO HELP ASSURE THE SECRETARY OF THE TREASURY, AND ULTIMATELY THE PRESIDENT AND THE CONGRESS, THAT THESE SELF EVALUATIONS ARE ACCOMPLISHING THE OBJECTIVES OF THE ACT, AND THAT THE RESULTS ARE CLASSIFIED PROPERLY AND THE CONCLUSIONS ARE REPORTED ACCURATELY.

THE FMFIA REQUIRES FEDERAL AGENCIES TO CERTIFY COMPLIANCE WITH THE APPLICABLE PROVISIONS OF SECTION 2, CONCERNING THE ADEQUACY OF SYSTEMS OF INTERNAL MANAGEMENT CONTROLS, AND SECTION 4, ADDRESSING COMPLIANCE WITH GOVERNMENTWIDE REQUIREMENTS FOR FINANCIAL MANAGEMENT SYSTEMS. CONTINUING MATERIAL WEAKNESSES IN IRS' SYSTEMS OF INTERNAL MANAGEMENT CONTROLS AND NONCONFORMANCE IN ITS FINANCIAL ACCOUNTING SYSTEMS HAVE RESULTED IN THE COMMISSIONER'S QUALIFIED REASONABLE ASSURANCE THAT IRS COMPLIES WITH THE REQUIREMENTS OF THE FMFIA.

SEEING TO IT THAT THESE WEAKNESSES HAVE BEEN CLASSIFIED PROPERLY IN THE ANNUAL REPORTS TO THE PRESIDENT AND THE CONGRESS HAS REQUIRED SOME ASSERTIVENESS BY THE IRS CHIEF INSPECTOR'S OFFICE, WHICH I HAVE SUPPORTED. LET ME EXPLAIN. MANAGEMENT'S CONCLUSIONS CONCERNING FMFIA COMPLIANCE ARE BASED ON SELF EVALUATIONS WHICH, BY THEIR NATURE, ARE NOT EXACT AND EXPOSE THE PROCESS TO SUBJECTIVITY. IN ITS FISCAL YEAR 1995 ASSURANCE LETTER TO THE SECRETARY, IRS PROVIDED QUALIFIED REASONABLE ASSURANCE FOR SECTION 2 BY REPORTING CONTINUING WORK ON PREVIOUSLY IDENTIFIED MATERIAL WEAKNESSES AND TWO NEW MATERIAL WEAKNESSES CONCERNING ASPECTS OF THE LOW INCOME HOUSING CREDIT AND THE TAX EXEMPT BOND PROGRAMS.

HOWEVER, IRS CHARACTERIZED THE PROBLEMS IT IS FACING WITH TSM AS AN AREA OF CONCERN, WHILE THE CHIEF INSPECTOR'S OFFICE RECOMMENDED TSM BE CLASSIFIED AS A MATERIAL WEAKNESS. THE DEGREE OF DIFFERENCE BETWEEN AN AREA OF CONCERN AND A MATERIAL WEAKNESS COULD BE THE DECIDING FACTOR IN WHETHER OR NOT REASONABLE ASSURANCE UNDER FMFIA CAN BE PROVIDED TO THE PRESIDENT AND THE CONGRESS, AS WELL AS ITS DEGREE OF MATERIALITY DRAWING MORE SCRUTINY IN THE BUDGET PROCESS.

THE CHIEF INSPECTOR CONSIDERED TSM A MATERIAL WEAKNESS BECAUSE IRS HAS NOT EFFECTIVELY DEMONSTRATED CONTROLS OVER THREE AREAS: MODERNIZATION PROGRAM MANAGEMENT, INFORMATION SYSTEMS INFRASTRUCTURE, AND FINANCIAL MANAGEMENT. WHILE IRS MANAGEMENT HAS TAKEN A NUMBER OF CORRECTIVE ACTIONS TO RESOLVE THESE PROBLEMS, THE FIXES HAVE NOT YET TAKEN HOLD.

ONE YEAR EARLIER, A SIMILAR DISAGREEMENT OVER CLASSIFYING TSM AS A MATERIAL WEAKNESS OCCURRED WITH THE FISCAL YEAR 1994 ASSURANCE LETTER. IN THAT INSTANCE, THE DEPARTMENT DID NOT REPORT TSM AS A MATERIAL WEAKNESS, BUT DID INCLUDE A STATEMENT IN THE ASSURANCE LETTER NOTING MY OFFICE'S POSITION THAT TSM WAS A MATERIAL RISK REQUIRING CLOSE MONITORING BY SENIOR DEPARTMENTAL AND IRS MANAGEMENT. THIS ISSUE WAS ALSO HIGHLIGHTED IN MY APRIL 1995 SEMIANNUAL REPORT TO CONGRESS. WITH THE 1995 FMFIA CYCLE, HOWEVER, I AM PLEASED TO REPORT THAT OUR POSITION ON THE TSM CLASSIFICATION WAS ACCEPTED BY THE SECRETARY. TSM IS IDENTIFIED AS A MATERIAL WEAKNESS IN THE DEPARTMENT'S FISCAL YEAR 1995 FMFIA ASSURANCE LETTER.

SECOND, WE HAVE ADDRESSED TSM BY REVIEWING THE EFFECTIVENESS OF THE DEPARTMENT'S OVERSIGHT OF TSM. WE ACCOMPLISHED OUR OBJECTIVE BY ASSESSING THE DEPARTMENT'S POLICY, PROCEDURES AND DOCUMENTATION PERTAINING TO THE OVERSIGHT OF TSM AND APPROVAL OF BUDGET REQUESTS. WE ALSO ASSESSED THE DEPARTMENT'S ROLE IN MONITORING CORRECTIVE ACTIONS ON TSM PROBLEMS REPORTED BY GAO AND

THE CHIEF INSPECTOR'S OFFICE. THIS REVIEW WAS CONDUCTED DURING THE PERIOD SEPTEMBER 1994 THROUGH APRIL 1995 AND COVERED GAO AND IRS REPORTS ISSUED FROM 1989 THROUGH 1994.

IN SUMMARY, OUR OCTOBER 1995 REPORT ON THIS REVIEW CALLED FOR IMPROVEMENTS IN THE DEPARTMENT'S OVERSIGHT OF TSM. FIRST, WE RECOMMENDED THAT TSM OVERSIGHT RESPONSIBILITIES BE PROPERLY ALLOCATED AMONG VARIOUS DEPARTMENTAL OFFICES. UP TO THE TIME OF OUR REVIEW, TSM WAS BEING VIEWED PRIMARILY AS AN INFORMATION SYSTEMS INITIATIVE. ACCORDINGLY, THE OFFICE OF INFORMATION RESOURCES MANAGEMENT WAS CONDUCTING MOST OF THE WORK.

IN RESPONSE TO THIS RECOMMENDATION, THE ASSISTANT SECRETARY FOR MANAGEMENT AND CHIEF FINANCIAL OFFICER DESIGNATED AN EXECUTIVE DIRECTORATE TO COORDINATE THE ACTIVITIES OF THE VARIOUS DEPARTMENTAL OFFICES RESPONSIBLE FOR OVERSEEING TSM.

SECOND, INDEPENDENT MANAGEMENT REVIEWS NEED TO BE PERFORMED. WE RECOMMENDED THAT THE REVIEWS BE PRIORITIZED BY THOSE SYSTEMS SCHEDULED FOR BUDGET APPROVAL, AS WELL AS ITS OVERALL PURPOSE AND COST. THESE REVIEWS SHOULD ALSO BE COORDINATED WITH THE CHIEF INSPECTOR AND GAO. THE ASSISTANT SECRETARY HAS COMMITTED TO DEVELOPING AN INFORMATION RESOURCES MANAGEMENT REVIEW SCHEDULE WITHIN 60 DAYS OF RECEIVING BUREAU OPERATIONAL INFORMATION RESOURCES MANAGEMENT PLANS, AND THE OFFICE OF INFORMATION RESOURCES MANAGEMENT WILL ADVISE THE CHIEF INSPECTOR OF REVIEWS RELATED TO TSM.

THIRD, WE CONCLUDED THAT TSM PROBLEMS REPORTED BY SOURCES SUCH AS GAO, THE IRS CHIEF INSPECTOR AND OTHERS NEED TO BE USED MORE EFFECTIVELY TO ENSURE THAT RECURRING WEAKNESSES HAVE BEEN CORRECTED PRIOR TO APPROVING ADDITIONAL TSM INITIATIVES. IN THIS REGARD, THE DEPARTMENT HAS COMMITTED TO ESTABLISHING AND MAINTAINING A LIBRARY AND A COMPUTERIZED LISTING OF ALL TSM-RELATED REPORTS, REVIEWS AND ANALYSES. THIS INFORMATION WILL BE

AVAILABLE TO DESK OFFICERS AND OTHER DEPARTMENTAL OFFICES PRIOR TO THE ANNUAL BUDGET REVIEW, AND IT WILL BE USED IN THE DEPARTMENT'S REVIEW PROCESS.

GAO CRITIQUED IRS' EFFORTS TO MODERNIZE TAX PROCESSING IN ITS JULY 1995 REPORT TITLED, "MANAGEMENT AND TECHNICAL WEAKNESSES MUST BE CORRECTED IF MODERNIZATION IS TO SUCCEED". THE REPORT DESCRIBED SERIOUS REMAINING MANAGEMENT AND TECHNICAL WEAKNESSES, AND MADE OVER A DOZEN RECOMMENDATIONS FOR IMPROVEMENT.

THE MODERNIZATION INITIATIVE WAS ALSO INCLUDED IN GAO'S FEBRUARY 1995 OVERVIEW OF GOVERNMENT HIGH RISK AREAS. GAO REPORTED THAT THE OVERALL DESIGN OF TSM IS STILL INCOMPLETE AND IRS IS CONTINUING TO AUTOMATE EXISTING PROBLEM PLAGUED FUNCTIONS WITH LIMITED UNDERSTANDING OF WHETHER OR HOW DIFFERENT SYSTEMS WILL EVENTUALLY CONNECT TO IMPROVE TAX ADMINISTRATION.

MOVING FROM TSM BACK TO THE ISSUE OF FINANCIAL MANAGEMENT, THE IRS COMMISSIONER CAN NOT PROVIDE REASONABLE ASSURANCE THAT THE OBJECTIVES OF SECTION 4 HAVE BEEN ACHIEVED DUE TO CONTINUED WEAKNESSES IN IRS' REVENUE ACCOUNTING SYSTEMS. THESE SYSTEMS DO NOT MEET TODAY'S ACCOUNTING STANDARDS FOR FINANCIAL MANAGEMENT SYSTEMS, NOR DO THEY PROVIDE AN ADEQUATE TRANSACTION TRAIL.

THESE WEAKNESSES, WHICH INCLUDE THE AUDITORS' INABILITY TO RECONCILE REVENUE AND VALIDATE ACCOUNTS RECEIVABLE ESTIMATES, LED TO GAO DISCLAIMING AN OPINION ON IRS' FISCAL YEAR 1994 FINANCIAL STATEMENTS. IN THIS REGARD, SEVERAL OF THE MAJOR PROGRAM AREAS IN THE TSM BUDGET ADDRESS REVENUE ACCOUNTING ISSUES. SUCCESSFUL COMPLETION OF THESE TASKS ASSOCIATED WITH THESE PROGRAM AREAS SHOULD HELP ADDRESS THE FINANCIAL STATEMENT DISCLAIMER.

GAO IS NOW WRAPPING UP ITS REVIEW OF THE FISCAL YEAR 1995 FINANCIAL STATEMENTS. THIS SUMMER MY OFFICE WILL FORM A PARTNERSHIP WITH GAO AND THE CHIEF INSPECTOR'S OFFICE TO REVIEW

THE FISCAL YEAR 1996 FINANCIAL STATEMENTS. I HAVE EVERY CONFIDENCE THAT THIS COMBINED EFFORT WILL CONTRIBUTE TO CONTINUED PROGRESS IN RESOLVING IRS' FINANCIAL MANAGEMENT PROBLEMS.

THIRD, WE CONDUCTED A FOLLOW UP REVIEW OF IRS ACTIONS TO CORRECT PROBLEMS WITH EMPLOYEE BROWSING OF TAXPAYER INFORMATION. IN 1994, WE REPORTED TO THE CHAIRMAN OF THIS COMMITTEE THAT THE CHIEF INSPECTOR'S EFFORTS FOR CORRECTING THIS PROBLEM HAD BEEN EXTENSIVE. LATER, WE FOLLOWED UP ON THE ACTIONS TAKEN TO IMPLEMENT OUR RECOMMENDATIONS. A MARCH 1996 REPORT TO THE IRS COMMISSIONER SUMMARIZES THE SERVICE'S PROGRESS IN IMPLEMENTING THE INTEGRATED DATA RETRIEVAL SYSTEM (IDRS) ACTION PLAN.

IN SUMMARY, WE FOUND THE CHIEF INSPECTOR'S OFFICE HAD SUCCESSFULLY COMPLETED THE TEN IDRS ACTION ITEMS ASSIGNED TO IT FOR HELPING CONTROL MISUSE OF THE SYSTEM. WE ALSO FOUND THAT THE IRS HAD SUCCESSFULLY INITIATED SEVERAL PROACTIVE FUNCTIONS TO HELP PREVENT IDRS ABUSES. BUT, THE NEW SYSTEMS DEVELOPED TO BETTER CONTROL IDRS MISUSE WERE NOT ALWAYS EXECUTED IN ACCORDANCE WITH REQUIRED PROCEDURES. FOR EXAMPLE, TWO SYSTEMS DEVELOPED TO BETTER CONTROL IDRS MISUSE HAD NOT FULLY MET REQUIRED PROCEDURES FOR SYSTEMS SECURITY CERTIFICATION AND ACCREDITATION BEFORE THE SYSTEMS WERE PUT INTO USE. WITHOUT SUCH CERTIFICATION, IRS HAD MORE LIMITED ASSURANCE THAT THESE SYSTEMS WERE NOT VULNERABLE TO SECUIRTY RISKS AND POSSIBLE INCREASED MISUSE.

ALSO, WE FOUND THAT HIGHER LEVEL POSITION SENSITIVITY AND BACKGROUND INVESTIGATIONS SHOULD HAVE BEEN REQUIRED FOR PERSONS WORKING ON SENSITIVE IDRS-RELATED SYSTEMS. MOREOVER, THE CORRECTIVE ACTIONS NECESSARY FOR IMPLEMENTING AUDIT RECOMMENDATIONS WERE SOMETIMES REPORTED CLOSED BEFORE ALL CORRECTIVE ACTIONS WERE COMPLETED.

IRS MANAGEMENT AGREED WITH OUR RECOMMENDATIONS AND DESCRIBED THE CORRECTIVE ACTIONS THEY ARE TAKING, OR HAVE PLANNED, TO RESOLVE

THE IDENTIFIED PROBLEMS. WE CONCUR WITH IRS' ACTIONS AND BELIEVE THAT WHEN THEY ARE FULLY IMPLEMENTED, THE PROPOSED ACTIONS WILL HELP CORRECT THE REPORTED DEFICIENCIES.

FOURTH, WE HAVE BEEN WORKING CLOSELY WITH THE CHIEF INSPECTOR'S OFFICE BY FORMING PARTNERSHIP ARRANGEMENTS ON AUDITS OF PROGRAMS, ACTIVITIES AND FUNCTIONS THAT INVOLVE IRS AND OTHER TREASURY BUREAUS. FOR EXAMPLE, WE RECENTLY COMPLETED AN ANALYSIS OF THE INTERNAL CONTROLS OVER THE PROCESSING AND ISSUANCE OF INCOME TAX REFUNDS. THE SCOPE OF WORK ON THIS ASSIGNMENT INCLUDED IRS AND THE FINANCIAL MANAGEMENT SERVICE'S OPERATIONS FOR ISSUING REFUNDS TOTALING MORE THAN $96 BILLION FOR FISCAL YEAR 1994.

WE ARE CURRENTLY PERFORMING A JOINT PROJECT WITH THE CHIEF INSPECTOR'S OFFICE IN ASSESSING THE IRS ROLE AS EXECUTIVE AGENT FOR THE DEPARTMENT'S DIGITAL TELECOMMUNICATIONS SYSTEM. AS PART OF THIS ASSIGNMENT, WE ARE FOCUSING ON FINANCIAL MANAGEMENT ISSUES SUCH AS INVENTORY VALUATION AND REVENUE AND EXPENSE RECOGNITION THAT WILL DIRECTLY AFFECT THE IRS FINANCIAL STATEMENTS. THESE ASSIGNMENTS REPRESENT THE MOST EFFICIENT USE OF OUR PERSONNEL RESOURCES AND THE EXTENSIVE BODY OF KNOWLEDGE OUR TWO OFFICES HAVE ACCUMULATED ON THE MAJOR ISSUES CONFRONTING IRS.

MR. CHAIRMAN, THIS CONCLUDES MY PREPARED STATEMENT.

DEPARTMENT OF THE TREASURY
TREASURY NEWS
OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

ADV 9:30 a.m. EDT
Remarks as prepared for delivery.
June 6, 1996

**RECORD TESTIMONY OF TREASURY SECRETARY ROBERT E. RUBIN
COMMITTEE ON WAYS AND MEANS**

Mr. Chairman and Members of the Committee:

I am pleased to once again appear before the Ways and Means Committee in my role as Managing Trustee and Chairman of the Medicare Boards of Trustees. The Boards report annually to the Congress on the financial status of two separate Medicare trust funds -- the Hospital Insurance (or HI) Trust Fund and the Supplementary Medical Insurance (or SMI) Trust Fund.

One of the most important things our country has done over the past 30 years has been to work to reduce poverty and deprivation among senior citizens and disabled persons, and thereby also reduce the burden on and the anxiety of their children. Medicare has effectively provided a reliable source of medical care coverage for aged and disabled Americans. There are few issues of greater concern to working families than the cost of retirement and the problem of providing health care to the elderly.

As we have said for many years, the exhaustion date for Medicare is close. We should act. We must act. The best solution before the Congress to fix Medicare has been offered by President Clinton in his balanced budget proposal. We should pass that plan now, and then work together on a bipartisan basis to develop a long-term solution that the program needs and the country deserves.

The trustees include the members of the cabinet directly concerned with Social Security and Medicare, plus two members representing the broader public interest. As the trustees have reported for a number of years, this year's reports confirm that the costs of the SMI program continue to rise rapidly and that the HI Trust Fund will be exhausted about a year after the turn of the century. We note that as of December 1995 the HI trust fund had a balance of $130 billion, but that it is projected to be depleted in the year 2001. All of the trustees met yesterday and agree with the report.

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This is, obviously, not news to this committee. We provided a similar report a year ago, when the exhaustion date was projected to be 2002, and the year before, when we projected it to be 2001. Secretary Shalala and I also testified before your committee on this subject three months ago. Finally, the Congressional Budget Office produced its own independent projection last month, with an exhaustion date of 2001.

As we have in the past, we strongly urge prompt enactment of legislation to address the HI Trust Fund shortfall. Although the President and the Congress have made proposals that address this issue, there are structural and policy differences between them. However, there should be sufficient common ground to agree on legislation to extend the life of the trust fund.

We also note that this is only a first step in the longer-term process of review and reform. There are important changes underway in our health care system. These changes will affect both the quality and cost of medical care, and they will affect our decisions concerning Medicare. There are also significant demographic shifts ahead as the baby boom generation begins to retire in 2010 and the rates of retirees to working Americans begins to rise more steeply. We as trustees have recommended the creation of an advisory group to review these complex issues and help fashion solutions.

From the very beginning, this Administration has clearly recognized the importance of maintaining the solvency of the HI trust fund. The President's 1993 deficit reduction plan extended the trust fund exhaustion date by three years.

Last year, the Administration proposed additional measures to extend the HI trust fund. The President has advocated since June of 1995 reducing Medicare spending growth per beneficiary with savings scored by the Congressional Budget Office at $116 billion through 2002 and guaranteeing the solvency of the trust fund for more than a decade. The reforms give seniors more choices among private health plans, attack fraud and abuse, cuts the growth of provider payments but holds the Part B premium to 25 percent of program costs.

Medicare financing is a complex interaction of demographics and the rapidly rising costs that affect all parts of our health care system. We need to carefully reform Medicare. The Administration believes that the growth of federal health care expenditures, including Medicare, needs to be reduced in order to control the budget. But reducing this growth must be done by carefully weighing trade-offs and reforming these programs in the context of its impact on the health care delivery system. You can reach a balanced budget by preserving what is right about Medicare and still produce savings, or you can cut Medicare the wrong way at the cost of irreversibly damaging this important program.

Arbitrary attempts to resolve the financing crisis may restore solvency to the HI Trust Fund, but will create and intensify other problems. Specifically, we are concerned that excessive reductions in Medicare, largely through reduced payments to hospitals, and particularly in combination with deep Medicaid cuts may shift costs to the private sector and reduce quality of care for Medicare beneficiaries.

The Trustees have again provided the Congress, as they have for the last several years, with early and continued warning. It is time to act. Although the exhaustion date is now believed to be five, instead of six, years away, there still is more than enough time to extend it. It is better to do part of the job now, and do it right to avoid a hasty, unworkable solution that may have to be undone in the future.

Financial Status of the Medicare Trust Funds

As noted, the 1996 Trustees report projects the HI Trust Fund will be exhausted in 2001, one year sooner than projected last year. This worsening largely reflects program cost increases.

Over the long term, the 75-year actuarial deficit (interpreted as the amount of payroll tax increase or benefit reduction needed now to balance the trust fund over the next 75 years) was increased from last year's estimate of 3.52 percent to 4.52 percent of payroll.

The increase is largely the result of larger projected increases in the complexity of cases, a more rapid projected growth rate in home health care and skilled nursing facility costs, and the permanent effects of the higher than expected level of spending since the last report. The HI program remains substantially out of long-run actuarial balance, and that problem is not addressed by either of the current Congressional budget resolutions or the Administration's proposal.

The Trustees also continue to project rapid growth in Supplemental Medical Insurance program costs well into the future. Over the next five years, outlays are expected to increase 63 percent in the aggregate and 55 percent per enrollee. During the same period, the program is expected to grow about 28 percent faster than the overall economy.

Combined HI and SMI costs are expected to increase from 2.7 percent of GDP in 1996 to 8.8 percent in 2070 -- more than tripling -- due to anticipated demographic changes and projected increases in costs per beneficiary. Because of this rise in long-term program costs and the expected exhaustion of the HI fund in 2001, the Board of Trustees recommends effective Medicare reform, but again, we believe that this must be done with a careful weighing and balancing of all impacts and all considerations and in the context of the rapidly changing health care sector.

Medicare Financing and Health Care Reform

When the Hospital Insurance program faced financing problems in the past, Congress and the Executive Branch have been able to cooperate on making modest changes in the program that slowed the rate of cost increases.

The program has experienced financial difficulty since its inception in 1966 because of rapidly rising hospital costs, higher-than-expected utilization, and program expansion. During the 1990s, program expenditure increases were below those of the previous decade, reflecting a comparatively moderate rise in overall health care inflation and utilization.

Much can be done to strengthen the Medicare program. Taking steps to extend health insurance coverage to the uninsured population, and developing, through insurance reform, a competitive health care market will create a more efficient system. This increased efficiency will slow the growth in overall health care spending and provide long-term savings to the Medicare program.

In closing, the Administration has proposed steps to strengthen the HI Trust Fund problem and address the rising costs in the rest of the Medicare program in a thoughtful manner, and produce effective, acceptable solutions that will stand the test of time. Although we don't have bipartisan agreement on some of the structural changes that many members of the Majority are advocating, last year there was agreement on a significant number of Medicare proposals that would strengthen the Part A trust fund.

The President's balanced budget plan contains savings proposals that our actuaries estimate would extend the solvency of the Hospital Insurance Trust Fund through 2006, long enough to give us time to work together on longer term solutions. As we have done in the past, the Clinton Administration remains ready to work with the Congress to achieve the security that is so important to elderly Americans.

I will be happy to answer any questions you may have.

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR RELEASE AT 3:00 PM
June 6, 1996

Contact: Peter Hollenbach
(202) 219-3302

PUBLIC DEBT ANNOUNCES ACTIVITY FOR SECURITIES IN THE STRIPS PROGRAM FOR MAY 1996

Treasury's Bureau of the Public Debt announced activity figures for the month of May 1996, of securities within the Separate Trading of Registered Interest and Principal of Securities program (STRIPS).

Dollar Amounts in Thousands

Principal Outstanding (Eligible Securities)	$880,811,348
Held in Unstripped Form	$655,122,466
Held in Stripped Form	$225,688,882
Reconstituted in May	$14,677,650

The accompanying table gives a breakdown of STRIPS activity by individual loan description. The balances in this table are subject to audit and subsequent revision. These monthly figures are included in Table VI of the Monthly Statement of the Public Debt, entitled "Holdings of Treasury Securities in Stripped Form."

Information about "Holdings of Treasury Securities in Stripped Form" is now available on the Department of Commerce's Economic Bulletin Board (EBB). The EBB, which can be accessed using personal computers, is an inexpensive service provided by the Department of Commerce. For more information concerning this service call 202-482-1986.

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TABLE VI -- HOLDINGS OF TREASURY SECURITIES IN STRIPPED FORM, MAY 31, 1996
(In thousands)

Loan Description	Maturity Date	Principal Amount Outstanding: Total	Principal Amount Outstanding: Portion Held in Unstripped Form	Principal Amount Outstanding: Portion Held in Stripped Form	Reconstituted This Month #1
7-1/4% Note D-1996	11/15/96	20,258,810	16,378,810	3,880,000	88,000
8-1/2% Note A-1997	05/15/97	9,921,237	7,860,437	2,060,800	218,400
8-5/8% Note B-1997	08/15/97	9,362,836	7,081,236	2,281,600	174,400
8-7/8% Note C-1997	11/15/97	9,808,329	6,952,329	2,856,000	292,800
8-1/8% Note A-1998	02/15/98	9,159,068	7,963,868	1,195,200	326,400
9% Note B-1998	05/15/98	9,165,387	7,054,787	2,110,600	25,800
9-1/4% Note C-1998	08/15/98	11,342,646	8,620,246	2,722,400	24,000
8-7/8% Note D-1998	11/15/98	9,902,875	6,784,475	3,118,400	0
8-7/8% Note A-1999	02/15/99	9,719,623	8,340,423	1,379,200	68,800
9-1/8% Note B-1999	05/15/99	10,047,103	7,037,503	3,009,600	64,000
8% Note C-1999	08/15/99	10,163,644	7,754,019	2,409,625	193,000
7-7/8% Note D-1999	11/15/99	10,773,960	7,348,360	3,425,600	40,000
8-1/2% Note A-2000	02/15/00	10,673,033	8,064,233	2,608,800	151,600
8-7/8% Note B-2000	05/15/00	10,496,230	6,707,430	4,788,800	25,600
8-3/4% Note C-2000	08/15/00	11,080,646	7,091,686	3,988,960	56,640
8-1/2% Note D-2000	11/15/00	11,519,682	7,441,682	4,078,000	88,400
7-3/4% Note A-2001	02/15/01	11,312,802	8,067,202	3,245,600	106,400
8% Note B-2001	05/15/01	12,398,083	8,757,608	3,640,475	62,400
7-7/8% Note C-2001	08/15/01	12,339,185	9,703,985	2,635,200	20,800
7-1/2% Note D-2001	11/15/01	24,226,102	21,500,582	2,725,520	464,240
7-1/2% Note A-2002	05/15/02	11,714,397	10,173,917	1,540,480	148,280
6-3/8% Note B-2002	08/15/02	23,859,015	22,793,415	1,065,600	28,800
6-1/4% Note A-2003	02/15/03	23,562,691	22,906,987	656,704	235,392
5-3/4% Note B-2003	08/15/03	28,011,028	27,782,228	228,800	0
5-7/8% Note A-2004	02/15/04	12,955,077	12,953,477	1,600	0
7-1/4% Note B-2004	05/15/04	14,440,372	14,435,572	4,800	0
7-1/4% Note C-2004	08/15/04	13,346,467	13,306,467	40,000	0
7-7/8% Note D-2004	11/15/04	14,373,760	14,373,760	0	0
7-1/2% Note A-2005	02/15/05	13,834,754	13,834,354	400	0
6-1/2% Note B-2005	05/15/05	14,739,504	14,739,504	0	0
6-1/2% Note C-2005	08/15/05	15,002,580	15,002,580	0	0
5-7/8% Note D-2005	11/15/05	15,209,920	15,209,920	0	0
5-5/8% Note A-2006	02/15/06	15,513,587	15,513,587	0	0
6-7/8% Note B-2006	05/15/06	16,015,475	16,015,475	0	0
11-5/8% Bond 2004	11/15/04	8,301,806	4,025,006	4,276,800	46,400
12% Bond 2005	05/15/05	4,260,758	2,255,708	2,005,050	130,800
10-3/4% Bond 2005	08/15/05	9,269,713	6,686,513	2,583,200	275,200
9-3/8% Bond 2006	02/15/06	4,755,916	4,750,604	5,312	0
11-3/4% Bond 2009-14	11/15/14	6,005,584	1,995,984	4,009,600	568,000
11-1/4% Bond 2015	02/15/15	12,667,799	8,529,079	4,138,720	1,258,320
10-5/8% Bond 2015	08/15/15	7,149,916	2,432,796	4,717,120	278,400
9-7/8% Bond 2015	11/15/15	6,899,859	3,520,659	3,379,200	172,800
9-1/4% Bond 2016	02/15/16	7,266,854	6,406,854	860,000	44,800
7-1/4% Bond 2016	05/15/16	18,823,551	18,647,551	176,000	219,200
7-1/2% Bond 2016	11/15/16	18,864,448	18,150,288	714,160	197,120
8-3/4% Bond 2017	05/15/17	18,194,169	9,856,569	8,337,600	700,640
8-7/8% Bond 2017	08/15/17	14,016,858	8,596,058	5,420,800	212,000
9-1/8% Bond 2018	05/15/18	8,708,639	2,347,039	6,361,600	97,600
9% Bond 2018	11/15/18	9,032,870	2,550,670	6,482,200	120,000
8-7/8% Bond 2019	02/15/19	19,250,798	5,127,598	14,123,200	656,000
8-1/8% Bond 2019	08/15/19	20,213,832	17,619,272	2,594,560	610,240
8-1/2% Bond 2020	02/15/20	10,228,868	6,622,468	3,606,400	643,200
8-3/4% Bond 2020	05/15/20	10,158,883	4,087,363	6,071,520	298,200
8-3/4% Bond 2020	08/15/20	21,418,606	5,005,486	16,413,120	1,753,920
7-7/8% Bond 2021	02/15/21	11,113,373	10,135,773	977,600	305,800
8-1/8% Bond 2021	05/15/21	11,958,888	4,931,368	7,027,520	214,400
8-1/8% Bond 2021	08/15/21	12,163,482	3,708,442	8,455,040	293,440
8% Bond 2021	11/15/21	32,798,394	6,763,894	26,034,500	806,400
7-1/4% Bond 2022	08/15/22	10,352,790	8,547,990	1,804,800	436,400
7-5/8% Bond 2022	11/15/22	10,699,626	3,480,426	7,219,200	25,600
7-1/8% Bond 2023	02/15/23	18,374,361	14,789,761	3,585,600	281,600
6-1/4% Bond 2023	08/15/23	22,909,044	22,372,468	536,576	611,328
7-1/2% Bond 2024	11/15/24	11,469,662	4,376,382	7,093,280	169,520
7-5/8% Bond 2025	02/15/25	11,725,170	4,956,570	6,768,600	289,600
6-7/8% Bond 2025	08/15/25	12,602,007	12,391,767	210,240	21,120
6% Bond 2026	02/15/26	12,904,916	12,904,916	0	0
Total		880,811,348	655,122,466	225,688,882	14,077,050

#1 Effective May 1, 1987, securities held in stripped form were eligible for reconstitution to their unstripped form.

Note: On the 4th workday of each month Table VI will be available after 3:00 p.m. eastern time on the Commerce Department's Economic Bulletin Board (EBB). The telephone number for more information about EBB is (202) 482-1986. The balances in this table are subject to audit and subsequent adjustments.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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STATEMENT OF JAMES E. JOHNSON
ASSISTANT SECRETARY
(ENFORCEMENT)

PENNSYLVANIA AVENUE HEARING
BEFORE THE HOUSE COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
DISTRICT OF COLUMBIA SUBCOMMITTEE
FRIDAY, JUNE 7, 1996

RR-1123

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY

STATEMENT OF JAMES E. JOHNSON
ASSISTANT SECRETARY
(ENFORCEMENT)

PENNSYLVANIA AVENUE HEARING

BEFORE THE HOUSE COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

DISTRICT OF COLUMBIA SUBCOMMITTEE

FRIDAY, JUNE 7, 1996

MR. CHAIRMAN, AND MEMBERS OF THE SUBCOMMITTEE, THANK YOU FOR INVITING ME TO TESTIFY TODAY ABOUT THE DECISION TO PROTECT THE PRESIDENCY, THE WHITE HOUSE, VISITORS, DIGNITARIES AND PEDESTRIANS BY RESTRICTING VEHICULAR TRAFFIC FROM THE SEGMENT OF PENNSYLVANIA AVENUE IN FRONT OF THE WHITE HOUSE COMPLEX. AS TREASURY ASSISTANT SECRETARY FOR ENFORCEMENT, I HAVE OVERSIGHT RESPONSIBILITY FOR THE TREASURY'S LAW ENFORCEMENT BUREAUS, INCLUDING THE CUSTOMS SERVICE, ATF, THE FEDERAL LAW ENFORCEMENT TRAINING CENTER AND, OF COURSE, THE UNITED STATES SECRET SERVICE.

WE WILL BE AS INFORMATIVE AS POSSIBLE IN ADDRESSING THE LAW ENFORCEMENT AND SECURITY MATTERS THAT RELATE TO THE RESTRICTING OF VEHICULAR ACCESS TO THIS PORTION OF PENNSYLVANIA AVENUE. I MUST POINT OUT, HOWEVER, THAT THERE ARE SENSITIVE ISSUES ABOUT WHITE HOUSE SECURITY THAT WE CANNOT DISCUSS IN THIS FORUM. WE WOULD BE HAPPY, HOWEVER, TO BRIEF YOU ON THESE ISSUES DURING CLASSIFIED EXECUTIVE SESSIONS.

BASED UPON HIS STATUTORY AUTHORITY, SECRETARY OF THE TREASURY RUBIN ISSUED AN ORDER ON MAY 19, 1995 DIRECTING THE UNITED STATES SECRET SERVICE TO PROHIBIT VEHICULAR TRAFFIC ON SEGMENTS OF PENNSYLVANIA AVENUE AND SOUTH EXECUTIVE AVENUE, AND ON STATE PLACE. THE BASIS FOR THE SECRETARY'S DIRECTIVE WAS THE FINDING OF THE WHITE HOUSE SECURITY REVIEW ("REVIEW") THAT "THERE IS NO ALTERNATIVE TO PROHIBITING VEHICULAR TRAFFIC ON PENNSYLVANIA AVENUE THAT WOULD ENSURE THE SAFETY OF THE PRESIDENT AND OTHERS IN THE WHITE HOUSE COMPLEX FROM EXPLOSIVE DEVICES CARRIED BY VEHICLES NEAR ITS BOUNDARIES." THAT DECISION, WHICH WAS MADE FOR SECURITY REASONS AND IMPLEMENTED TO PROTECT PUBLIC ACCESS TO THE WHITE HOUSE, WAS CORRECT ONE YEAR AGO. SECRETARY RUBIN, THE

DEPARTMENT OF THE TREASURY, AND THE UNITED STATES SECRET SERVICE REMAIN FULLY COMMITTED TO THAT DECISION TODAY.

OVERVIEW

OVER AN EIGHT MONTH PERIOD, THE WHITE HOUSE SECURITY REVIEW EVALUATED THE OVERALL SECURITY OF THE WHITE HOUSE COMPLEX. THE REVIEW FOCUSED UPON THE IMPORTANT GOAL OF PROTECTING THE PRESIDENT AND THE FIRST FAMILY, THE EMPLOYEES AND THE NUMEROUS VISITORS AND TOURISTS WHILE THEY ARE IN AND AROUND THE WHITE HOUSE COMPLEX. THE REVIEW WAS FULLY AWARE OF THE IMPORTANCE OF PRESERVING THE WELCOMING ENVIRONMENT OF THIS NATIONAL TREASURE. BASED UPON THE EVIDENCE THEY ANALYZED, THE REVIEW CONCLUDED THAT IT HAD NO RECOURSE OTHER THAN TO RECOMMEND RESTRICTING VEHICULAR ACCESS FROM THE SEGMENT OF PENNSYLVANIA AVENUE IN FRONT OF THE WHITE HOUSE COMPLEX. THE INDEPENDENT NONPARTISAN ADVISORY COMMITTEE OF THE REVIEW, COMPOSED OF SIX DISTINGUISHED AMERICANS, SCRUTINIZED THE METHODS AND THE CONDUCT OF THE REVIEW, AND UNANIMOUSLY AGREED THAT THE FACTS COMPELLED ONLY ONE RECOMMENDATION: VEHICULAR ACCESS TO PENNSYLVANIA AVENUE MUST BE RESTRICTED IN ORDER TO PRESERVE THE SECURITY AND PUBLIC ACCESSIBILITY OF THE WHITE HOUSE. FACED WITH THIS OVERWHELMING INFORMATION, IT IS MY UNDERSTANDING THAT THE PRESIDENT

RELUCTANTLY AGREED TO THE SECRETARY'S RECOMMENDATION.

WITHIN THE CONTEXT OF UPHOLDING OUR VITAL, STATUTORILY-IMPOSED DUTY TO PROTECT THE PRESIDENT AND THE WHITE HOUSE COMPLEX, MAINTAINING PUBLIC ACCESS WAS AN IMPORTANT CONCERN THROUGHOUT THE REVIEW. THE REVIEW CONSIDERED HOW THE REROUTING OF TRAFFIC AROUND THE WHITE HOUSE COMPLEX WOULD AFFECT THE CITIZENS WHO LIVE AND WORK WITHIN THE DISTRICT OF COLUMBIA. PRIOR TO THE ANNOUNCEMENT OF THIS ACTION, THE REVIEW BRIEFED KEY MEMBERS OF CONGRESS ON THE RESULTS OF THE WHITE HOUSE SECURITY EVALUATION. THE REVIEW OFFERED TO ADDRESS THE CONCERNS OF DISTRICT OF COLUMBIA OFFICIALS REGARDING TRAFFIC, AMONG OTHER ISSUES.

BACKGROUND ON THE WHITE HOUSE SECURITY REVIEW

THE REVIEW WAS ESTABLISHED BY SECRETARY OF THE TREASURY LLOYD BENTSEN ON SEPTEMBER 12, 1994, FOLLOWING THE CRASH OF A SMALL PLANE ONTO THE SOUTH GROUNDS OF THE WHITE HOUSE. SECRETARY BENTSEN DIRECTED THEN-TREASURY UNDER SECRETARY RONALD K. NOBLE AND SECRET SERVICE DIRECTOR ELJAY B. BOWRON TO CONDUCT AN INVESTIGATION SO EXHAUSTIVE IN ITS SWEEP THAT "NO STONE WOULD BE LEFT UNTURNED." HAVING SERVED AS AN ASSISTANT DIRECTOR OF THE

REVIEW, I KNOW FIRST HAND THE AMOUNT OF WORK AND CAREFUL ANALYSIS THAT CULMINATED WITH THIS ACTION.

THE REVIEW EXAMINED THE PLANE CRASH, AS WELL AS A NUMBER OF OTHER INCIDENTS, INCLUDING THE OCTOBER 29, 1994 SHOOTING ON THE NORTH GROUNDS OF THE WHITE HOUSE. IN ADDITION, THE REVIEW EXAMINED THE DANGERS POSED TO THE WHITE HOUSE COMPLEX BY EITHER AIR OR GROUND ASSAULT.

SECRETARY BENTSEN APPOINTED A NONPARTISAN ADVISORY COMMITTEE COMPOSED OF SIX DISTINGUISHED AMERICANS TO ENSURE THAT THE REVIEW'S WORK WAS THOROUGH AND UNBIASED. THESE ADVISORS WERE ROBERT CARSWELL, FORMER DEPUTY SECRETARY OF THE TREASURY; WILLIAM COLEMAN, FORMER SECRETARY OF TRANSPORTATION; CHARLES DUNCAN, FORMER SECRETARY OF ENERGY AND DEPUTY SECRETARY OF DEFENSE; GENERAL DAVID JONES, FORMER CHAIRMAN OF THE JOINT CHIEFS OF STAFF; DR. JUDITH RODIN, PRESIDENT OF THE UNIVERSITY OF PENNSYLVANIA; AND JUDGE WILLIAM WEBSTER, FORMER DIRECTOR OF THE CIA AND THE FBI. THE MEMBERS OF THE ADVISORY COMMITTEE, WITH THEIR DIVERSE BACKGROUNDS, BROUGHT EXPERTISE AND CRITICAL INSIGHT TO THE WORK OF THE REVIEW. FURTHERMORE, THE ADVISORY COMMITTEE WAS ASKED TO EVALUATE THE REVIEW ON BEHALF OF THE GROUP MOST INTERESTED IN BALANCING THE SECURITY AND ACCESSIBILITY OF THE WHITE HOUSE COMPLEX--THE AMERICAN PEOPLE.

OVERSIGHT OF THE METHOD AND CONDUCT OF THE REVIEW ALSO WAS PROVIDED BY THE DEPARTMENT OF THE TREASURY'S OFFICE OF INSPECTOR GENERAL. THE INSPECTOR GENERAL DETERMINED THAT THE REVIEW WAS CONDUCTED IN A THOROUGH AND IMPARTIAL MANNER.

THE REVIEW IS THE MOST COMPREHENSIVE ANALYSIS OF WHITE HOUSE SECURITY EVER CONDUCTED. EXPERTS FROM EIGHT FOREIGN COUNTRIES WERE CONSULTED AND THREE FORMER PRESIDENTS WERE INTERVIEWED TO BRING ADDITIONAL PERSPECTIVE TO THE REVIEW. THE REVIEW INTERVIEWED OR RECEIVED BRIEFINGS FROM MORE THAN 300 INDIVIDUALS FROM AT LEAST TEN GOVERNMENT AGENCIES, AND ANALYZED MORE THAN 1,000 DOCUMENTS. WE ALSO CONSULTED MORE THAN TWENTY TECHNICAL AND PUBLIC ACCESS EXPERTS. THE REVIEW PRODUCED A CLASSIFIED REPORT OF MORE THAN 500 PAGES, AS WELL AS A PUBLIC REPORT.

THE REVIEW RETAINED TEN TECHNICAL CONSULTANTS TO STUDY OPTIONS FOR IMPROVING THE SECURITY OF THE WHITE HOUSE. THE REVIEW, WORKING WITH THE SECRET SERVICE, THE SECURITY CONSULTANTS, AND THE ADVISORY COMMITTEE, CAREFULLY STUDIED ALL POTENTIAL ALTERNATIVES SHORT OF CLOSING THE STREET TO VEHICULAR TRAFFIC. INDEED, A NUMBER OF THE ADVISORS WERE INITIALLY OPPOSED TO CLOSING PENNSYLVANIA AVENUE TO VEHICULAR TRAFFIC. AFTER HEARING ALL OF

THE TECHNICAL EVIDENCE, THE ADVISORS UNANIMOUSLY CONCLUDED THAT NONE OF THE ALTERNATIVES WOULD PROVIDE THE NECESSARY PROTECTION.

THE THREAT

NONE OF US WILL EVER FORGET EITHER THE PHYSICAL DESTRUCTION CAUSED BY THE BOMBINGS OF THE WORLD TRADE CENTER IN NEW YORK CITY AND THE MURRAH FEDERAL BUILDING IN OKLAHOMA CITY, OR THE MASSIVE LOSS OF LIFE AND INJURIES SUFFERED IN THOSE ATTACKS. IN THE OKLAHOMA CITY BOMBING, WHICH OCCURRED JUST A LITTLE OVER A YEAR AGO, OVER 300 BUILDINGS WERE DAMAGED; THERE ALSO WERE AT LEAST TEN COLLAPSED STRUCTURES. ALL OF THIS OCCURRED WITHIN A FIVE-BLOCK RADIUS OF THE MURRAH BUILDING.

THE ECONOMIC IMPACT OF THE BLAST ON OKLAHOMA CITY EXCEEDS $400 MILLION. IF YOU INCLUDE THE FEDERAL GOVERNMENT'S LOSSES, THE TOTAL INCIDENT LOSS APPROACHES $700 MILLION. SEVEN THOUSAND RESIDENTS OF OKLAHOMA CITY WERE LEFT WITHOUT A WORKPLACE AND ALMOST FIVE HUNDRED WERE LEFT HOMELESS.

AS DIRECTOR BOWRON WILL CONFIRM IN A FEW MOMENTS, THERE STILL ARE INDIVIDUALS HERE IN THE UNITED STATES WHO WOULD TARGET OUR WORKPLACES AND NATIONAL SYMBOLS SUCH AS THE WHITE HOUSE. WE

ARE WELL AWARE OF THEIR ABILITY TO INFLICT CATASTROPHIC DAMAGE. ALTHOUGH I CANNOT DISCUSS IN THIS FORUM THE SPECIFIC SENSITIVE INFORMATION THAT LED THE REVIEW TO RECOMMEND PROHIBITING VEHICULAR TRAFFIC ON THE SEGMENT OF PENNSYLVANIA AVENUE IN FRONT OF THE WHITE HOUSE, I CAN DIRECT YOU TO PUBLICLY AVAILABLE INFORMATION THAT ILLUSTRATES THE EXTENT OF THE THREAT.

FOR EXAMPLE -- IN A SPEECH THAT WAS LATER INTRODUCED AS EVIDENCE DURING HIS TRIAL, SHEIK OMAR ABDEL-RAHKMAN, LEADER OF THE GROUP OF NEW YORK CITY BOMBING CONSPIRATORS WHO WERE CONVICTED OF THE 1993 WORLD TRADE CENTER BOMBING, SAID THAT HIS GOAL HAD BEEN TO DESTROY HIS ENEMIES

...BY MEANS OF DESTROYING AND EXPLODING THE STRUCTURE OF THEIR CIVILIZED PILLARS SUCH AS THE TOURISTIC INFRASTRUCTURE WHICH THEY ARE PROUD OF AND THEIR HIGH WORLD BUILDINGS WHICH THEY HAVE THEIR STATUES WHICH THEY ENDEAR AND THE BUILDINGS IN WHICH GATHER THEIR LEADERS."

IN SHORT, THE THREAT IS REAL. WE CAN ALL IMAGINE THE DEVASTATING EFFECT THAT AN OKLAHOMA CITY-LIKE BLAST WOULD HAVE ON AND AROUND THE WHITE HOUSE. SINCE MAY 1995, ALMOST 800,000 VISITORS HAVE TOURED THE WHITE HOUSE, AN AVERAGE OF 2,300 VISITORS EACH DAY. THIS NUMBER DOES NOT INCLUDE, HOWEVER, THE FOREIGN DIGNITARIES AND OTHER OFFICIAL VISITORS TO THE WHITE HOUSE. AND IT

ALSO DOES NOT INCLUDE THE COUNTLESS MEN, WOMEN AND CHILDREN WHO STROLL THE PUBLIC AREAS IMMEDIATELY ADJACENT TO THE WHITE HOUSE GROUNDS EACH YEAR.

HAVING IDENTIFIED THE THREAT, WE THEN HAD TO DETERMINE WHAT TO DO.

CONSULTATIONS

FOR SECURITY REASONS, WE COULD NOT SEEK A FULL PUBLIC DEBATE ON THIS ISSUE PRIOR TO RESTRICTING VEHICULAR ACCESS TO PENNSYLVANIA AVENUE. ON THE EVENING OF MAY 19, 1995, THE REVIEW CONSULTED THE PRESIDENT, WHO RELUCTANTLY PROVIDED FINAL CONCURRENCE WITH SECRETARY RUBIN'S DECISION. WE THEN IMMEDIATELY NOTIFIED MAYOR BARRY, COUNCIL CHAIRMAN DAVID CLARKE, AND YOU, CHAIRMAN DAVIS. THE FOLLOWING WEEK, WE MET WITH MR. CLARKE AND MEMBERS OF THE COUNCIL OF THE DISTRICT OF COLUMBIA, AT WHICH TIME WE PROVIDED MORE DETAILED SECURITY INFORMATION, AND WE HAD THE OPPORTUNITY TO LISTEN CAREFULLY TO THEIR CONCERNS. THAT SAME WEEK WE MET ALSO WITH MAYOR BARRY AND CITY ADMINISTRATOR MICHAEL ROGERS, AND HELD A SIMILAR FRANK AND OPEN DISCUSSION OF THE ISSUES. WE THEN CONDUCTED FURTHER OUTREACH BY MEETING WITH REPRESENTATIVES FROM THE FEDERAL CITY COUNCIL, THE D.C. CHAMBER OF COMMERCE, AND

THE GREATER WASHINGTON BOARD OF TRADE.

THE REVIEW HAD ALREADY FULLY INVESTIGATED THE HISTORICAL SIGNIFICANCE OF PENNSYLVANIA AVENUE TO THE DISTRICT OF COLUMBIA AND THE PRESIDENTIAL PARK. TO ENSURE THAT THOSE CONCERNS WERE PROPERLY ADDRESSED, THE REVIEW CONSULTED THE FOLLOWING EXPERTS: HAROLD ADAMS, ARCHITECT; MAXINE GRIFFITH, URBAN DESIGNER AND MEMBER OF THE NEW YORK CITY URBAN PLANNING COMMISSION; NICHOLAS QUENNELL, LANDSCAPE ARCHITECT; WILLIAM SEALE, FORMER WHITE HOUSE HISTORIAN; VINCENT SCULLY, ARCHITECTURAL HISTORIAN; JOHN CARL WARNECKE, DESIGNER OF THE LAFAYETTE SQUARE PROJECT FOR FORMER FIRST LADY JACQUELINE KENNEDY ONASSIS; GEORGE WHITE, ARCHITECT OF THE CAPITOL; AND WILLIAM HOLLINGSWORTH WHYTE, URBAN PLANNER. EACH OF THE EXPERTS AGREED THAT PUBLIC ACCESS WOULD BE ENHANCED THROUGH STRATEGIC PLANNING.

FURTHERMORE, THE REVIEW RECOGNIZED THAT THE CITIZENS WHO LIVE AND WORK WITHIN THE DISTRICT OF COLUMBIA HAVE A UNIQUE AND IMPORTANT STAKE IN THE WHITE HOUSE AND ITS SURROUNDING STREETS. TO ENSURE THAT THE REVIEW CONSIDERED THEIR CONCERNS, WE MET WITH NUMEROUS INDIVIDUALS PRIOR TO THE SECRETARY'S ORDER TO ADDRESS THESE ISSUES: MEMBERS OF THE BLOOMINGDALE CIVIC ASSOCIATION:

REPRESENTATIVES FROM THE UNITED STATES CHAMBER OF COMMERCE AND THE ASSOCIATION OF D.C. CIVIC ASSOCIATIONS; LAWRENCE REUTER, THE GENERAL MANAGER OF THE WASHINGTON METROPOLITAN AREA TRANSIT AUTHORITY (WMATA); ENGINEER REPRESENTATIVES FROM WMATA AND THE DISTRICT OF COLUMBIA DEPARTMENT OF PUBLIC WORKS; LARRY KING, DIRECTOR, DEPARTMENT OF PUBLIC WORKS; CHIEF FRED THOMAS, METROPOLITAN POLICE DEPARTMENT; REGINALD GRIFFITH, EXECUTIVE DIRECTOR AND HARVEY GANTT, CHAIRMAN, OF THE NATIONAL CAPITAL PLANNING COMMISSION; GEORGES JACQUEMART, TRANSPORTATION PLANNER AND TRAFFIC ENGINEER; AND MEMBERS OF THE COMPREHENSIVE DESIGN PLAN FOR THE WHITE HOUSE. IN ADDITION, ROBERT L. MORRIS, CONSULTANT IN TRAFFIC AND TRANSPORTATION, CONDUCTED A STUDY ON THE FEASIBILITY OF REROUTING TRAFFIC AROUND THE WHITE HOUSE.

IN ADDITION, THE REVIEW SOUGHT THE ADVICE AND SUPPORT OF CONGRESS REGARDING THIS IMPORTANT DECISION. PRIOR TO THE SECRETARY'S ORDER, THE REVIEW CONSULTED WITH HOUSE AND SENATE LEADERSHIP AND WITH THE APPROPRIATE COMMITTEE MEMBERS WITH OVERSIGHT RESPONSIBILITY FOR THE SECRET SERVICE. TO CONTINUE THIS IMPORTANT DISCUSSION, THE SECRET SERVICE MET WITH MEMBERS OF THIS COMMITTEE TO DISCUSS THESE ISSUES, INCLUDING YOU, MR. CHAIRMAN, CONGRESSWOMAN NORTON, CONGRESSMAN HERR, CONGRESSMAN CLINGER,

AND CONGRESSMAN GUTKNECHT.

LEGAL AUTHORITY

THE SECRETARY'S ORDER WAS BASED ON HIS AUTHORITY UNDER 18 U.S.C. SECTION 3056 AND RELATED STATUES, THEIR LEGISLATIVE HISTORIES, AND RELEVANT COURT DECISIONS. LEGAL OPINIONS THAT DISCUSS THE SECRETARY'S AUTHORITY WERE PROVIDED BY TREASURY'S GENERAL COUNSEL AND THE OFFICE OF LEGAL COUNSEL AT THE DEPARTMENT OF JUSTICE. THE LAWYERS FROM BOTH DEPARTMENTS CONCLUDED THAT 18 U.S.C. SECTION 3056 GRANTS TO THE TREASURY SECRETARY THE BROAD AUTHORITY TO TAKE ACTIONS SUCH AS THIS ONE THAT ARE NECESSARY AND PROPER TO PROTECT THE PRESIDENT.

THE OFFICE OF LEGAL COUNSEL AT THE DEPARTMENT OF JUSTICE STATED IN ITS OPINION THAT "SECTION 3056 GRANTS THE SECRETARY BROAD AUTHORITY TO TAKE ACTIONS THAT ARE NECESSARY AND PROPER TO PROTECT THE PRESIDENT. IN LIGHT OF THE RECOMMENDATIONS OF THE WHITE HOUSE SECURITY REVIEW AND THE UNITED STATES SECRET SERVICE'S UNIQUE EXPERTISE AND SPECIAL RESPONSIBILITY IN THIS MATTER, WE AGREE WITH [THE] CONCLUSION THAT SECTION 3056 AUTHORIZES THE ACTIONS CONTEMPLATED BY THE SECRETARY."

PUBLIC ACCESS CONSIDERATIONS

THE REVIEW WAS CONCERNED NOT ONLY WITH PROTECTING THE PRESIDENCY, BUT ALSO WITH PRESERVING THE PUBLIC'S ACCESS TO THE WHITE HOUSE DESPITE THE NECESSITY OF IMPLEMENTING ADDITIONAL SECURITY MEASURES. FOR THAT REASON, THE REVIEW CONSULTED A NUMBER OF ARCHITECTS, HISTORIANS, AND URBAN PLANNERS WHO UNIFORMLY ENDORSED THE IDEA OF CONVERTING THIS STRETCH OF PENNSYLVANIA AVENUE INTO A PEDESTRIAN MALL. THEY CONSISTENTLY OPINED THAT A PEDESTRIAN PLAZA IN FRONT OF THE WHITE HOUSE COMPLEX WOULD ENHANCE THE PUBLIC ENJOYMENT OF THIS NATIONAL LANDMARK BY CREATING A FRIENDLIER, OPEN ENVIRONMENT. DISTRICT OF COLUMBIA AND NATIONAL TRAFFIC EXPERTS CONSULTED BY THE REVIEW CONFIRMED THAT, WITH PROPER IMPLEMENTATION, THE ADJACENT THOROUGHFARES WOULD ACCOMMODATE THE DIVERTED TRAFFIC.

TRAFFIC ISSUES

I UNDERSTAND THAT FEDERAL HIGHWAY ADMINISTRATOR SLATER WILL TESTIFY LATER TODAY ON ISSUES RELATING TO THE REROUTING OF TRAFFIC FROM PENNSYLVANIA IN FRONT OF THE WHITE HOUSE. I WOULD LIKE TO SPEND JUST A MOMENT ON THE PROCESS WE FOLLOWED AT TREASURY TO NOTIFY AND WORK WITH DISTRICT OF COLUMBIA ENTITIES AS

WE MOVED TOWARD IMPLEMENTING THE SECRETARY'S ORDER.

PRIOR TO RESTRICTING VEHICULAR ACCESS TO PENNSYLVANIA AVENUE, THE SECRET SERVICE MET WITH REPRESENTATIVES FROM THE DISTRICT OF COLUMBIA DEPARTMENT OF PUBLIC WORKS (DPW) AND THE METROPOLITAN POLICE DEPARTMENT (MPD) TO INFORM THEM THAT TRAFFIC REROUTING WAS A DISTINCT POSSIBILITY. THE SECRET SERVICE, DPW, AND MPD CONSTRUCTED A SHORT-TERM PLAN TO MANAGE TRAFFIC IN THE EVENT THE REROUTING OCCURRED. AFTERWARD, THE TREASURY DEPARTMENT FULLY REIMBURSED THE MPD FOR THE COSTS IT INCURRED IN ASSIGNING OFFICERS TO WORK OVERTIME TO DIRECT TRAFFIC.

IMMEDIATELY AFTER THE REROUTING WAS MADE DEFINITE, THE DEPARTMENT OF TRANSPORTATION AND THE FEDERAL HIGHWAY ADMINISTRATION (FHWA) JOINED IN THE TRAFFIC MANAGEMENT EFFORTS, OFFERING THE EXPERTISE OF THEIR ENGINEERS AND RESOURCES TO ALLEVIATE THE ECONOMIC IMPACT ON THE CITY.

I UNDERSTAND THAT DECISIONS REGARDING THE IMPACT OF THE RESTRICTING OF VEHICULAR TRAFFIC FROM THE SEGMENT OF PENNSYLVANIA AVENUE IN FRONT OF THE WHITE HOUSE IN AMONG A BROAD RANGE OF FEDERAL/DISTRICT ISSUES THAT IS BEING CONSIDERED BY THE PRESIDENT'S INTERAGENCY TASK FORCE ON THE DISTRICT OF COLUMBIA. THE TASK FORCE WAS CREATED LAST YEAR TO DEVELOP OPTIONS FOR EXECUTIVE BRANCH AGENCIES TO ASSIST THE DISTRICT IN ITS FISCAL RECOVERY EFFORTS. I HAVE BEEN INFORMED THAT THE TASK FORCE WILL REVIEW THE IMPACT OF THE PENNSYLVANIA AVENUE DECSION AND DETERMINE WHAT MAY BE NEEDED TO MITIGATE ITS IMPACT IN THE CONTEXT OF THESE AND OTHER ISSUES. THE DEPARTMENTS OF TRANSPORTATION AND TREASURY ARE CURRENTLY ACTIVE TASK FORCE MEMBERS, AND I UNDERSTAND THAT GSA AND INTERIOR HAVE PARTICIPATED IN TASK FORCE ACTIVITIES.

TREASURY, WITH THE ASSISTANCE OF THE FEDERAL HIGHWAY ADMINISTRATION, IS WORKING TO COMPLY WITH ALL REQUIREMENTS OF THE NATIONAL ENVIRONMENTAL POLICY ACT (NEPA), AND HAS PAID ALL COSTS ASSOCIATED WITH THAT ENDEAVOR. IN ADDITION, TREASURY COORDINATED WITH THE ADVISORY COUNCIL ON HISTORIC PRESERVATION AT THE TIME OF THE SECRETARY'S ORDER AND CONTINUES TO ADDRESS HISTORIC PRESERVATION ISSUES IN CONNECTION WITH OUR NEPA WORK.

PENNSYLVANIA AVENUE IN THE FUTURE

AS YOU MAY KNOW, THE PROCESS OF PLANNING THE PEDESTRIAN PLAZA IS BEING UNDERTAKEN BY AGENCIES OTHER THAN TREASURY. I WILL NOT COMMENT ON THESE AREAS EXCEPT IN THE FOLLOWING TERMS.

I UNDERSTAND THAT THE DEPARTMENT OF THE INTERIOR AND THE NATIONAL PARK SERVICE ARE SPEARHEADING THE EFFORT TO DEVELOP BOTH SHORT-AND LONG-TERM DESIGNS FOR THAT SEGMENT OF PENNSYLVANIA AVENUE IN FRONT OF THE WHITE HOUSE. THE NATIONAL PARK SERVICE IS NOW WORKING WITH A PREEXISTING GROUP, THE COMPREHENSIVE DESIGN PLAN FOR THE WHITE HOUSE, TO DEVELOP THOSE PLANS.

I HAVE BEEN INFORMED THAT ON MAY 22, 1996, THE COMPREHENSIVE DESIGN PLAN ANNOUNCED THEIR DESIGN ALTERNATIVES FOR PENNSYLVANIA AVENUE. I UNDERSTAND THAT DESIGN ALTERNATIVES RESULT FROM THE COLLABORATIVE EFFORTS OF SEVERAL ENTITIES INCLUDING CONGRESS AND DISTRICT OF COLUMBIA OFFICIALS.

I UNDERSTAND THAT THE PROPOSED PEDESTRIAN PLAZA WILL MAINTAIN THE DISTINCTIVELY AMERICAN ACCESS TO OUR LEADERS WHO RESIDE IN THE WHITE HOUSE. OF ALL EXECUTIVE MANSIONS AROUND THE WORLD THAT WERE STUDIED, ONLY AT THE WHITE HOUSE IS THE PUBLIC

GIVEN ACCESS WHILE THE PRINCIPAL RESIDENT IS THERE. THE PEDESTRIAN PLAZA CONCEPT IS CONSISTENT WITH L'ENFANTS' AND PRESIDENT WASHINGTON'S VISION FOR THE WHITE HOUSE, AND IT IS SIMILAR TO AN IDEA THAT PRESIDENT AND MRS. KENNEDY ENDORSED A GENERATION AGO. AT THE SAME TIME, THE PLAZA WILL SIGNIFICANTLY REDUCE THE SECURITY RISK POSED TO THE WHITE HOUSE AND NEARBY AREAS BY AN EXPLOSIVE-LADEN VEHICLE.

WE ALL BELIEVE THAT THIS EFFORT WILL BE TO MAKE THE SEGMENT OF PENNSYLVANIA AVENUE IN FRONT OF THE WHITE HOUSE A BEAUTIFUL AND INVITING PEDESTRIAN AREA. PENNSYLVANIA AVENUE WILL CONTINUE TO BE THE SITE OF THE PRESIDENTIAL INAUGURAL PARADE; AND EMERGENCY AND OFFICIAL VEHICLES WILL CONTINUE TO HAVE ACCESS TO THIS AREA. WE WILL CONTINUE OUR EFFORTS TO COORDINATE WITH ALL INTERESTED PARTIES TO MAKE THE AREA BENEFICIAL TO THE PRESIDENT AND THE FIRST FAMILY; TO THE CITIZENS OF THE DISTRICT OF COLUMBIA AND THE METROPOLITAN WASHINGTON AREA; AND TO ALL THOSE WHO EITHER VISIT OR HOPE TO VISIT THE "PEOPLE'S HOUSE.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
June 10, 1996

STATEMENT BY TREASURY SECRETARY ROBERT RUBIN MEETING WITH AFRICAN AMERICAN MINISTERS ON CHURCH FIRES

We had a productive and candid meeting today with ministers from the southeastern United States whose churches have been victims of the awful string of arsons in the last few years. The ministers met yesterday with Attorney General Reno, and I am pleased to have had an opportunity to meet with them today and to hear their concerns.

President Clinton made it clear in his Saturday morning radio address that this Administration will do everything in our power to get to the bottom of these fires. Few crimes are as sensitive or important as the torching of our places of worship. We must never let our country return to the violence of the 1950s and 1960s that was used to intimidate civil rights activists. ATF was not around then, but it is today. Therefore, we will not be satisfied until 100 per cent of the arson cases are solved, and the perpetrators brought to justice. Whatever it takes, however long, and whomever is responsible.

I expressed my commitment to the high-level task force -- which will be led by Assistant Treasury Secretary for Enforcement James Johnson and Assistant Attorney General Patrick, and will include ATF Director John Magaw and FBI Director Louis Freeh. We will continue our extensive efforts to bring the perpetrators of these crimes to justice.

We discussed the new ATF security packet which will be distributed to churches throughout the region. Furthermore, as the President announced Saturday, ATF now has a toll-free number to collect information on the fires. The number is 1-888-ATF-FIRE.

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RR-1124

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
June 10, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $15,727 million of 13-week bills to be issued June 13, 1996 and to mature September 12, 1996 were accepted today (CUSIP: 9127943G7).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.14%	5.28%	98.701
High	5.16%	5.30%	98.696
Average	5.16%	5.30%	98.696

Tenders at the high discount rate were allotted 40%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$53,797,577	$15,726,581
Type		
Competitive	$48,669,732	$10,598,736
Noncompetitive	1,423,065	1,423,065
Subtotal, Public	$50,092,797	$12,021,801
Federal Reserve	3,294,780	3,294,780
Foreign Official Institutions	410,000	410,000
TOTALS	$53,797,577	$15,726,581

5.15 - 98.698

RR-1125

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
June 10, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $15,574 million of 26-week bills to be issued June 13, 1996 and to mature December 12, 1996 were accepted today (CUSIP: 9127942B9).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.33%	5.55%	97.305
High	5.35%	5.58%	97.295
Average	5.34%	5.57%	97.300

Tenders at the high discount rate were allotted 13%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$57,839,574	$15,574,277
Type		
Competitive	$50,634,845	$8,369,548
Noncompetitive	1,213,029	1,213,029
Subtotal, Public	$51,847,874	$9,582,577
Federal Reserve	3,450,000	3,450,000
Foreign Official Institutions	2,541,700	2,541,700
TOTALS	$57,839,574	$15,574,277

RR-1126

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
June 11, 1996

Contact: Rebecca Lowenthal
(202) 622-2960

TREASURY TO WORK WITH CONGRESS ON PREPAID TUITION PLANS

The U.S. Treasury Department and the Internal Revenue Service are studying state-sponsored prepaid tuition plans and intend to work with Congress to develop legislation clarifying the tax treatment of these plans to encourage parents to save for their children's education.

The President's budget for fiscal year 1997 already includes a provision allowing IRAs to invest in state-sponsored prepaid tuition plans.

At least 12 states currently sponsor plans designed to help residents save for the cost of higher education. Other states have passed or are considering legislation creating similar plans. Although the terms of the plans vary, the typical plan allows residents to purchase a contract to save for college. The contract can be redeemed for tuition or credits, or the payment on the contract can be linked to the change in the price of college. If the beneficiary of the contract does not attend a covered post-secondary institution, many of the plans return to the purchaser the initial purchase price of the contract.

Treasury also announced that final Treasury regulations issued June 11 that address the treatment of certain financial instruments will not apply to contracts issued pursuant to a state-sponsored prepaid tuition plan. In addition, pursuant to Revenue Procedure 96-34, also issued today, the IRS will not issue private rulings on state-sponsored prepaid tuition plans while they are being studied.

-30-

RR-1127

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGOED UNTIL 2:30 P.M.
June 11, 1996

CONTACT: Office of Financing
202/219-3350

TREASURY'S WEEKLY BILL OFFERING

The Treasury will auction two series of Treasury bills totaling approximately $27,000 million, to be issued June 20, 1996. This offering will result in a paydown for the Treasury of about $13,650 million, as the maturing bills total $40,652 million (including the 36-day cash management bill issued on May 15, 1996, in the amount of $13,045 million).

Federal Reserve Banks hold $6,849 million of the maturing bills for their own accounts, which may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders.

Federal Reserve Banks hold $4,629 million as agents for foreign and international monetary authorities, which may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders. Additional amounts may be issued for such accounts if the aggregate amount of new bids exceeds the aggregate amount of maturing bills.

Tenders for the bills will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

Details about each of the new securities are given in the attached offering highlights.

oOo

Attachment

RR-1128

HIGHLIGHTS OF TREASURY OFFERINGS OF WEEKLY BILLS
TO BE ISSUED JUNE 20, 1996

June 11, 1996

<u>**Offering Amount**</u>	$13,500 million	$13,500 million
<u>**Description of Offering**</u>:		
Term and type of security	91-day bill	182-day bill
CUSIP number	912794 Z8 0	912794 3S 1
Auction date	June 17, 1996	June 17, 1996
Issue date	June 20, 1996	June 20, 1996
Maturity date	September 19, 1996	December 19, 1996
Original issue date	September 21, 1995	June 20, 1996
Currently outstanding	$32,825 million	- - -
Minimum bid amount	$10,000	$10,000
Multiples	$ 1,000	$ 1,000

<u>**The following rules apply to all securities mentioned above**</u>:

<u>Submission of Bids</u>:

Noncompetitive bids . . . . Accepted in full up to $1,000,000 at the average discount rate of accepted competitive bids

Competitive bids . . . .
(1) Must be expressed as a discount rate with two decimals, e.g., 7.10%.
(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position is $2 billion or greater.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

<u>Maximum Recognized Bid at a Single Yield</u> . . . . 35% of public offering

<u>Maximum Award</u> . . . . 35% of public offering

<u>Receipt of Tenders</u>:

Noncompetitive tenders . . . . . . Prior to 12:00 noon Eastern Daylight Saving time on auction day

Competitive tenders . . . . Prior to 1:00 p.m. Eastern Daylight Saving time on auction day

<u>Payment Terms</u> . . . . Full payment with tender or by charge to a funds account at a Federal Reserve Bank on issue date

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

June 11, 1996

Monthly Release of U.S. Reserve Assets

The Treasury Department today released U.S. reserve assets data for the month of May 1996.

As indicated in this table, U.S. reserve assets amounted to $83,469 million at the end of May 1996, down from $83,710 million in April 1996.

U.S. Reserve Assets
(in millions of dollars)

End of Month	Total Reserve Assets	Gold Stock 1/	Special Drawing Rights 2/3/	Foreign Currencies 4/	Reserve Position in IMF 2/
1996					
April	83,710	11,052	10,963	46,578	15,117
May	83,469	11,052p	11,037	46,153	15,227

1/ Valued at $42.2222 per fine troy ounce.

2/ Beginning July 1974, the IMF adopted a technique for valuing the SDR based on a weighted average of exchange rates for the currencies of selected member countries. The U.S. SDR holdings and reserve position in the IMF also are valued on this basis beginning July 1974.

3/ Includes allocations of SDRs by the IMF plus transactions in SDRs.

4/ Includes holdings of Treasury and Federal Reserve System; beginning November 1978, these are valued at current market exchange rates or, where appropriate, at such other rates as may be agreed upon by the parties to the transactions.

p Preliminary

RR-1129

DEPARTMENT OF THE TREASURY
BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

Arson and Explosives Division

Church Threat Assessment Guide

1996

DIRECTOR'S MESSAGE

The burning of churches is a particularly heinous crime because those who would attack our churches seek to strike at our most fundamental liberties and sources of personal support. Historically, churches have served as places of sanctuary, centers of the community, and symbols of freedom. ATF is committed to fully applying our investigative resources to determine the cause of those fires and arrest those responsible for the arsons.

One aspect of this commitment is the dissemination of the Church Threat Assessment guide. It contains valuable information on the steps that may be taken to prevent fires at churches, the steps to follow after an incident has occurred, the toll free telephone number, 1-888-ATF-FIRE, and the telephone numbers of ATF offices for providing authorities information about any acts of violence, or threats of violence, directed at churches nationwide.

We must all work together to solve and prevent these despicable crimes. With your continued assistance and support, and your cooperation in applying the recommendations contained within this booklet, churches and congregations will be better protected from this type of violence.

John W. Magaw

John W. Magaw
Director

CHURCH THREAT ASSESSMENT GUIDE

The following is a guide to assessing church vulnerability to arson and bombing attacks. It should not be considered all inclusive. Your local Bureau of Alcohol, Tobacco and Firearms (ATF) office, police or sheriff's department should be contacted for additional guidance concerning a specific plan for your church.

Areas of Vulnerability

- Churches located in isolated or rural areas.
- Churches left unattended for extended periods of time.
- Churches with unsecured doors and/or uncovered windows leave weak points for forced entry by intruders.
- The absence of an adequate burglar alarm system provides a determined criminal with additional time for criminal activity.
- Heavy shrubs and outside vegetation, and/or the absence of sufficient perimeter lighting, provides security for criminals, not victims.

Affirmative Actions to Reduce Vulnerability

1. Install perimeter floodlights outside the building.

   Criminals can conceal their presence and activity from witnesses at night. Adequate lighting that illuminates all points of entry *(doors, windows, skylights, etc.)* discourages them. Interior lights in areas visible through exterior windows should be left on during all hours of darkness. Exterior lights should have protective screens over them to prevent vandalism. All lights should be checked weekly for serviceability. Relatively inexpensive motion activated and/or timing equipment may be purchased to automatically turn lights on and off.

2. Install an adequate burglar alarm system.

   Alarms should be installed by reputable local companies that can service and properly maintain the equipment. Please note that some municipalities or police departments have enacted burglar alarm standards and will not respond to false alarms by inferior systems that frequently cause false alarms. Check with your local police or sheriff's department.

3. Install entrance/exit doors with interior hinges and hinge pins to prevent an intruder from removing the door. Solid wood or sheet metal faced doors provide extra integrity that a hollow core wooden door cannot. Metal security grates or screens that cover the entire door and frame also provide added security.

A steel door frame that properly fits the door is as important as the construction of the door.

With the proper foundation of a sufficient door and frame, the most obvious consideration, door locks, can be addressed. Long throw dead bolts of hardened steel are excellent deterrents to forced entry. Many standard locks are easy to pick or break open.

4. Install burglar-proof bars on screens, and large roof vents to prohibit access through them. However, it should be noted that aesthetic or fire safety considerations often preclude their use. **Local ordinances should be researched BEFORE costly security renovations are undertaken.**

   Windows are common points of entry for criminals, regardless of their height from the ground. Burglars can open unlocked windows, break glass and unlock locked windows, saw through metal or wooden frames, or pry entire window frames from exterior walls.

5. Heavy shrubs and vines should be kept low to the ground to reduce their potential to conceal criminals or incendiary or explosive devices. Large trees or vines should be removed to prevent criminals from climbing to upper windows, large vents, or onto the roof.

6. Participate in formal Neighborhood Watch type programs conducted by your local law enforcement agency.

7. Meet with your neighbors and security personnel assigned to your neighboring businesses. Explain your situation and ask them to keep an eye on your church.

8. Educate personnel on methods to deal with telephoned threats and conducting bomb searches. Develop a written protocol for threats and keep it posted.

9. Document any strange or threatening phone calls. Talk with the phone company about tracing your lines or installing Caller ID to identify your callers if you are receiving threats.

10. If a suspicious package or letter is received, immediately call your local police or sheriff's department. Do not touch or manipulate the object in any manner. Be alert for letters or packages that display an excessive amount of postage, contain grease stains, or have unfamiliar or missing return addresses. *(See the "Suspect Letter and Package Indicators" page)*

11. Keep the handling of threatening correspondence, once identified, to an absolute minimum. Place envelopes, letters or the packages in clear plastic bags and do not compress the bag. Store them in another location until they can be turned over to law enforcement.

12. On a rotating basis, have a member of the congregation, who is at least 18 years of age, check on the church daily. Evaluate the need for a security guard for nights and weekends.

13. Obtain as detailed a physical description as possible of any suspicious person(s) noticed in or around your facility, including a description of vehicles and license numbers. (Refer to enclosed worksheet, "Suspect Description")

14. Duplicate all documents, computer disks, and records that are stored at the church. Complete a comprehensive inventory of all furniture and equipment, to include serial numbers and value. Evaluate insurance coverage frequently.

15. Remove all potential fire hazards from the church grounds, such as trash, lawn clippings and debris. Store all combustible materials in a locked room, shed, etc.

CAUTIONARY NOTES:

A. DO NOT allow watch persons to sleep inside the church

B. The carrying of firearms, nightsticks, mace, or any type of weapon while conducting surveillance or participating in church watch programs should not be permitted.

C. DO NOT approach a suspicious person, challenge anyone, or otherwise place yourself in jeopardy. If a suspicious situation is found, report it to the nearest law enforcement agency. Take detailed, legible notes of the activity, which may be used later for court or police purposes.

D. DO NOT pursue vehicle or suspects.

E. Remember, you do not possess police powers and you are liable as an individual for civil and criminal charges should you exceed your authority. The key is to OBSERVE and REPORT.

F. DO NOT allow anyone to check on the church after having consumed alcohol. Do not allow anyone to stand watch and consume alcohol.

G. If possible, conduct the watch patrol in pairs.

H. Conduct watches in a random fashion and not in an observable pattern.

Please realize that a perfect security system does not exist and that some of these recommendations may or may not be practical for a place of worship. However, these suggestions can reduce the potential for an arson, bombing, or burglary at your church. Many of the listed security measures are quite expensive and may be beyond the means of many churches. Local police crime prevention sections are excellent sources for security evaluations and suggestions. They will assist you in prioritizing your needs within your budget constraints.

We realize these recommendations are not all inclusive. We welcome your ideas for improving this assessment and also the descriptions of any measures you have taken, not contained within this guide, that should be shared with other congregations. Please contact ATF through our Toll Free number, 1-888-ATF-FIRE, to provide this information.

SUSPECT DESCRIPTION

FILL OUT AS BEST YOU CAN

GIVE TO THE FIRST POLICE OFFICER ON THE SCENE

SEX	RACE	AGE	HEIGHT	WEIGHT	WEAPON TYPE

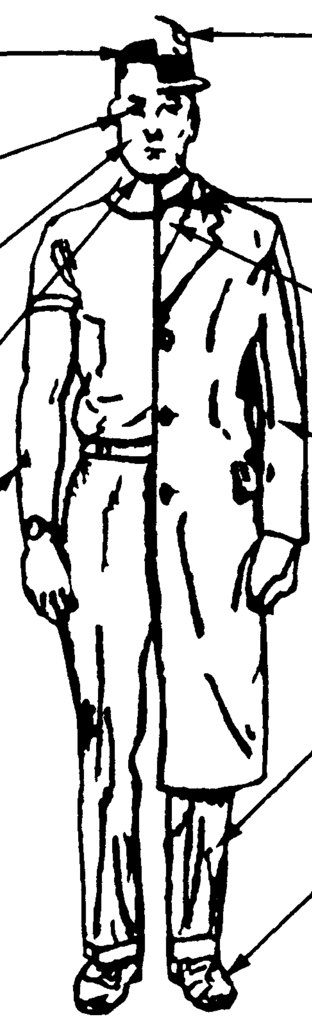
HAIR

GLASSES TYPE

COMPLEXION

SCARS/MARKS

TATTOOS



HAT (color, type)

TIE

SHIRT

COAT

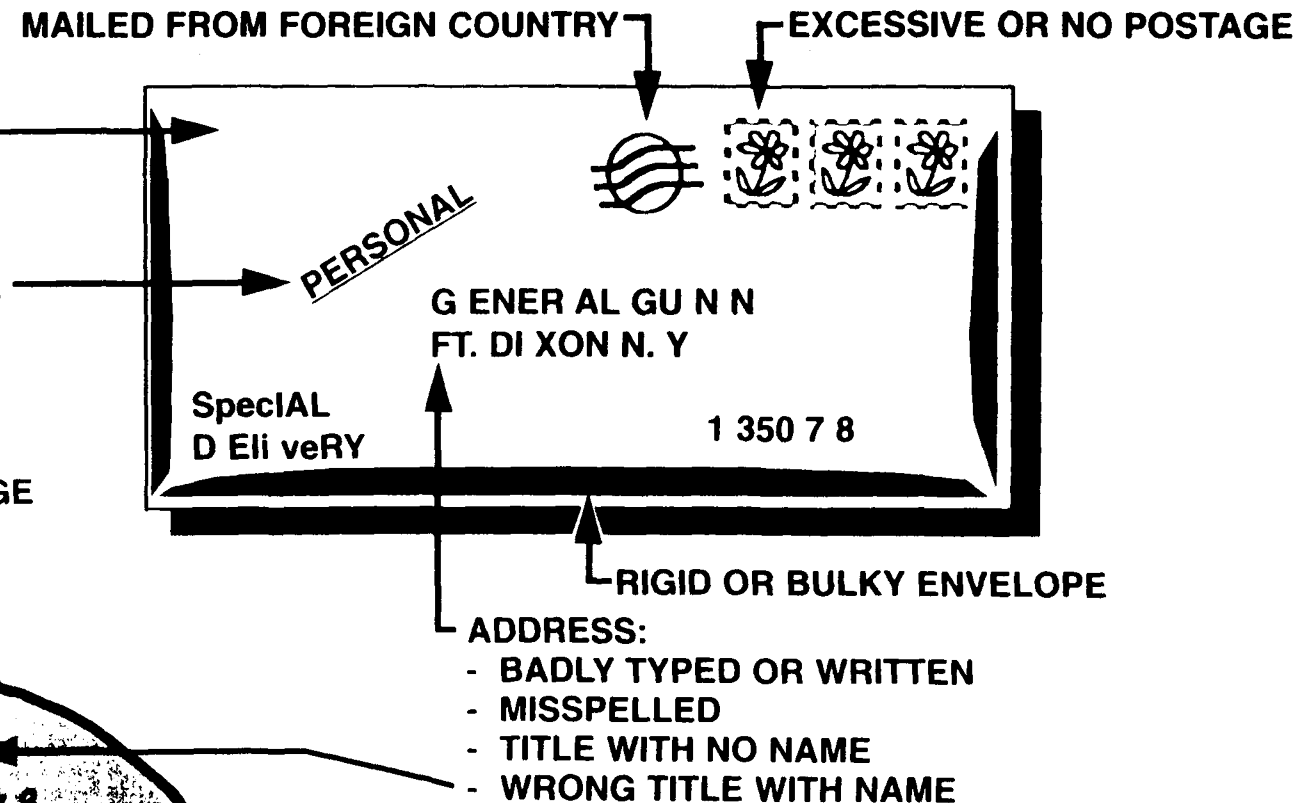
TROUSERS

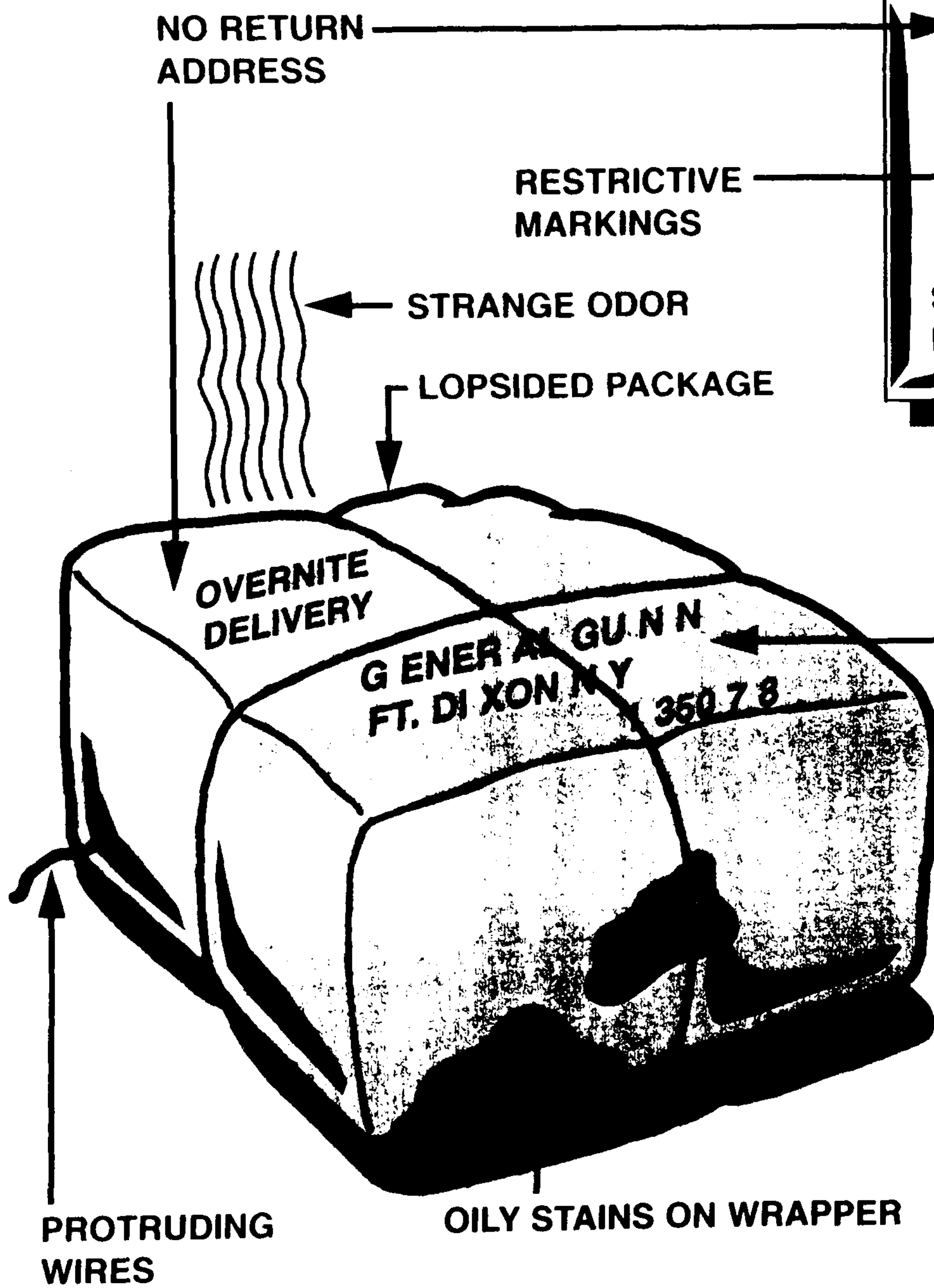
SHOES

AUTO LICENSE, MAKE, COLOR	DIRECTION OF TRAVEL

ADDITIONAL INFORMATION:

WARNING! Suspect Letter and Package Indicators





PRECAUTIONS:

1. Never accept mail, especially packages, while in a foreign country.

2. Make sure family members and clerical staff know to refuse all unexpected mail at home or office.

3. Remember - <u>IT MAY BE A BOMB</u> - Treat it as suspect.

FOR MORE INFORMATION ON BOMB SECURITY OR BOMB THREATS, CONTACT YOUR LOCAL ATF OFFICE.

ATF I 3324.1 (6/95)

BUREAU OF ALCOHOL, TOBACCO AND FIREARMS
ARSON AND BOMBING RESPONSE NUMBERS

ATF NATIONAL ARSON HOTLINE (OPERATIONAL 24 HOURS A DAY)	TOLL FREE 1-888-ATF-FIRE
ATF NATIONAL BOMB HOTLINE (OPERATIONAL 24 HOURS A DAY)	TOLL FREE 1-888-ATF-BOMB
ATF NATIONAL COMMUNICATIONS CENTER (OPERATIONAL 24 HOURS A DAY)	TOLL FREE 1-800-800-3855
ATF ARSON AND EXPLOSIVES DIVISION (HEADQUARTERS - WASHINGTON, D.C.)	202-927-7930

ATF LAW ENFORCEMENT FIELD OFFICES

ATLANTA FIELD DIVISION: 404-331-6526

Atlanta, GA. (ARSON II GROUP) 404-331-6436
Macon, GA. 912-474-0477
Savannah, GA. 912-652-4251

BALTIMORE FIELD DIVISION: 410-962-0897

Baltimore, MD. (GROUP I) 410-962-4115
Hyattsville, MD. 301-436-8313
Wilmington, DE. 302-573-6102

BIRMINGHAM FIELD DIVISION: 205-731-1205

Birmingham, AL. 205-731-1111
Gulfport, MS. 601-863-4871
Huntsville, AL. 205-539-0623
Jackson, MS. 601-965-4205
Mobile, AL. 334-441-5338
Montgomery, AL. 333-223-7507
Oxford, MS. 601-234-3751

BOSTON FIELD DIVISION: 617-565-7042

Boston (GROUP I/ARSON) 617-565-7050
Burlington (WILLSTON,VT.) 802-463-3238
Hartford, CT. 203-240-3185
New Haven, CT. 203-773-2060
Portland, ME. 207-780-3324

BOSTON FIELD DIVISION (CONTINUED): **617-565-7042**

Concord, NH. 603-225-1547
Providence, RI. 401-528-4366
Springfield, MA. 413-785-0007
Worchester, MA. 508-793-0240

CHARLOTTE FIELD DIVISION: **704-344-6125**

Charlotte, NC. (GROUP I) 704-344-6126
Charlotte, NC. (GROUP II) 704-344-6119
Charleston, SC. 803-727-4275
Columbia, SC. 803-765-5723
Fayetteville, NC. 910-483-3030
Greenville, SC. 864-232-3221
Greensboro, NC. 910-547-4224
Raleigh, NC. 919-856-4366
Wilmington, NC. 910-343-4936

CLEVELAND FIELD DIVISION: **216-522-7210**

Cincinnati, OH. 513-684-3354
Cleveland, OH. 216-522-3080/3786
Columbus, OH. 614-469-6717
Toledo, OH. 419-259-7520
Youngstown, OH. 216-747-8285

CHICAGO FIELD DIVISION: **312-353-6935**

Chicago, IL. (ARSON GROUP) 312-886-5441
Oakbrook, IL. 708-268-0986/1274
Springfield, IL. 217-492-4273
Merrillville, IN. 219-791-0702

DALLAS FIELD DIVISION: **214-767-2250**

Dallas, TX. (ARSON GROUP) 214-767-0530
Fort Worth, TX. 817-334-2771
Lubbock, TX. 806-798-1030
Oklahoma, TX. 405-297-5060
Tyler, TX. 903-592-3927
Tulsa, OK. 918-581-7731

DETROIT FIELD DIVISION: **313-393-6019**

Detroit, MI. (ARSON GROUP) 313-393-6036
Flint, MI. 810-766-5010

Detroit Field Division (Continued): 313-393-6019

Grand Rapids, MI. 616-456-2566

Houston Field Division: 713-449-2073

Austin, TX 512-349-4545
Beaumont, TX 409-835-0062
Corpus Christi, TX 512-888-3392
El Paso, TX 915-534-6449
Houston, TX (Arson Group) 713-449-2093
McAllen, TX 210-687-5207
San Antonio, TX 210-805-2727
Waco, TX 817-741-9900

Kansas City Field Division: 816-421-3440

Colorado Springs, CO. 719-473-0166
Des Moines, IA. 515-284-4372
Denver, CO. (Arson/Explosives Group) 303-866-1173
Kansas City, MO. (Arson Group) 816-421-3231
Omaha, NE. 402-221-3651
Springfield, MO. 417-864-4707
Wichita, KS. 316-269-6229

Los Angeles Field Division: 213-894-4812

Los Angeles, CA. (Arson Group) 213-894-4840
Long Beach, CA. 310-980-3434
Riverside, CA. 909-276-6031
San Diego, CA. 619-557-6663
Van Nuys, CA. 818-756-4350

Louisville Field Division: 502-582-5211

Ashland, KY. 606-329-8092
Bowling Green, KY. 502-781-7090
Ft. Wayne, IN. 219-424-4440
Indianapolis, IN. 317-226-7464
Lexington, KY. 606-233-2771
Louisville, KY. (Field Office) 502-582-5213

Miami Field Division: 305-597-4800

Jacksonville, FL. 904-232-2228
Ft. Lauderdale, FL. 954-356-7369
Ft. Myers, FL. 813-334-8086

Miami Field Division (Continued): 305-597-4800

Hato Rey San Juan, PR. 809-766-5084
Miami, FL. 305-597-4778/4807
Orlando, FL. 407-648-6136
Pensacola, FL. 904-435-8485
St. Croix, VI. 809-692-9435
St. Thomas, VI. 809-774-5757
Tallahassee, FL. 904-942-9660
Tampa, FL. 813-228-2184
West Palm Beach, FL. 407-835-8878

Nashville Field Division: 615-781-5364

Chattanooga, TN. 423-855-6422
Knoxville, TN. 423-545-4505
Memphis, TN. 901-766-2904

New Orleans Field Divison: 504-589-2350

Baton Rouge, LA. 504-389-0485
Little Rock, AR. 501-324-6181
New Orleans, LA. (Arson Group) 504-589-2314/2563
Shreveport, LA. 318-676-3301

New York Field Division: 212-264-4658

Albany, NY. 518-431-4182
Buffalo, NY. 716-551-4041
Melville, NY. 516-694-8372
New York (Arson Group) 718-896-6400
Newark, NJ. (Arson Group) 201-357-4070
Rochester, NY. 716-262-2110
Syracuse, NY. 315-448-0889

Philadelphia Field Division: 215-597-7266

Atlantic City, NJ. 609-625-2228
Camden, NJ. 609-968-4884
Harrisburg, PA. 717-782-3884
Philadelphia, PA. (Arson Group) 215-597-9080
Pittburgh, PA. (Arson Group) 412-644-2911
Reading, PA. 610-320-5222
Trenton, NJ. 609-989-2155
Wheeling, WV. 304-232-4170

PHOENIX FIELD DIVISION: **602-640-2840**

Albuquerque, NM. 505-766-2271
Phoenix, AR. (FIELD OFFICE) 602-640-2025
Tucson, AR. 520-670-4725/4882

SAN FRANCISCO FIELD DIVISION: **415-744-7001**

Bakersfield, CA. 805-861-4420
Fresno, CA. 209-487-5393
Las Vegas, NV. 702-388-6584
Reno, NV. 702-784-5251
Oakland, CA. 510-637-3431
Sacramento, CA. 916-498-5100
Salt Lake City, UT. 801-524-5853
San Francisco, CA. (ARSON GROUP) 415-744-7012

SEATTLE FIELD DIVISION: **206-220-6440**

Agana, GUAM 671-472-7129
Anchorage, AK. 907-271-5701
Billings, MT. 406-657-6886
Boise, ID. 208-334-1983
Cheyenne, WY. 307-772-2346
Helena, MT. 406-441-1101
Honolulu, HI. 808-541-2670
Portland, OR. 503-326-2171
Seattle, WA. (ARSON GROUP) 206-220-6450
Spokane, WA. 509-353-2862
Yakima, WA. 509-454-4403

ST. LOUIS FIELD DIVISION: **314-425-5560**

Cape Girardeau, MO. 573-335-3163
Fairview Heights, IL. 618-632-9380
St. Louis, MO. (FIELD OFFICES) 314-425-5563/5551

ST. PAUL FIELD DIVISION: **612-290-3092**

Fargo, ND. 701-239-5176
Milwaukee, WI. 414-297-3937
Sioux Falls, SD. 605-330-4368
St. Paul, MN. (FIELD OFFICE) 612-290-3459

WASHINGTON FIELD DIVISION: 202-219-7751

Bristol, VA. 540-466-2727
Falls Church, VA. (ARSON GROUP) 703-285-2551
Norfolk, VA. 804-441-3190
Richmond, VA. 804-560-0005
Roanoke, VA. 540-857-2300

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

Remarks as prepared for delivery
June 13, 1996

STATEMENT OF RAYMOND M. KELLY NOMINEE FOR UNDER SECRETARY OF THE TREASURY FOR ENFORCEMENT SENATE FINANCE COMMITTEE

RR-1130

PREPARED STATEMENT OF RAYMOND M. KELLY
NOMINEE FOR UNDER SECRETARY OF THE TREASURY FOR ENFORCEMENT

STATEMENT OF RAYMOND W. KELLY

MR. CHAIRMAN, SENATOR MOYNIHAN AND MEMBERS OF THE COMMITTEE. THANK YOU FOR GIVING ME THIS OPPORTUNITY TO APPEAR BEFORE YOU TODAY AS YOU CONSIDER MY NOMINATION AS UNDER SECRETARY OF THE TREASURY FOR ENFORCEMENT.

I ALSO WANT TO THANK PRESIDENT CLINTON AND SECRETARY RUBIN FOR THEIR EXPRESSION OF CONFIDENCE IN ME WITH THIS NOMINATION.

(WITH ME TODAY ARE MY WIFE VERONICA AND SON JAMES. MY OTHER SON, GREGORY, A MARINE CORP CAPTAIN AND PILOT, UNFORTUNATELY COULD NOT BE HERE).

NEARLY ALL OF MY PROFESSIONAL LIFE HAS BEEN INVOLVED WITH LAW ENFORCEMENT. MOST OF IT WITH THE NEW YORK CITY POLICE DEPARTMENT WHICH I JOINED WHEN I WAS STILL IN COLLEGE AND LEFT 32 YEARS LATER AS POLICE COMMISSIONER, HAVING SERVED IN NEARLY EVERY RANK AND IN 25 SEPARATE COMMANDS.

SHORTLY AFTER I LEFT THE POLICE DEPARTMENT FOR THE PRIVATE SECTOR, I WAS ASKED BY THE STATE DEPARTMENT TO BE DIRECTOR OF THE INTERNATIONAL POLICE MONITORS IN HAITI. THERE, I WAS GRAPHICALLY REMINDED OF HOW THE INTEGRITY OF THE POLICE IS FUNDAMENTAL TO THE FUNCTIONING OF A DEMOCRACY. OUR FIRST RESPONSIBILITY IN HAITI WAS NOT SO MUCH TO MAKE SURE THE PUBLIC UPHELD THE LAW, BUT TO MAKE SURE THE POLICE DIDN'T BREAK IT.

THAT CHALLENGING EXPERIENCE NOT WITHSTANDING, TO ME, NEW YORK WAS, AND REMAINS TODAY, ONE OF THE MOST COMPLEX POLICING ENVIRONMENTS IN THE WORLD. AND FOR THAT REASON, IT PUTS EXTRAORDINARY DEMANDS ON INDIVIDUAL POLICE OFFICERS, THEIR SUPERVISORS AND THE DEPARTMENT'S EXECUTIVE CORPS.

BUT THE RESULTS WERE JUST AS REWARDING AS THE ENVIRONMENT WAS DEMANDING. WE HELPED KEEP THE PUBLIC SAFE, AND WE HELPED BRING TO JUSTICE THOSE WHO BROKE THE LAW. I CAN'T THINK OF A BETTER DEFINITION OF JOB SATISFACTION, WHETHER IN THE SERVICE OF MY HOMETOWN OR OUR NATION.

AS POLICE COMMISSIONER, I FREQUENTLY WORKED CLOSELY WITH MANY OF THE SAME TREASURY AGENCIES THAT I AM NOW BEING CONSIDERED TO OVERSEE AS UNDER SECRETARY FOR ENFORCEMENT.

THIS IS A PARTICULAR PRIVILEGE FOR ME BECAUSE OF THE LONG EXPERIENCE THE NEW YORK CITY POLICE DEPARTMENT HAS IN WORKING WITH THE CUSTOMS SERVICE, THE SECRET SERVICE, AND THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS.

MUCH OF OUR MUTUAL COOPERATION AND COORDINATION BECAME ROUTINE OVER THE YEARS. BUT SOMETIMES THE ROUTINE GAVE WAY TO TRAGEDIES, SUCH AS OUR JOINT EMERGENCY RESPONSE TO, AND INVESTIGATION OF, THE WORLD TRADE CENTER BOMBING.

HUNDREDS, IF NOT THOUSANDS OF FEDERAL AND LOCAL LAW ENFORCEMENT PERSONNEL PLAYED ROLES IN SAVING LIVES THE DAY THE WORLD TRADE CENTER WAS BOMBED, AND IN SAVING COUNTLESS OTHERS WHO SURELY WOULD HAVE DIED HAD THE TERRORISTS BEEN ALLOWED TO RETURN TO BOMB AGAIN IN NEW YORK.

TREASURY, OF COURSE, PLAYED A SPECIAL ROLE IN THE DARK AND DANGEROUS RUBBLE BENEATH THE WORLD TRADE CENTER. AN ATF BOMB EXPERT FOUND THE CLUE THAT WOULD BREAK THE CASE WIDE OPEN.

IT IS PRECISELY THAT KIND OF EXPERTISE - - BE IT EXPERTISE IN COMBATING DRUG SMUGGLING OR MONEY LAUNDERING OR ARSON OR COUNTERFEITING - - THAT THE ENFORCEMENT ARMS OF THE TREASURY DEPARTMENT USE MORE EFFECTIVELY THAN ANYONE ELSE TO ADDRESS PROBLEMS TOO BIG OR TOO COMPLEX FOR LOCAL OR EVEN STATE JURISDICTIONS ALONE.

TREASURY'S LAW ENFORCEMENT PERSONNEL CONSTITUTE A WEALTH OF EXPERTISE PROBABLY UNEQUALED IN THE WORLD. THEY HAVE USED IT TO SAVE THE LIVES OF ORDINARY AMERICANS, TO SAFEGUARD OUR LEADERS AND OUR ECONOMIC INSTITUTIONS. THEY HAVE A LOT TO BE PROUD OF. AS UNDER SECRETARY, I WOULD CONVEY THAT PRIDE AND MAKE CERTAIN TREASURY'S ENFORCEMENT PERSONNEL WERE RECOGNIZED FOR THEIR OUTSTANDING WORK.

AT THE SAME TIME, I WOULD MOVE TO QUICKLY CORRECT ANY FAILURES WITH A THOROUGH AND FRANK ASSESSMENT OF WHAT WENT WRONG, AND THEN TAKE PROMPT ACTION TO CORRECT IT.

I HAVE BEEN IN LAW ENFORCEMENT TOO LONG TO BELIEVE THAT THINGS WON'T EVER GO WRONG. I ALSO KNOW THAT THE ONLY WAY TO PROCEED WHEN MISTAKES ARE MADE IS TO ADMIT THEM, TAKE CORRECTIVE ACTION AND MOVE ON.

THERE IS REALLY NO OTHER CHOICE FOR LAW ENFORCEMENT. TOO MUCH IS AT STAKE. THE PEOPLE, THROUGH CONGRESS, HAVE INVESTED EXTRAORDINARY AUTHORITY IN U.S. LAW ENFORCEMENT AGENTS. THEY RANGE FROM AUTHORITY TO CONFISCATE PROPERTY, TO TAKE A PERSON INTO CUSTODY, TO USE DEADLY FORCE.

THESE ARE AWESOME RESPONSIBILITIES.

THE EXTRAORDINARY POWERS ENTRUSTED TO LAW ENFORCEMENT MUST BE EXERCISED WITH THE UTMOST CARE AND RESPECT FOR THE DEMOCRACY FROM WHICH THEY ARISE. THEY DEMAND THE HIGHEST STANDARDS OF PROFESSIONAL CONDUCT FROM THOSE WHO TAKE AN OATH TO UPHOLD THE CONSTITUTION OF THE UNITED STATES.

I HAVE BEEN HELD TO THOSE STANDARDS AS A POLICE OFFICER, AS A POLICE COMMANDER AND AS POLICE COMMISSIONER. I HAVE DEMANDED THEM FOR EVERYONE WHO HAS EVER REPORTED TO ME, AND GIVEN THE OPPORTUNITY TO SERVE, I WILL DO SO AS UNDER SECRETARY FOR ENFORCEMENT.

AGAIN, MR. CHAIRMAN, MEMBERS OF THE COMMITTEE, THANK YOU FOR THIS OPPORTUNITY, AND NOW I'LL BE HAPPY TO ANSWER ANY QUESTIONS YOU MAY HAVE.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGOED UNTIL 2:30 P.M.
June 14, 1996

CONTACT: Office of Financing
202/219-3350

TREASURY'S 52-WEEK BILL OFFERING

The Treasury will auction approximately $19,250 million of 52-week Treasury bills to be issued June 27, 1996. This offering will result in a paydown for the Treasury of about $75 million, as the maturing 52-week bill is currently outstanding in the amount of $19,322 million. In addition to the maturing 52-week bills, there are $26,699 million of maturing 13-week and 26-week bills.

Federal Reserve Banks hold $11,329 million of bills for their own accounts in the maturing issues. These may be refunded at the weighted average discount rate of accepted competitive tenders.

Federal Reserve Banks hold $9,259 million of the maturing issues as agents for foreign and international monetary authorities. These may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders. Additional amounts may be issued for such accounts if the aggregate amount of new bids exceeds the aggregate amount of maturing bills. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $1,528 million of the maturing 52-week issue.

Tenders for the bills will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D.C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

Details about the new security are given in the attached offering highlights.

oOo

Attachment

RR-1131

HIGHLIGHTS OF TREASURY OFFERING OF 52-WEEK BILLS TO BE ISSUED JUNE 27, 1996

June 14, 1996

Offering Amount	$19,250 million
Description of Offering:	
Term and type of security .	364-day bill
CUSIP number	912794 2R 4
Auction date	June 20, 1996
Issue date	June 27, 1996
Maturity date	June 26, 1997
Original issue date	June 27, 1996
Maturing amount.	$19,322 million
Minimum bid amount	$10,000
Multiples	$1,000
Submission of Bids:	
Noncompetitive bids	Accepted in full up to $1,000,000 at the average discount rate of accepted competitive bids
Competitive bids . . .	(1) Must be expressed as a discount rate with two decimals, e.g., 7.10%
	(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position are $2 billion or greater.
	(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.
Maximum Recognized Bid at a Single Yield . . .	35% of public offering
Maximum Award	35% of public offering
Receipt of Tenders:	
Noncompetitive tenders . .	Prior to 12:00 noon Eastern Daylight Saving time on auction day
Competitive tenders	Prior to 1:00 p.m. Eastern Daylight Saving time on auction day
Payment Terms	Full payment with tender or by charge to a funds account at a Federal Reserve bank on issue date

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FOR IMMEDIATE RELEASE
June 17, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $13,588 million of 13-week bills to be issued June 20, 1996 and to mature September 19, 1996 were accepted today (CUSIP: 912794Z80).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.07%	5.21%	98.718
High	5.09%	5.23%	98.713
Average	5.08%	5.22%	98.716

$100,000 was accepted at lower yields.
Tenders at the high discount rate were allotted 7%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$66,871,746	$13,587,526
Type		
Competitive	$61,866,094	$8,581,874
Noncompetitive	1,466,342	1,466,342
Subtotal, Public	$63,332,436	$10,048,216
Federal Reserve	3,449,310	3,449,310
Foreign Official Institutions	90,000	90,000
TOTALS	$66,871,746	$13,587,526

5.00 -- 98.736

RR-1132

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FOR IMMEDIATE RELEASE
June 17, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $13,532 million of 26-week bills to be issued June 20, 1996 and to mature December 19, 1996 were accepted today (CUSIP: 9127943S1)

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.25%	5.47%	97.346
High	5.27%	5.49%	97.336
Average	5.27%	5.49%	97.336

Tenders at the high discount rate were allotted 12%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$54,649,932	$13,532,100
Type		
Competitive	$47,201,110	$6,083,278
Noncompetitive	1,192,222	1,192,222
Subtotal, Public	$48,393,332	$7,275,500
Federal Reserve	3,400,000	3,400,000
Foreign Official Institutions	2,856,600	2,856,600
TOTALS	$54,649,932	$13,532,100

5.26 - 97.341

RR-1133

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EMBARGOED UNTIL 2:30 P.M.
June 18, 1996

CONTACT: Office of Financing
202/219-3350

TREASURY'S WEEKLY BILL OFFERING

The Treasury will auction two series of Treasury bills totaling approximately $26,000 million, to be issued June 27, 1996. This offering will result in a paydown for the Treasury of about $700 million, as the maturing 13-week and 26-week bills are outstanding in the amount of $26,699 million. In addition to the maturing 13-week and 26-week bills, there are $19,322 million of maturing 52-week bills. The disposition of this latter amount was announced last week.

Federal Reserve Banks hold $11,329 million of bills for their own accounts in the three maturing issues. These may be refunded at the weighted average discount rate of accepted competitive tenders.

Federal Reserve Banks hold $9,272 million of the three maturing issues as agents for foreign and international monetary authorities. These may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders. Additional amounts may be issued for such accounts if the aggregate amount of new bids exceeds the aggregate amount of maturing bills. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $7,744 million of the original 13-week and 26-week issues.

Tenders for the bills will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

Details about each of the new securities are given in the attached offering highlights.

oOo

Attachment

RR-1134

HIGHLIGHTS OF TREASURY OFFERINGS OF WEEKLY BILLS
TO BE ISSUED JUNE 27, 1996

June 18, 1996

Offering Amount	$13,000 million	$13,000 million
Description of Offering:		
Term and type of security	91-day bill	182-day bill
CUSIP number	912794 3H 5	912794 3T 9
Auction date	June 24, 1996	June 24, 1996
Issue date	June 27, 1996	June 27, 1996
Maturity date	September 26, 1996	December 26, 1996
Original issue date	March 28, 1996	June 27, 1996
Currently outstanding	$13,545 million	- - -
Minimum bid amount	$10,000	$10,000
Multiples	$ 1,000	$ 1,000

The following rules apply to all securities mentioned above:

Submission of Bids:

Noncompetitive bids . . . . Accepted in full up to $1,000,000 at the average discount rate of accepted competitive bids

Competitive bids . . . .
(1) Must be expressed as a discount rate with two decimals, e.g., 7.10%.
(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position is $2 billion or greater.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Maximum Recognized Bid at a Single Yield . . . . 35% of public offering

Maximum Award . . . . 35% of public offering

Receipt of Tenders:

Noncompetitive tenders . . . . . . Prior to 12:00 noon Eastern Daylight Saving time on auction day

Competitive tenders . . . . Prior to 1:00 p.m. Eastern Daylight Saving time on auction day

Payment Terms . . . . Full payment with tender or by charge to a funds account at a Federal Reserve Bank on issue date

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EMBARGOED UNTIL 2:30 P.M.
June 19, 1996

CONTACT: Office of Financing
202/219-3350

TREASURY TO AUCTION 2-YEAR AND 5-YEAR NOTES
TOTALING $31,250 MILLION

The Treasury will auction $18,750 million of 2-year notes and $12,500 million of 5-year notes to refund $27,452 million of publicly-held securities maturing June 30, 1996, and to raise about $3,800 million new cash.

In addition to the public holdings, Federal Reserve Banks hold $2,177 million of the maturing securities for their own accounts, which may be refunded by issuing additional amounts of the new securities.

The maturing securities held by the public include $3,053 million held by Federal Reserve Banks as agents for foreign and international monetary authorities. Amounts bid for these accounts by Federal Reserve Banks will be added to the offering.

Both the 2-year and 5-year note auctions will be conducted in the single-price auction format. All competitive and non-competitive awards will be at the highest yield of accepted competitive tenders.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

Details about each of the new securities are given in the attached offering highlights.

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Attachment

RR-1135

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC OF 2-YEAR AND 5-YEAR NOTES TO BE ISSUED JULY 1, 1996

June 19, 1996

Offering Amount	$18,750 million	$12,500 million
Description of Offering:		
Term and type of security	2-year notes	5-year notes
Series	AG-1998	K-2001
CUSIP number	912827 Y3 0	912827 Y4 8
Auction date	June 25, 1996	June 26, 1996
Issue date	July 1, 1996	July 1, 1996
Dated date	July 1, 1996	July 1, 1996
Maturity date	June 30, 1998	June 30, 2001
Interest rate	Determined based on the highest accepted bid	Determined based on the highest accepted bid
Yield	Determined at auction	Determined at auction
Interest payment dates	December 31 and June 30	December 31 and June 30
Minimum bid amount	$5,000	$1,000
Multiples	$1,000	$1,000
Accrued interest payable by investor	None	None
Premium or discount	Determined at auction	Determined at auction

The following rules apply to all securities mentioned above:

Submission of Bids:

Noncompetitive bids . . . Accepted in full up to $5,000,000 at the highest accepted yield

Competitive bids . . . . (1) Must be expressed as a yield with three decimals, e.g., 7.123%
(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all yields, and the net long position is $2 billion or greater.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Maximum Recognized Bid at a Single Yield . . . 35% of public offering

Maximum Award . . . . 35% of public offering

Receipt of Tenders:

Noncompetitive tenders . Prior to 12:00 noon Eastern Daylight Saving time on auction day

Competitive tenders . . . Prior to 1:00 p.m. Eastern Daylight Saving time on auction day

Payment Terms . . . . Full payment with tender or by charge to a funds account at a Federal Reserve Bank on issue date

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FOR IMMEDIATE RELEASE
June 19, 1996

Contact: Michelle Smith
(202) 622-2960

TREASURY SECRETARY RUBIN TO DISCUSS UPCOMING G-7 MEETINGS AT NATIONAL PRESS CLUB THURSDAY

Treasury Secretary Robert E. Rubin will preview the upcoming G-7 meetings at a National Press Club luncheon in Washington, D.C. at 12:30 pm on Thursday, June 20, 1996.

Secretary Rubin will discuss the G-7's initiatives to strengthen and improve the effectiveness of international financial institutions; development issues; international capital markets; and the importance of the G-7 process to the United States. A question and answer period will follow his remarks.

The G-7 meetings will take place in Lyon, France, from June 27-29. President Clinton will lead the U.S. delegation to the meetings, which will include leaders from the G-7 nations (Canada, France, Germany Great Britain, Italy, Japan, and the United States).

National Press Club members and non-members interested in attending the luncheon must call Chad Taylor, National Press Club Reservations Desk at (202) 662-7539 <u>before 10 am on Thursday</u> for reservations.

-30-

RR-1136

DEPARTMENT OF THE TREASURY
TREASURY NEWS
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ADV 2:30 pm EDT
Text as prepared for delivery
June 20, 1996

RECORD TESTIMONY OF TREASURY SECRETARY ROBERT E. RUBIN SENATE APPROPRIATIONS SUBCOMMITTEE ON TREASURY, POSTAL SERVICE AND GENERAL GOVERNMENT

INTRODUCTION

Senator Shelby, Senator Kerrey, members of the Subcommittee:

I appreciate the opportunity to testify on the Department's fiscal year 1997 request. With me today is George Muñoz, our Assistant Secretary for Management and Chief Financial Officer.

The responsibilities of our Department cover areas as diverse as law enforcement, revenue collection, financial management and regulation, international economic affairs, and manufacturing currency and coins. Treasury is one of the principle agencies that advises the President on policies that maintain a healthy economy, create jobs and increase incomes. In addition, our bureaus are among those that carry out these policies. We are proud of our record with regard to the economy -- unemployment has dropped to 5.6 percent, 9.7 million new jobs have been created in 40 months, inflation is at a near 30-year low, and the deficit is now forecast to fall for four straight years. I knew of Treasury's reputation for excellence during my 26 years on Wall Street and two years at the White House. After a year and a half as Treasury Secretary, I can tell you that the highly-capable and dedicated professionals at Treasury are serving the American public very well , and my first priority as Secretary is to maintain the excellence of the institution.

RR-1137

OVERVIEW OF THE FISCAL YEAR 1997 BUDGET

In view of our roles and missions, Treasury's fiscal year 1997 budget strikes an appropriate balance between the competing goals of adequately funding our priorities and fairly contributing to balancing the Federal budget. Our request emphasizes the administration's top funding priorities in areas such as tax systems modernization and border protection, while at the same time stressing the principals of reform and reinvention, which allow us to address old problems with new solutions.

Treasury originally requested $11.4 billion in operating funds for fiscal 1997. Since then, there have been two changes. First, Congress decided to leave CDFI funding responsibility at VA/HUD. We had requested $125 million in our budget for CDFI which is no longer in our request. Second, we informed this subcommittee and the House subcommittee that our Tax Systems Modernization request of $850 million could be reduced by $186 million to $664 million under the new management baseline. While that brings our request to $11.1 billion, we know that this morning you received your 602(b) allocations, and the Treasury share is likely to be below our revised budget request. We recognize that, but want to discuss some of the key priority areas of our request in revenue collection and law enforcement. I want to emphasize that, throughout the budget formulation process, we asked our bureaus to limit their requests to essential activities -- particularly in light of the House markup this week that has the potential for severe and negative impacts on our tax administration system. I would also like to add at this moment a request for your support of the President's request this week for supplemental appropriation action to address acts of arson against African-American churches. The request would support the ability of the Bureau of Alcohol, Tobacco and Firearms to investigate and solve these crimes.

My testimony today will not only outline our request and highlight some of our accomplishments, but also report on Treasury's stewardship and management of its bureaus. I'd like to summarize our fiscal 1997 request, starting with the Internal Revenue Service and TSM. We've attached a more detailed presentation of our fiscal 1997 request to my remarks.

IRS continues its Tax Systems Modernization effort. Deputy Secretary Summers came to Congress earlier this year to discuss Treasury's concerns with IRS's Tax Systems Modernization program. The General Accounting Office, the National Research Council, and this Committee have criticized IRS's fundamental ability to modernize itself. While we share some of those same concerns, we are pursuing a number of strong corrective actions. Specifically, we have:

- Articulated the vision for TSM as contained in our recent report to Congress.

- Put in place a new management team. Established a single point of accountability and budget control in the person of the Associate Commissioner for Modernization. We have also appointed a new Chief Information Officer , who has successfully implemented a tax systems modernization program for New York State.

- Established an investment review process in accordance with GAO Strategic Information Management (SIM) best practice guidelines, through which we are subjecting all information systems investments to a disciplined review process.

- Re-scoped our entire budget request from $6.7 billion in five years to less than $4 billion.

- Leveraged technical and management skills by increasing reliance on the private sector for systems engineering, design, development and integration so that by the end of FY 1997, 68 percent of TSM labor dollars will go to outside contractors.

- Significantly increased Departmental oversight of TSM through a restructured joint Treasury/IRS Modernization Management Board, which the Deputy Secretary chairs.

- Used expert consultants experienced in large scale government systems management and development efforts to augment our efforts.

As part of our review of funding requirements, in correspondence to you on June 6, 1996, we have reduced our requirements for FY 1997 in the TSM area from the original request of $850 million to $664 million. The revised level for FY 1997 is proposed in addition to the actual slow-down that has already occurred within the FY 1996 enacted budget of $695 million, an amount that is over $300 million less than the Administration's original FY 1996 request. The revised $664 million is based on an updated assessment of where we are in the modernization process and reflects a deferral of some program development as IRS shifts from in-house work to contractors. It stems from a review of the entire TSM project in terms of four basic risk categories: maintenance and operations; investment in program management, engineering and infrastructure; roll-out of proven projects; and incremental investment in the development of new TSM capabilities.

We need to ensure effective stewardship in Treasury of the limited dollars that you have to appropriate and demonstrate clear accountability for the investments we undertake. Treasury will approve funding for only those projects that present a favorable business case and appropriate readiness reviews, regardless of the TSM funding level in FY 1997. The Investment Board will manage the investment decision making process which the Deputy Secretary will oversee through the Modernization Management Board.

On that final point, I would like to add that the IRS has made progress in reducing the burden on taxpayers and improving customer service, although much remains to be done as we work smarter with scarcer resources. More taxpayers can file electronically or over the phone and take advantage of direct deposit for tax returns. Taxpayers calling the IRS will find their calls answered more frequently, with more satisfactory service. Information and forms can even be downloaded directly from the IRS Internet home page. Moreover, the IRS has been working with small businesses to reduce the paperwork involved in record keeping. They have also reduced the time and effort involved in resolving account and collections issues.

The IRS will continue to protect tax revenue and maintain fairness. The $359 million increase requested for IRS tax law enforcement will, by IRS estimates, result in $1.5 billion in added revenue collections in fiscal 1997. Over the seven-year budget period, this initiative will result in a 4-to-1 return of revenues collected and deposited into the General Fund versus the cost of the initiative. Under the pay-go scoring rules of the Budget Enforcement Act, these revenues must be used for deficit reduction and cannot support new spending or tax cuts. This proposal adds staff and improves systems to increase telephone and correspondence compliance activities. It is a strategy that emphasizes account resolution early in the process, which is more cost-effective, and less intrusive and burdensome than face-to-face enforcement actions by revenue agents and revenue officers.

Customs will continue to strengthen protection of the Southwest Border. The total request for this initiative is $65 million, including $41 million for 657 new agents, inspectors, and other staff at the border. The remainder of these funds are requested from the Violent Crime Reduction Fund to equip the new border personnel for their jobs and for technology improvements. This initiative combats drug smuggling while making inspections less intrusive and vehicle processing quicker and more effective. We have seen how effective the Customs Service can be on the border through the results of Operation Hard Line. Because of Operation Hard Line, in the past year on the southwest border, cocaine seizures are up 19 percent, heroin seizures almost 110 percent, marijuana seizures are up 25 percent, and there has been a doubling of drug seizures in commercial cargos. As you are aware, as our enforcement actions hit smugglers hard in one area, they often tend to shift entry areas, so we have now heightened our watch on the atlantic and caribbean to counter smuggling there. Project gateway is having some important successes.

Treasury also will continue its support of Community Development Financial Institutions. The President's budget request includes $125 million for the Community Development Financial Institutions Fund (CDFI). This initiative will help create a nationwide network of diverse, specialized, private financial institutions that will bring needed investment capital to distressed urban and rural communities. These institutions include community development banks, credit unions, loan funds, venture capital funds, and micro-enterprise loan funds. This effort is grounded in private sector market discipline while it leverages large amounts of private capital. The effect of these investments will encourage renewed and healthy private market activity in distressed communities, promote entrepreneurship, revitalize neighborhoods, generate tax revenues, and empower local residents.

The Financial Management Service will continue to improve and modernize its financial systems and services to government agencies. These efforts include the expansion of Electronic Funds Transfer and Electronic Benefits Transfer; continued standardization of government-wide data in financial systems, which improves tracking and accountability; and the establishment of a debt management operations center to assist efforts at other government agencies with delinquent debt collections.

ACCOMPLISHMENTS

As I mentioned at the outset, Treasury has responsibilities that range from domestic and international economic policy, to law enforcement and manufacturing our money. We collect 97 percent of the revenues taken in by the federal government. We have 40 percent of the law enforcement personnel in the government. While I've mentioned a few of our accomplishments so far, I'd like to highlight some others and talk about some of the innovations now under way within the Treasury Department. Among the other highlights over the last year were:

- The indictment of over 70 members of the Cali cocaine cartel through the efforts of the Customs Service and other law enforcement agencies;

- ATF's quick effort in uncovering important evidence from the Oklahoma City Federal Building bombing site;

- The Federal Law Enforcement Training Center's new training involving improved federal guidelines for the use of force in law enforcement; and

- The increased targeting of IRS investigators to key money laundering cases. This effort, in particular, led to 117 arrests of major drug traffickers worldwide.

Perhaps the most visible of our more recent efforts is the new $100 note being produced by the Bureau of Engraving and Printing and introduced into circulation earlier this year. It is the first of five notes to be redesigned with anti-counterfeiting protections to stay ahead of the technology curve. The smooth roll out of this note serves to maintain confidence in our currency as well as economic stability in countries where U.S. currency is a preferred medium of exchange.

Our fiscal bureaus continue to improve their services. The U.S. Mint is now entirely under a revolving fund, which enables more business-like operations and better financial management.

The Office of the Comptroller of the Currency streamlined its bank examination procedures and reduced the volume of information banks need to produce in advance. The Bureau of Public Debt completed its consolidation in Parkersburg, West Virginia and continues to enjoy increased savings and efficiency.

Since this time last year, our Tax Policy division presented seven new international tax treaties to the Senate for its advice and consent. We have completed negotiations on five additional treaties and are actively negotiating ten new treaties. These treaties will strengthen tax fairness and promote the international exchange of tax data. Some of these treaties also contain important features to aid in countering the new wave threat of money laundering. We are currently holding discussions about money laundering in our international economic forums and Treasury enforcement functions are now routinely being incorporated in this area.

Our International Affairs division performed some critical work with regard to strengthening financial markets following the Mexico crisis, work endorsed by global leaders at the G-7 Halifax Summit and now being replicated in important regional forums. In addition, they have been working diligently on the goal of opening financial markets and encouraging development and reform in the developing and transitional economies.

STEWARDSHIP OF RESOURCES

If I could turn now to the manner in which Treasury has used the resources entrusted to us. The Department has used two tools to improve its stewardship of public resources: Reinvention, and Performance-Based Management. I'd like to summarize our efforts in these areas.

Treasury is an active, award-winning participant in the effort to reinvent government. Last year, the Administration began the second stage of the National Performance Review. The goals were to improve customer service, lower costs, and increase efficiency. Last year, the Department worked with its bureaus to generate a set of wide-ranging proposals to meet those goals. I want to highlight three key reinvention efforts: Debt Collection Management, the Federal-State Tax Partnership and a consolidation of administrative functions.

- Last June, the President announced the **Debt Collection initiative** to improve the collection of non-tax receivables and reduce the cost of delinquent debt collection.

- **The Federal/State Tax Partnership** allows business taxpayers in 31 states to file one return for both their federal and state submission.

- The Department is beginning to study and design **consolidating administrative functions**. In looking to the future, this budget requests funds for the first stage of this effort -- a reengineering of human resources functions Treasury-wide.

Performance-Based Management has changed our management focus from inputs and processes to an emphasis on outcomes and program results. Treasury has embraced this management style in three ways: strategic planning, innovative resource management, and improved accountability.

Strategic planning is critical to effective resource management. However, just a few years ago, most Treasury bureaus had no strategic plan. Today, we have a coordinated, Department-wide planning process. This effort coincided with the passage of the Government Performance Review Act. Treasury has already requested each bureau to develop a five-year strategic plan this Spring -- one year earlier than the law mandates.

Good strategic planning also includes regular reporting on annual performance. Last year, we began to replace our workload measures with program measures. This year, our budget improves this set of program performance targets. Good measures are not always available and ours are not perfect. However, we believe that we have made progress and will continue to look for improvements. The Committee's staff has already been helpful in the early development stages. We welcome your continued feedback.

Next year, our budget request will also contain a report on our performance against the previously proposed targets. Including the report on program performance in the budget document is one of the key steps we are taking to integrate the entire process of resource management in the Department.

- **Treasury is taking advantage of innovative resource management tools.** The Government Management Reform Act, or GMRA, provided agencies with the authority to create franchising— new mechanisms for delivering common administrative products and services on a competitive and self-sustaining basis. Services provided under franchising will achieve greater efficiency and quality.

- **Treasury is improving its accountability for its use of resources.** We are participating in a GMRA pilot program to prepare an "Accountability Report." This report summarizes and combines a variety of financial management reports, required by many different laws, into a single, streamlined, easy-to read document. Our goal is to have this one report fulfill the reporting requirements of the underlying statutes.

The Department continues to improve its financial management. Of the eleven financial statement audits of Treasury entities conducted for FY 1994 pursuant to the Chief Financial Officers Act, eight received unqualified audit opinions. This is one more than we received for FY 1993, and five more than we received two years ago.

This year, Treasury is implementing a major element of a Treasury-wide integrated financial management system. The Treasury Information Executive Repository (TIER) is a computer database that will house our Treasury-wide General Ledger and allow bureaus to directly transmit account information electronically to the Department.

CONCLUSION

In closing, I'd like to review the main points and leave you with a few thoughts before I take your questions. First, given the breadth of responsibilities of the Treasury Department, the budget we have submitted strikes a balance between adequately funding our priorities and fairly contributing to deficit reduction. Second, with Deputy Secretary Summers' and Commissioner Richardson's leadership, the IRS will strengthen and focus its modernization efforts to produce real benefits to taxpayers. I would urge you, however, to recognize that, just as it has taken many years to get us where we are today, all of TSM's problems will not be solved overnight. Third, Treasury is, I believe I can fairly say, a leader among government agencies in innovation and improving customer service. Fourth, we are integrating enforcement policies into our more traditional functions. And finally, Treasury is absolutely committed to using the monies entrusted to us wisely, to reinventing our operations to make them more efficient, and to a strategic planning process that gives our Department a better look at where we are headed not one or two but five years down the road so we can make the best use of our resources and the strengths of our individual components.

Again, I appreciate this opportunity to come before you and share our successes and our plans. I would be happy to address any questions you may have.

# # #

DEPARTMENT OF THE TREASURY

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**ORAL TESTIMONY OF TREASURY SECRETARY ROBERT E. RUBIN
SENATE APPROPRIATIONS SUBCOMMITTEE ON
TREASURY, POSTAL SERVICE AND GENERAL GOVERNMENT**

Chairman Shelby, Senator Kerrey, members of the Subcommittee: I appreciate the opportunity to testify on our fiscal year 1997 request. With me is George Muñoz, our Assistant Secretary for Management and Chief Financial Officer, and he will join me in responding to your questions.

During my 26 years on Wall Street and two years at the White House, I knew of Treasury's reputation for excellence. After 17 months as Treasury Secretary, I can tell you that the American people are well-served by the highly capable and dedicated professionals at Treasury, and my first priority as Secretary is to maintain the excellence of the institution.

In my written testimony, I spell out the balance we have struck between the President's investment priorities and his strong commitment to deficit reduction. I will speak for a few minutes about a few of our top priorities, and then, given the actions taken by the House subcommittee on Tuesday, I will focus my remarks on the need for adequate funding for reform and modernization at the Internal Revenue Service.

Treasury originally requested $11.4 billion in operating funds for fiscal 1997. Our revised request, as you know, is $11.1 billion. We know that you have received your 602b allocations, and the Treasury allocation is below our revised budget request, but I will be discussing our key priorities in the context of the President's request.

We have made it a priority for Customs to strengthen protection of the Southwest Border. We've requested $65 million, for 657 new personnel at the border and for equipment and technology improvements. Operation Hardline has already shown real results. As smugglers respond to our successes by shifting to other locations, we have implemented Project Gateway in the Atlantic and Caribbean region.

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(more)

In the area of economic empowerment, Treasury strongly supports the Community Development Financial Institutions Fund. The President asked for $125 million in the Treasury budget under this subcommittee's jurisdiction. As you are aware, this item is now in the VA/HUD subcommittee. We strongly urge that it be fully funded. It will help build a nationwide network of private sector community financial institutions to bring investment capital to distressed urban and rural communities.

Let me also note that the Financial Management Service will continue to modernize, including expansion of Electronic Funds Transfer and Electronic Benefits Transfer, standardization of government-wide data in financial systems, and establishment of an operations center to assist with debt collection.

Let me also take a moment to say that I have the highest esteem for the law enforcement officers of Treasury. They perform a difficult and dangerous mission every day. I have been heartened by the support that the Bureau of Alcohol, Tobacco, and Firearms has received in their efforts to investigate the church fires. As you know, we have transmitted to Congress a request for a $12 million supplemental to support ATF's church fires investigations; a similar amount is included in the House mark.

As you undoubtedly know, earlier this week, the House Treasury-Postal subcommittee laid down its mark for FY 1997. Given the severity of the proposed cuts, I will focus my remarks now on the Internal Revenue Service and TSM. We have grave concern over cuts of this magnitude. While we are still studying the mark, preliminary conclusions are possible.

First, let me comment on ongoing operations. The mark may require the IRS to reduce or lay off thousands of federal employees, and it targets more than half of those reductions in IRS's information systems personnel. That would jeopardize the IRS's ability to maintain vital systems to process over 200 million tax returns and over 80 million refunds annually, to provide telecommunications to support telephone customer services and the automated technologies to facilitate tax examination and collection. These cuts go to the heart of the IRS's ability to provide taxpayers with the services that they have a right to expect, from improved telephone access -- now at a too low rate of 38 percent -- to prompt payment of refunds -- coming on the heels of a solid filing season. The House mark also contains a number of measures that interfere with effective management of the IRS. To take but one example, the mark requires that the Department of Defense be responsible for contracting decisions on tax information systems.

Second, these reductions may not only jeopardize our ability to maintain all IRS systems nationwide for ongoing operations, but also might deny the IRS even minimal resources to continue with necessary modernization. Let me be clear: we know that there are serious problems with TSM, and we have begun to put this program on track. But deeply cutting IRS personnel who are responsible for these improvements is no way to get there. I have had private sector experience overseeing the restructuring of a badly flawed system, and let me say, even if one relies heavily on outside contractors, it is critical to have them managed internally by adequate numbers of knowledgeable people.

While Members are familiar with TSM, let me emphasize that modernizing the tax system is about much more than simply replacing computer systems. It is about developing a set of new technologies that did not exist when the current system was built, and it will take fundamental change in work practices and in the ways that the IRS interacts with taxpayers. We expect these efforts, over the long run, to lead to major improvements in taxpayer service, compliance, and IRS productivity.

The beginning of solving any problem is recognizing that you have a problem. Over the past year, Treasury has spent a lot of time understanding and evaluating the problems of TSM. These problems developed over a long period of time and they will not be solved quickly. But we are committed to solving them. The GAO has raised many concerns, and we and they both recognize that there is a lot that needs to be done. That is why, even before the GAO reported its observations, we informed this subcommittee and the House subcommittee that we would reduce our fiscal 1997 funding request by $186 million, from $850 million to $664 million, as we refocus TSM.

We have restructured our oversight process and I have asked Deputy Secretary Summers to manage TSM as if he were a board chairman overseeing a major long-term capital investment program. Treasury's oversight will include involvement in all major strategic and investment decisions. We are pursuing a vigorous program of corrective actions. We anticipate a greater use of outside contractors. And we have hired a highly experienced chief information officer, Arthur Gross, who has successfully led a similar modernization effort in New York.

TSM is contributing to important improvements in taxpayer services. TSM initiatives enable millions of Americans to receive around-the-clock, automated tax information, download tax forms from the internet, and file taxes from computers and over a touch-tone telephone, not by longhand. But with the provisions of the House mark requiring a "fencing off" of TSM funding, these ongoing programs would be in jeopardy.

Third, cuts of this magnitude will undermine the IRS's ability to protect tax revenue and maintain fairness. The increase of $359 million in the President's budget would beef up IRS tax law enforcement. The IRS estimates this increase would result in $1.5 billion in additional tax collected in fiscal 1997, for deficit reduction. By contrast, cuts of the magnitude described in the House mark would mean lost revenues of $3.2 billion.

Moreover, this revenue loss would not just be to the federal government. Countless states rely on information-sharing on audits and re-adjustments made by the IRS in collecting revenues owed to them under state tax law. These cuts may reduce these information flows and thus cut state revenue significantly.

In sum, deep cuts to the IRS may do grave damage to our ability to collect revenue, enforce the tax laws, and continue to provide the services that taxpayers have a right to expect. We need to work together to remedy this situation, and to provide adequate support for an IRS that will work for all Americans. I urge you to fund the IRS at a level necessary to maintain an efficient and functioning IRS. Let me also say that we look forward to working closely with the National Commission on the IRS, as we reform and modernize it.

Treasury is committed to using the monies entrusted to us wisely, to reinventing our operations to make them more efficient, and to strategic planning that gives our Department a better look at where we are headed years down the road.

Let me refer you to my written testimony for a further elaboration of our top priorities and accomplishments, including the Department's important work in economic policy, law enforcement, tax policy, international finance and opening markets, new currency, financial services and other matters.

Again, I appreciate this opportunity to appear before you today. Assistant Secretary Muñoz and I would be happy to take your questions.

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REMARKS OF TREASURY SECRETARY ROBERT E. RUBIN
THE NATIONAL PRESS CLUB

In less than a week, the President, Secretary Christopher and I leave for the G-7 leaders meeting in Lyon. Lyon offers a prism for seeing in a different way the enormous changes that have taken place over the past several years and are taking place that will profoundly affect the economic and national security future of our country.

First, we've had a sea-change improvement in our economy which is not only important in itself, but has dramatically increased our capacity to provide leadership in the world on international economic issues.

Second, the G-7 process has been re-energized and contributed significantly to America's ability to deal with what economic changes that some have described as the most significant since the industrial revolution.

Third, and finally, as America's economic prospects and security interests are increasingly bound-up in the success of the global economy, we must remain vigilant against those forces of isolation, protectionism and retreat which would pull us back from the world, diminish our credibility and leadership, and reverse the advances we have made in making our nation stronger economically.

This is a time of historic change in the world economy. Financial markets and trade have become globalized in ways and to degrees not imaginable fifteen or twenty years ago. There is a new economic consensus around the world in favor of market economies. People are striving for capitalism and democracy. Economies throughout Asia have emerged as powerhouses. Latin American economies are reforming and playing increasingly important roles. Technology is changing rapidly, and there are enormous practical advances in using technology.

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http://www.ustreas.gov (more)

In response to this time of historic change, the G-7 countries have led in reforming the international financial institutions to deal with risk in capital markets and to bring a new approach to development and reform. Moreover, the G-7 has rallied the world around a market-based economic structure and sound economic policies.

Let me be clear: the G-7 has been absolutely indispensable in advancing the long-term economic interests of the American people. We must remain fully engaged as leader in the G-7 process and in the international arena more generally.

It is worth focusing for a moment on the economic context in which the United States goes to Lyon. I can remember in years past that presidents went to summits and found their ability to exert leadership limited by our vast budget deficits and perceived unwillingness to address them, and because we had lost our competitive edge in a wide array of industries. Tokyo was this president's first summit. I was there and it was remarkable how different this all was. The President's deficit reduction program was on the threshold of being enacted by Congress and interest rates had reacted very favorably. The President was able to stand tall as a leader, and you could see the other leaders at the summit regarded him as the clear leader on economic issues.

Although many factors have contributed to our economic success in the past three and one-half years, in my view there is simply no argument that the President's leadership on deficit reduction has been the key and absolutely indispensable element.

To be sure, problems still remain. We need to do more to raise incomes and wages, though over the past year wage stagnation has started to reverse. We need to do more to improve and expand education. We need to do more to bring America's inner cities into the mainstream. And we must do these things as we complete the progress toward balancing the budget.

But today, in contrast to five years ago, America is back as the international economic power, healthy and strong. In many ways, the U.S. economy is, once again, the economy the world is looking at. In under four years, our economy has created nearly ten million new jobs. Unemployment has fallen to 5.6 percent from 7.3 percent three and one-half years ago. Inflation is near a 30-year low. We have enjoyed solid growth. Interest rates remain below the levels when the President first took office. And the deficit will have been cut in half and more than in half as a percentage of our economy by the end of this year.

Our situation looks even more favorable when you match our performance against that of our Summit partners. Our economy has created 7 times more jobs that all the other G-7 nations combined. Business investment in the United States grew 28 percent in real terms over the past three years while investment was falling in Japan and continental Europe. Our government sector budget deficit is the lowest among the G-7 in proportion to GDP.

Our progress putting our house in order and our strong economic performance has given President Clinton great credibility and leverage as we lead the world to policies that produce greater growth and security for all.

President Clinton has grasped the opportunities that the G-7 process provides to use the international fora strategically and comprehensively to advance America's economic interests. From the beginning of the Administration, the President understood that we could best realize our objectives if the G-7 process had the energy and credibility to address serious economic issues.

Through the G-7, there has been a major push on international trade to complete the Uruguay Round and to create the World Trade Organization. Through the G-7 we have led a major effort to mobilize conditioned support to spur reform in the former Soviet Union. In these areas, the G-7 has been successful.

The United States has also led through the G-7 to spearhead substantial changes in how the international financial institutions respond to the globalization of financial markets and in their approach to development and reform.

Recognizing the challenge of dealing with these issues, the President two years ago in Naples launched a fundamental re-examination of the roles and missions of our international financial institutions -- the World Bank, the regional development banks, the International Monetary Fund, and others.

At the Halifax Summit a year later, the G-7 endorsed a set of U.S. proposals in response to that mandate. We are now putting in place the broad elements of the strategy outlined in Halifax.

First, we have strengthened the international capacity to prevent future financial crises and to deal effectively with crises that occur.

The IMF has put in place a set of strong disclosure standards, which will help provide early warning of impending problems and allow governments and investors to react accordingly. I believe had this provision been in place at the time Mexico got in trouble, global investors and markets might well have stopped that situation way before it reached crisis levels.

The international regulatory community has agreed on ways to enhance regulatory cooperation, including an important initiative to provide a consistent approach to supervising activities of financial firms that operate across national boundaries.

We are working to strengthen banking systems in emerging markets to reduce one potential source of future crises.

We have reached agreement on a proposal to increase the resources available to the IMF in financial crises, building the General Agreements to Borrow, which raises a substantial share of the total from new participants.

And we have outlined specific proposals to change the way a future country debt crisis would be handled, with a view to putting more responsibility on market participants, that is, on private sector creditors, to prepare for and share the cost of problems.

Together, these changes will make the U.S. economy and the international financial system more resistant to crises, and they will help see that the United States does not bear a disproportionate share of the financial responsibility for dealing with crises.

Second, in addition to the proposals for strengthening the capital markets, we have made important progress in improving the effectiveness of the international financial institutions to promote development and economic reform. In the context of the global economy, the global financial markets and the new consensus for market economies, they will now be focussed on doing a better job in channeling assistance to the underpinnings for a successful market economy, including poverty alleviation, education, health and women's issues. In addition, they will also focus on dealing with post-conflict situations in areas such as Bosnia and the Middle East.

These accomplishments are critical to our economy and national security.

From Naples to Halifax, to Lyon and into the future, these actions mean the American economy will be less prone to shocks from crisis abroad. They mean that when there are crises, America does not assume a disproportionate share of the responsibility for responding. They mean that our national security is enhanced by economic growth and the greater likelihood of political stability. They mean more growth in the developing world and therefore more exports by the United States, which increases jobs and increases standards of living.

If I might expand for one moment on the economic significance of all this. More than 40 percent of our exports go into developing economies. More than a third of the real growth in our GDP in this decade is attributable to exports. In 1994, the United States sold $40 billion in goods to countries who have graduated from the International Development Association's economic reform programs. That same year, we sold more than $20 billion to countries currently in IDA programs.

Despite the critical contributions these institutions make to our economy and our national security, there is no domestic American constituency for them. They are not well appreciated by the public. They are opposed by the voices of isolationism and protectionism. They are not adequately funded by Congress. As a result we are falling further and further behind in our obligations, and our commitment to pay our obligations is being called into question. And that has the potential if not remedied to undermine our ability to lead in these institutions, to undermine the institutions themselves, and to more broadly undermine our ability to lead internationally. Great nations should not act this way.

There are polls that show some Americans believe we spend 15 percent of our budget on foreign assistance, when in truth the number is well under 1 percent. We spend less per capita -- sometimes two-thirds less --- than many developed nations. We are dead last among OECD nations in foreign aid as a percentage of GDP. Again, this is no way for a great nation to behave. And this is why the Clinton Administration has been and is committed to restoring the bipartisan coalition critical to international engagement.

In closing, over the past four years we have taken steps to greatly strengthen our economy, and a strong economy has given us great credibility in forums like the G-7. We have used the increased credibility to address changes in the global financial markets and focus the international financial institutions on new approaches to promoting development and reform to reflect the enormous changes in the world economy.

When the President and Secretary Christopher and I go to these international meetings -- from economic summits to our regional summits -- it is to continue the job of making our country economically strong and secure by strengthening the global economy. Over the long haul, the G-7 is making a difference not just for America but for the world as well.

If you look across the last half century, the American record is one to be proud of -- the Marshall Plan and the defeat of communism. That record is a great tribute to the generation that came before us. If we keep on the path I have described today and the President has pursued, this generation will not be put in the position of having to apologize to our children for failing to seize this opportunity to make the global economy work to the benefit of all Americans.

Thank you.

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STATEMENT OF
DONALD C. LUBICK
ACTING ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Madam Chairman and Members of the Subcommittee:

I am pleased to be here today to present the views of the Department of the Treasury on issues relating to the classification of workers as employees or independent contractors. This is a significant and complex issue that merits careful study. We commend the Members of this Subcommittee for holding hearings on this important subject.

Background

Whether workers are classified as employees or as independent contractors is significant for both Federal income tax purposes and Federal employment tax (i.e., Social Security, Medicare, Federal unemployment insurance and withholding) purposes. Income, Social Security and Medicare taxes on employees are collected mainly by employers through the withholding system, whereas the same taxes on independent contractors are collected mainly through self-assessment under the estimated tax system. Independent contractors can offset income by deductions for business expenses that generally are not as readily available to employees (except to the extent that the employee itemizes deductions and business expenses and other miscellaneous itemized deductions exceed 2 percent of adjusted gross income). In contrast, certain fringe benefits provided by a business to employees are eligible for greater tax preferences than are available to independent contractors, although independent contractors can adopt tax-qualified self-employed retirement plans that can be similar to employer-sponsored plans for employees. The classification of workers as employees or independent contractors is also significant under a variety of Federal and State labor and worker protection laws that cover only employees, such as unemployment insurance, workers' compensation, wage and hour requirements, and family and medical leave requirements.

Most workers are classified as employees or independent contractors based on the traditional common-law test for determining the employer-employee relationship.[1] This test focuses on whether the employer has the right to control not only the result of the worker's services but also the means by which the worker accomplishes that result.

The common-law control test is, by its nature, a test that depends on the specific facts and circumstances of each situation. In an effort to administer this facts and circumstances standard better, the Internal Revenue Service (IRS) has derived from the case law a variety of factors that should be considered, with more or less weight being accorded to particular factors depending on the factual context. In the vast majority of cases, the classification of a worker under the common-law standard is clear. However, because the control test is inherently a factual determination, there are cases in which the correct status of a worker is less obvious.[2] The uncertainty in these cases has been perpetuated by the long-standing statutory prohibition on the issuance of regulations or revenue rulings regarding the proper classification of workers.

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[1]The Internal Revenue Code (Code) does contain special rules for classifying certain categories of workers. Briefly, these include mandatory independent contractor classification of certain licensed real estate agents, direct sellers, and sitting-service placement agents (sections 3506 and 3508 of the Code); and mandatory employee classification of corporate officers and certain agent-or commission-drivers, life insurance salesmen, home workers, and traveling salesmen (section 3121(d) of the Code).

[2]Cases in which there is intentional misclassification of an employee as an independent contractor should be distinguished from the classification issue generally. In these cases, there is no real question as to whether the workers are employees or independent contractors. Rather, the parties involved may use misclassification as a guise to avoid the costs of Federal and State mandates designed to protect employees or as a method to avoid full reporting of income and to evade taxes.

Current tax law does not consistently favor status as either an employee or an independent contractor.[3] However, in particular circumstances one of the classifications may be advantageous to a service provider, the service recipient, or both. A company's costs may, for example, be lower if its workers are classified as independent contractors rather than employees to the extent the company can pay independent contractors less than the sum of the cash compensation, the costs of the company's portion of Social Security and Medicare taxes, unemployment insurance, workers' compensation, other fringe benefits that the company incurs for employees, and the overhead costs of withholding and recordkeeping. In addition, the income and employment tax provisions of the Code may favor classification as an independent contractor where a worker has significant unreimbursed business expenses. This is primarily because independent contractors face significantly fewer restrictions on their ability to deduct trade or business expenses than employees, as noted earlier.[4] Conversely, employee status may be advantageous for workers with few business expenses who benefit from the tax advantages accorded to fringe benefits, especially those that are more cheaply obtainable or only obtainable through an employer, such as employer-provided group health insurance, workers' compensation insurance, or unemployment insurance.

Workers who are classified as independent contractors may also have greater opportunities than employees to avoid full compliance with the tax laws. As previously noted, employees are subject to withholding, and the amount of their wage income is reported with great precision to the IRS. Independent contractors may find it easier to omit some of their income on their tax returns without detection. Underreporting of income becomes more difficult when an independent contractor's gross

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[3]Prior to 1984, compensation earned by independent contractors was subject to lower rates for Social Security and Medicare taxes than wage income. This disparity was believed to create an incentive for misclassification. The differences were actually less significant than they appeared, however. Although tax rates were lower for self-employment income than for wages, an independent contractor could not deduct self-employment taxes while an employer could deduct its portion of Social Security and Medicare taxes in computing its taxable income for income tax purposes.

[4]Also, the estimated tax system used to collect income, Social Security, and Medicare taxes from independent contractors largely avoids the overwithholding that can result when an employee incurs large business expenses, has net income that fluctuates during the year, or is employed for only part of a year.

income is reported to the IRS on information returns, although the worker can incorporate and avoid information reporting because of the current law rule which excludes payments to corporate independent contractors from reporting. Moreover, even independent contractors that report 100 percent of income have greater opportunities to overstate deductible business expenses. Clearly, some taxpayers have made use of these opportunities, and this has resulted in significant amounts of noncompliance.

Recent Legislative History

Since the late 1970s, Congress, Treasury, and the Internal Revenue Service have considered numerous proposals aimed at resolving issues associated with the classification of workers as employees or independent contractors. To date, legislation dealing with classification issues has focused primarily on relieving employers of what has been viewed as the excessive penalties associated with honest errors in the misclassification of employees as independent contractors.

Prior to statutory changes, when the IRS reclassified a worker as an employee, the employer was generally held liable for the full amount of unwithheld income taxes and the unwithheld employee share of Social Security and Medicare taxes for all years open under the statute of limitations. In addition, the employer remained liable for the employer share of Social Security, Medicare and Federal unemployment insurance taxes, plus interest on these amounts. Penalties also could be assessed. The employer's liability for underwithholding was abated to the extent that the employer could demonstrate that the misclassified worker had paid income, Social Security and Medicare taxes on the compensation received. Data to support the determinations were often difficult to obtain, however, especially if the worker was no longer providing services to the employer.

Section 530. In response to a number of large retroactive employment tax assessments in the 1970s, Congress provided certain employers with general statutory relief from IRS reclassification of workers from independent contractors to employees. Section 530 of the Revenue Act of 1978 prohibits the IRS from correcting erroneous classifications of workers as independent contractors for employment tax purposes, including prospective corrections, as long as the employer has a reasonable basis for its treatment of the workers as independent contractors. A reasonable basis includes reliance on (i) judicial precedent, published rulings, letter rulings or technical advice memoranda; (ii) a past IRS audit (although not necessarily an employment tax audit) in which there was no assessment attributable to the employment tax treatment of the worker or of workers holding substantially similar positions; (iii) a long-standing recognized practice of a significant segment of the industry in which the worker was engaged; or (iv) any other reasonable basis for the employer's treatment of the worker.

The relief provided by section 530 is not available unless the employer consistently treats the worker, and any other worker holding a substantially similar position, as an independent contractor (sometimes referred to as the "substantive consistency" test) and complies with the statutory requirements for payments to independent contractors. For example, section 530 relief is not available if the employer has failed to comply with the information reporting requirements associated with its treatment of the worker as an independent contractor.

Section 530 applies solely for purposes of the employment tax provisions of the Code. It has no legal effect on an employer's treatment of a worker as an employee for income tax purposes. Further, it does not affect the worker's own tax treatment for any purpose. Consequently, section 530 can result in the receipt of less than the appropriate amount of employment taxes for some workers. This is because these workers are simultaneously treated as employees for their own tax purposes, and thus are subject only to the employee share of Social Security and Medicare taxes, and are treated as independent contractors by their employers, which pay no employment taxes with respect to these workers. As a result, an amount equal to the employer portion of Social Security and Medicare taxes is not paid. Section 530 also has no impact on determinations of employment status for other purposes, such as eligibility for workers' compensation and unemployment insurance.

Section 530 was enacted as a one-year "stopgap" measure until Congress could devise a less contentious standard for classifying workers. It was extended several times and finally extended indefinitely in 1982.

Section 530 prohibits the IRS from issuing any regulations or revenue rulings regarding the proper classification of workers. As a result, the IRS has not been able to issue any generally applicable guidance in this area for close to 20 years.

Section 3509. In the Tax Equity and Fiscal Responsibility Act of 1982, Congress added section 3509 to the Code in order to mitigate employers' liabilities for retroactive employment tax assessments where section 530 relief was not available. Section 3509 generally limits an employer's liability for failure to withhold income, Social Security, and Medicare taxes on payments made to an employee whom it has misclassified as an independent contractor.

Under section 3509, an employer is liable for 1.5 percent of the wages paid to the employee, in lieu of the income taxes that were not withheld, plus 20 percent of the employee's portion of the Social Security and Medicare taxes on those wages. If the employer has not complied with the information reporting requirements associated with the treatment of the worker as an independent contractor, however, these percentages are doubled to 3.0 and 40 percent, respectively. In addition, the employer's liability under section 3509 cannot be reduced by any self-employment or income taxes paid by the misclassified worker. Section 3509 also does not relieve the employer of its liability for 100 percent of the employer portion of Social Security and Medicare taxes. The relief provided by section 3509 is not available if the employer has intentionally disregarded the withholding requirements with respect to the employee.

The rules of section 3509 were developed in an attempt to place employers and the Federal Government in approximately the same financial position, on average, in which they would have been if the amount of taxes actually paid by the misclassified employees had been determined and used to abate the employers' liabilities, without the need actually to determine those amounts. Thus, section 3509 has no effect on an employer's own liability for Federal or State unemployment insurance taxes or the employer portion of Social Security or Medicare taxes. Also, in return for limiting the employer's liability for failure to withhold employee taxes, section 3509 prohibits the employer from reducing its own liability by recovering any tax determined under the section from the employee, and, as discussed above, gives it no credit for any taxes ultimately paid by the employee.[5]

<u>Section 1706</u>. In the mid-1980s, some employers in the technical services industry complained that the relief granted under section 530 created an unfair advantage for certain of their competitors. They noted that section 530 affects different taxpayers differently, depending on whether they satisfy the statutory conditions for relief. In particular, employers that have consistently misclassified their employees as independent contractors are entitled to relief under section 530, while other employers in the same industry (that, for example, have sometimes taken more conservative positions on classification issues) are not entitled to relief because they cannot satisfy the consistency requirements of section 530. The crux of the employers' complaints was that certain taxpayers in the industry

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[5]Under section 3509, as under prior law, the full amount of the misclassified worker's gross compensation is subject to tax, even though, if the worker had always been treated as an employee, the employer would presumably have negotiated to reduce wages to reflect the employer's liability for its portion of Social Security and Medicare taxes, unemployment insurance, and any fringe benefits provided by the employer at its option.

achieved unfair cost savings by treating the service providers as independent contractors.[6]

As a result of these complaints, in section 1706 of the Tax Reform Act of 1986, Congress excluded from the ambit of section 530 taxpayers that broker the services of engineers, designers, drafters, computer programmers, systems analysts and "other similarly skilled workers engaged in a similar line of work," effective for payments made after December 31, 1986. Section 1706 applies exclusively to multi-party situations, i.e., those involving (i) technical services workers, (ii) a business that uses the workers, and (iii) a firm that supplies the workers to the business. The effect of section 1706 is to deny section 530 relief solely to the firm that supplies the workers. Section 1706 did not affect the application of section 3509 to such firms.

Recent Administrative Initiatives

The IRS has recently announced several administrative initiatives to improve the current situation in the worker classification area.

In March of this year, the IRS released to the public for advance comment new training materials for IRS examiners. The training materials are intended to ensure that examiners make legally correct determinations about whether workers are properly classified as employees or independent contractors under the common-law standard. The materials emphasize to examiners that they must approach the issue of worker classification in a fair and impartial manner, and remind examiners that either worker classification -- independent contractor or employee -- can be a valid and appropriate business choice. These new training materials also demonstrate how the application of the common-law standard has evolved to reflect the changing nature of business relationships. The materials (including the opportunity provided for taxpayers and all other interested parties to comment on a draft of the materials) and the IRS training program based on the

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[6]As explained above, however, misclassification of an employee as an independent contractor does not necessarily result in any cost savings. However, cost savings could be achieved if, for example, the client is able to pay the independent contractor less than the sum of the cash compensation, its portion of Social Security and Medicare taxes, unemployment insurance, workers compensation, the cost of other State and Federal protections, fringe benefits that it would have paid to an employee, and the overhead costs of withholding and recordkeeping. Cost savings also could be achieved if the worker accepts a lower payment as an independent contractor because he intends to evade taxes by underreporting income or overstating deductions.

new materials will help promote both consistency and additional clarity concerning IRS application of the common-law classification standard.

The IRS training document also addresses in detail the application of section 530 of the Revenue Act of 1978. It makes clear to examiners that section 530 should be actively considered during an examination. In fact, the materials state that examiners are required to explore the applicability of section 530 even if not raised by the taxpayer, in order to correctly determine the taxpayer's tax liability.

Another recent initiative taken by the IRS is a classification settlement program that allows businesses to resolve worker classification cases earlier in the examination process, reduce taxpayer costs, and ensure the proper application of the provisions of section 530.[7] Businesses that have misclassified their workers as independent contractors, have filed Form 1099 information returns, but have failed to meet all of the other requirements for relief under section 530, can settle the matter with IRS examiners by reclassifying their workers prospectively and paying only limited tax assessments.[8] This reduces the risk that tax assessments could be applied for multiple years.

Participation by businesses in the settlement program is entirely voluntary, and businesses declining to participate retain all rights that exist under the IRS's current procedures. The program is intended to simulate the results that would be obtained under current law if businesses accepting the offers had instead exercised their right to administrative or judicial appeal.

In addition, the IRS has recently announced procedures for allowing businesses, at their option, to resolve employment tax

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[7] The program is scheduled for a two-year test period during which time it will be evaluated.

[8] If the business meets the section 530 reporting consistency requirement but the business either clearly does not meet the section 530 substantive consistency requirement or clearly cannot meet the section 530 reasonable basis test, the assessment would be limited to one year of employment tax liability (as limited by Code section 3509). If the reporting consistency requirement is met and the business has a colorable argument that it meets the substantive consistency requirement and the reasonable basis test, the assessment would be limited to 25 percent of one year's income tax withholding, Social Security and Medicare tax liability for the year (as limited by Code section 3509), plus the Federal unemployment insurance tax liability for the year.

issues more quickly by appealing these issues to the IRS Appeals function even while an examination on other issues is still in progress. The appeals procedure runs for a one-year test period during which time it will be evaluated.

Further, we are working with IRS to develop administrative guidance on the often difficult issue of whether a taxpayer has satisfied section 530 by virtue of reliance on a long-standing recognized practice of a significant segment of the industry in which the worker was engaged. The guidance is expected to provide that, in defining a significant segment of an industry, no fixed percentage is appropriate for all cases because the determination is part of a facts and circumstances analysis involving a number of variables. However, depending on the facts, less than a half of the industry may constitute a significant segment of the industry. In addition, the guidance is expected to make clear that, while determination of whether a practice is "long-standing" is based on facts and circumstances, a practice will be presumed to be "long-standing" if it has been in effect for 10 years or more, and that an industry with a "long-standing" practice can include an industry that was established after 1978 (when section 530 was enacted).

We believe that these initiatives represent a significant response to concerns expressed by taxpayers, particularly small businesses, in the worker classification area. We would urge that these initiatives be given a chance to work, especially in conjunction with the legislative changes proposed on page 13 below to eliminate past employment tax liability in certain cases where taxpayers have a reasonable argument that they meet the requirements of section 530, and to provide easier access to an independent determination by the Tax Court.

Legislative Proposals

Concerns Regarding Proposed Changes to Classification Standards. The Subcommittee will be examining legislative proposals to change the Federal tax rules for determining whether a worker is an employee or an independent contractor. In particular, the Subcommittee has requested comments on H.R. 1972 and H.R. 582. These bills would provide new standards under which workers would be classified as independent contractors. Under these bills, where the standards were not met, the current common-law classification test would still apply.

At the outset, we note that worker classification is a difficult and long-standing issue that has far-reaching implications. Fundamental issues, including issues beyond the collection of income and employment taxes, may be affected by legislative changes altering the standard for determining whether a worker is an employee or an independent contractor.

Accordingly, in evaluating possible legislative proposals in this area, we believe it is helpful to bear in mind a number of important (albeit sometimes conflicting) principles and objectives. Among these is the principle that absent good cause, government generally should not interfere in the legal relationship between workers and service recipients. At the same time, legislative changes should not impair the ability of government to collect the proper amount of income and employment taxes in a reasonable and efficient manner. In addition, an effective system of government should attempt to promote certainty and fairness in the application of the law. Consistency of worker classification for various Federal and State law purposes, and for businesses entering into similar relationships with workers, are also important considerations, in part because consistency reduces compliance burdens for businesses. Further, much of the existing legal system that is in place to protect workers against certain types of risks applies only to workers who are classified as employees. For that reason, it is important that any legislation altering the status of workers be analyzed carefully to determine its potential impact on worker protections.

Under current law, worker classification in the Internal Revenue Code directly affects income, Social Security and Medicare taxes. However, it also affects other issues such as the availability of employer-provided pensions and group health insurance. For example, under current law, tax-qualified retirement plans sponsored by a business are permitted to cover only the business's employees. Legislation that resulted in the conversion of employees into independent contractors for Federal tax purposes would reduce the number of people eligible to save for retirement in tax-qualified employer-provided pension, 401(k), and other retirement plans. These reclassified workers would be free to establish their own tax-favored retirement plans. However, with automatic employer contributions, employee savings through payroll deduction, employer matching contributions, employer education programs, and economies of scale, employer-sponsored plans have proven to be a particularly effective means of promoting retirement savings for workers, especially for middle- and lower-income workers who might be less likely to save outside the workplace. In addition, converting employees into independent contractors could result in fewer people receiving the benefits of lower-cost group health coverage through their employers.

In evaluating any proposed legislation, it is also important to consider whether a new statutory standard under Federal tax law would lead to similar changes in coverage under other Federal and State laws, such as the laws that provide unemployment insurance, workers' compensation, minimum wage and maximum hour protections, workplace health and safety standards, and family and medical leave protections to workers who are classified as employees. This might occur, for example, if businesses that reclassified workers as independent contractors under a new Federal employment tax standard also treated those workers as independent contractors for purposes of other laws that are based on employee status. Broader reclassification under these other statutory provisions could also result from subsequent efforts, in the interest of simplification, to eliminate inconsistencies between the classification standards under those State and Federal non-tax laws and a new Federal employment tax classification standard by conforming them to the new standard. These potentially sweeping implications should be explored carefully and thoroughly before enactment of any new statutory classification standard for Federal tax purposes.

As a general matter, experience suggests that it is difficult to devise one simple, specific statutory definition or safe harbor that applies appropriately to the many varied existing worker relationships and occupations. Moreover, specific statutory rules, by contrast to regulations and rulings, are not easily adapted to the changes that are constantly taking place in an area as complex and dynamic as the American work place.

Legislative proposals to replace current worker classification rules with new standards raise a number of serious concerns. First, in an effort to achieve simplicity and objectivity in this area, some proposals would prescribe "safe harbor" criteria for classification as an independent contractor that are easily satisfied and that could result in large-scale shifting of workers from employee to independent contractor status. For example, requirements that workers have significant training in order to constitute independent contractors could be automatically satisfied by large classes of workers with licenses, professional degrees, vocational training, or various types of technical training. Requirements that workers have made themselves available to work for others could be satisfied through low-cost advertisement or registration by employees who have no intention of working for anyone other than their employers.

Second, under some proposals, worker status is easily recharacterized without altering the underlying relationship between the worker and the employer. For example, it is not difficult for an employer to structure an artificial arrangement that would appear to meet a requirement that an individual be able to realize a profit or loss to be considered an independent contractor. An employer could require the employee to purchase or rent certain tools and supplies used in generating the employer's product, but could protect the employee from loss by directly compensating the employee through a commensurate pay increase. This could permit an employee to appear to "realize a profit or loss" without changing the nature of the employer-employee relationship or the tasks that the employee would undertake, particularly if the worker purchases supplies and rents equipment from which the worker could "walk away" if employment terminates. By similar means, an employer can fairly easily restructure payments to make it appear that an employee will incur significant unreimbursed expenses. The employer can require the worker to furnish certain tools and supplies while the employer provides a corresponding increase in the payments made to the worker that is not characterized as a reimbursement. The requirement that the worker and service recipient enter into a written agreement concerning worker classification also would fail to prevent inappropriate recharacterization of employee status, particularly where workers do not have as much bargaining power as the business.

Third, in the interest of simplification, some legislative proposals sacrifice clarity, using terms that sound easy to apply in the abstract but would leave serious ambiguities regarding their interpretation. For example, proposals may require that a worker make "significant" investment in tools, equipment, or training to constitute an independent contractor. Yet what is "significant" is not objectively determinable, and may vary among occupations and industries. Such provisions would only replace the current standards with new standards that also have inherent ambiguities.

Fourth, by permitting workers to become independent contractors by meeting alternative criteria, many proposals would allow taxpayers to apply criteria that, while appropriate in certain contexts, are inappropriate for the occupation or industry being considered. Thus, the problems identified above are exacerbated when one or two criteria alone become determinative in classifying workers. In a well-meaning attempt to craft a "one-size fits all" solution, legislators may craft a standard that is too loose for many occupations and industries. For example, some might argue that it is appropriate to determine whether an architect, working full-time on a building project for an employer, is an independent contractor based on whether the architect has significant investment in training and has performed or offered to perform substantial services for others in the past year. However, these same broad statutory standards could then be applied to employees in fields with high turnover and significant training requirements, such as certain nurses working in hospital settings, to shift numerous employees to independent contractor status.

In summary, many legislative proposals establish standards that are easily satisfied or manipulable, lack clarity, and would impose alternative requirements that allow taxpayers to pick and choose elements in a manner inappropriate to the occupation or industry involved. While most workers are readily classified as employees or independent contractors, there will always be a class of cases that are less obvious. The formulation of objective, mechanical standards to resolve these cases has proven to be an elusive goal because classification under the common-law control standard looks to the realities of the situation and therefore is inherently fact-sensitive. Moreover, in light of the significant worker protections that hinge on status as an employee, it is important to consider carefully the risk that new statutory classification standards could result in significant shifts of workers from employee to independent contractor status.

Proposals for Statutory Modifications Relating to Section 530 and Tax Court Jurisdiction. Perhaps the greatest problem for business in this troubled area is not the possibility that an employer treating its employees as independent contractors will be required to reclassify them as employees for the future, but the risk of substantial employment tax liability and penalties for previous years, even where the employer had a reasonable argument and belief that it was entitled to section 530 protection.

To address this problem, we propose that Congress permit businesses that fail to meet the requirements of section 530 and misclassify workers as independent contractors to reclassify their workers prospectively with no employment tax liability for prior years, provided that they satisfy certain conditions.[9] To qualify for this relief, the business would have to meet the section 530 reporting consistency condition, and have a reasonable argument that it meets the section 530 substantive consistency and reasonable basis requirements. This "reasonable argument" standard is intended to provide relief to taxpayers who fall just short of meeting those section 530 requirements. Of course, as under current law, if workers are correctly classified as independent contractors, or if the taxpayer meets section 530, then the business would not be required to reclassify the workers as employees.

Under the proposal, a taxpayer that believes the IRS has erred in its case would be given an expanded opportunity to obtain an independent review of the IRS decision. United States Tax Court jurisdiction would be enlarged to cover worker classification determinations for employment tax purposes. Of course, the Tax Court would have the authority described above to determine whether misclassified workers should be reclassified on a prospective basis only.

Access to the Tax Court would permit disputes to be resolved more quickly and at lower cost than in Federal district court.

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[9]This suggested legislative change builds on the relief provided under the IRS's Classification Settlement Program, described above.

The Tax Court provides simplified procedures that might be adapted for small business cases. Tax Court judges have considerable experience in resolving tax cases involving similar issues, and many small cases are currently resolved without requiring the business to retain counsel. We believe that the expanded Tax Court jurisdiction would provide a business with increased access to an independent judicial resolution if the business believed its determination, rather than the IRS position, was correct.

These legislative proposals -- to eliminate past employment tax liability in certain cases where taxpayers fall just short of meeting section 530, and to increase a small business's access to an independent, third-party determination -- should further help taxpayers to resolve worker classification problems in a fair and cost-effective manner. We believe that, in combination with the administrative steps described earlier, they would provide significant relief to small businesses from the most serious problems relating to worker classification.

In addition, we believe that it may be possible to improve understanding of the common-law classification standard through a revenue ruling or other guidance. The recently revised IRS training materials take an important step in this direction by emphasizing that the true common-law test is the right to "direct and control" and that the "20 factors" that are often referred to in connection with this test are relevant only insofar as they provide evidence bearing on whether the test is satisfied. We think that it would be helpful to taxpayers for this message to be communicated through more formal guidance (such as a revenue ruling), and we also believe that such guidance could help taxpayers focus on factors -- likely five or fewer -- that are most relevant to their particular situations. At present, section 530 precludes the issuance of a revenue ruling or regulations to provide this clarification. We would be pleased to explore with Congress the possibility of amending section 530 at least to the extent necessary to permit publication of such guidance.

<u>Proposals for Statutory Modifications Relating to Information Reporting</u>. We believe that any proposal in this area should attempt to improve compliance with regard to independent contractors. Under current law, service-recipients engaged in a trade or business are required to report, on Form 1099, payments in the course of such trade or business to any individual independent contractor of $600 or more during a calendar year. This information-reporting system is one of the most effective tools for enforcing proper reporting of income by independent contractors, because taxpayers are more likely to report a payment on their income tax return if they know the payment already has been reported to the IRS by the payor.

The penalty on a service-recipient for failure to file the information return, however, is only $50 (unless the failure is due to intentional disregard of the reporting requirement). We believe this relatively minor penalty, last increased in 1982, contributes to substantial noncompliance with these reporting requirements. In recent years, many experts in this area have proposed substantially increasing this penalty. The Administration's fiscal year 1997 budget proposes to increase the general penalty for any failure to file an information return to the greater of $50 per return (the current penalty) or 5 percent of the total amount required to be reported. Increasing the penalty in proportion to the amount of the unreported payment balances the need to have a stronger incentive to comply with the reporting rules with the concern that the penalty not be unduly harsh. The proposal includes limits on the penalty to ensure that the increase will not be imposed on those firms that have very substantially complied with the reporting requirements, i.e., where the failure is likely due to inadvertence or administrative error in a firm that has made a serious attempt to fully comply with the rules. Specifically, under the proposal the penalty will not apply if the failure is corrected by August 1 of the year the return is due. In addition, the penalty will be limited to $50 per failure, as under current law, if the taxpayer properly reported at least 97 percent of all amounts required to be reported for that period. We note that the Tax Section of the New York State Bar Association has made a similar proposal. (See the 1995 Report on Proposed Reforms to Administration and Enforcement of Employment Tax and Income Taxes on Individual Workers.)

In addition, under current law, a service-recipient is not required to file an information return with respect to payments made to a corporation for services rendered. The Administration believes that corporations doing business with the Federal government should report as income their payments from the Federal government. Accordingly, the Administration's fiscal year 1997 budget would generally require Federal agencies to report payments of $600 or more to corporations for services rendered, with appropriate exceptions as prescribed in regulations.

Conclusion

Worker classification is a difficult and complex issue that has far-reaching implications. Legislative changes that would result in the reclassification of workers from employee to independent contractor status could affect a variety of protections for these workers. It is important to explore these potential consequences thoroughly before enacting any new statutory classification standard for Federal tax purposes. At the same time, we believe that Congress should consider proposals to eliminate retroactive employment tax liabilities in certain cases where an employer has a reasonable argument that it meets the requirements of section 530, and to permit taxpayers to resolve disputes with IRS in a simpler and more cost-effective manner.

The Treasury Department appreciates the ongoing efforts by the Members of this Subcommittee and others to address this subject. We would be pleased to explore these issues further with the Subcommittee.

Madam Chairman, this concludes my formal statement. I will be pleased to answer any questions that you or other Members may wish to ask.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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"The Twenty-First Century American Economy"
Lawrence H. Summers
Deputy Secretary of the Treasury
The International Council of Shopping Centers
Washington, DC
June 20, 1996

Introduction

Good afternoon. It is a pleasure to be here among a group that has worked so hard to build America's future. My subject today is the American economy of the twenty-first century. More than anything else, the success of the United States in the 21st Century will depend on our ability to generate rapid and inclusive economic growth. That has been and must continue to be the primary goal of national economic policy.

The Importance of Growth

No matter what problem, opportunity or challenge you wish to discuss, the solution comes back to growth. It comes back to growth because:

- Growth means more families able to achieve their Americn dream of a higher and rising standard of living.
- Growth means more jobs at higher wages.
- Growth provides the wherewithal for us to fulfill our public mission--be it solving the problems of the inner-city or facing the demographic challenge of retiring baby boomers.
- Growth determines our international strength. Ultimately, it was the strength of the American economic machine that won us the Cold War. And continued economic strength is essential if we are to continue to lead the world peacefully into the 21st Century.

No Limits to Growth

The potential for the American economy to grow is unbounded. As the President has said, we live in an Age of Possibility. America is the world's leader in innovation in almost

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any post-industrial activity that you can name. Think of Microsoft or McDonald's or Visa or Federal Express or Disney or Wal-Mart.

We cannot and will not accept any "speed limit" on American economic growth. It is the task of economic policy to grow the economy as rapidly, sustainably and inclusively as possible. Of course, the maintenance of low inflation must be a crucial objective of economic policy. But we have nothing to fear and everything to gain from increases in growth arising from productivity growth or the expansion of the economy's capacity to produce. For the long run, over the 21st Century, it will be our ability to raise productivity growth and expand capacity that will determine how we fare economically as a nation.

No one can say how fast the economy will grow with the right policies over the next ten years. Of course, we must be conservative in prearing our budget forecasts. But we must not be conservative in setting our vision.

I want to talk today about President Clinton's growth strategy. Before I do, I want to highlight the progress we have made so far. We are enjoying the first investment-led, low inflation recovery since John F. Kennedy was President.

- Since the beginning of the Administration, this economy has created over 9.7 million new jobs.
- Real wages are starting to rise for the first time in years. In 1994, mean family income rose by 2.3% after several years of negative change.
- Investment in equipment is at an all time high as a share of GDP.

In short, our growth strategy is working.

Twentieth Century Economics

Our growth strategy is rooted in the principles of 21st century economics. Some of these principles are eternal verities. Others reflect changing economic conditions.

The first principle is that we can only reap what we sow.

- Continued growth in our nation's standard of living depends on continued investment in our future. While this principal is as old as the bible, it has at times been forgotten. Ultimately, economic growth can only come from expanding our nation's productive capacity. This depends on capital.
- Capital takes many forms. It is equipment and buildings, highly trained workers and networks of idea generators. It is physical capital, human capital, intellectual capital and social capital.

The second principle that must govern our strategy for growth is that a nation's people are its most important resource.

- No longer does economic success depend on what lies in or below the ground--on what a country can grow or what it can mine.

- In a world where capital can move, where technology can move and where the very notion of a national company is being lost, a nation's most important resource is its people. America's people are our only uniquely national resource.
- If one looks at the tremendous economic success of Asian countries over the last few decades, it probably has many roots. But none is more fundamental than those countries' commitment to universal education and the reverence for learning that they have instilled in their people.

The third principle is that in the 21st Century, nations will either grow together or stagnate apart.

- Trade means more and better jobs. Roughly 11 million Americans hold jobs that are supported by exports and those jobs are good jobs paying 15% more than average. Trade also spurs our producers to be more efficient and provides more products to consumers at lower cost. No nation can survive as an island unto itself.
- When the history of our era is told, I believe that the end of the Cold War will be the second most important story. More important is the fact that this is the period when 3 billion people around the world boarded the escalator to modernity. Growth around the world is creating huge new markets for American products. In the 1950s only about 2% of growth was attributable to exports. In the 1990s, over one-third of real economic growth came from exports.
- American leadership is necessary to promote economic reform, to open markets, and to safeguard the functioning of international financial markets.

The fourth principal is that the 21st Century economy will be information-based not mass-based. Prosperity will bubble up; it will not trickle down.

- In the 20th Century, it was the mass of products that determined their value--the tons of wheat or size of cars. In the 21st Century, it will be the knowledge imbedded in them. This puts a premium on flexibility and innovation.
- Think of the difference between steel and semiconductors or between chemical production and biotechnology. Indeed, the entire sector of information services will be entirely free of mass.
- No example proves this principle better than the experience of the former Soviet Union. Their production in terms of machine tonnage was indeed tremendous, but in terms of value it was minuscule. They were measuring success with the metrics of the past, not the metrics of the future.

The Administration's Five-Part Strategy for Growth

These principles, based on experience and a vision of the capacity for America to grow, have guided us in formulating a five part strategy to develop the twenty-first century economy.

The first element of our strategy for growth is the promotion of investment and savings.

- As a result of the Administration's 1993 budget deal and the faster economic growth it stimulated, the deficit has been cut in half. From an all-time high of $290 billion in FY 1992, the deficit was reduced to $164 billion last year, and is on track to come in below $130 billion this year. That's in nominal dollars.
- Now we have to finish the job. The President has proposed balancing the first balanced presidential budget since the 1970s. It is based on spending reductions, it includes tax cuts, it takes place in seven years and it is based on Congressional forecasts. It is the right way to balance the budget.
- Having reduced our rate of government dis-savings, we must now turn our attention to personal savings. To this end, the President has introduced reforms of IRAs and a new pension plan for small businesses that will include pension portability.
    - And let me mention here a new product the treasury may soon offer: inflation protection securities. These bonds will offer protection from inflation; and it is possible to conceive of loan instruments where re-payment is backloaded to correspond to inflation.

The second element of growth is investment in people.
- Improved quality of primary and secondary education will allow more people to excel, to create, to innovate. That's why we have insisted on adequate funding for Head Start, and have developed the bipartisan Goals 2000 program, which encourages states to set high educational standards. Under the Congressional leadership's budget, up to 20,000 children in 1997 would be denied the opportunities of Head Start.
- Higher education will be the key to success in the 21st century. Already, those with a college degree make almost twice as much as who only completed high school. Our tuition tax credit will go a long way toward making 14 years of school as universal as the first 12 are today.
- And because what you learn in college may not be enough for your whole career, we have proposed skill grants to pursue lifelong learning.

The third element of our growth strategy is a coordinated attack on closed markets and an effort to open up the world economy.
- We have put the American government behind the American exporter. Our actions include helping U.S. bidders in global competitions, removing bureaucratic obstacles to exporting and promoting U.S. exports abroad.
- We stood up for NAFTA and got it passed. It is a good agreement that has been good for us, good for Canada, and good for Mexico.
- To date, we have negotiated 21 trade agreements with Japan in sectors ranging from cellular telephones to rice.
- The President has sketched out a bold vision of free trade in the Americas and free trade in the Pacific.

Fourth, government has a major role to play in technology and fostering innovation. Historically, science and technology have enjoyed bi-partisan, broad based support.

- In fact, today's most exciting technologies were engineered by the US government. The Internet was developed by the Defense Department, and managed by the National

Science Foundation. Today, the value of the top 10 Internet companies exceeds $16 billion dollars.

- The Mid-Atlantic region is one that has benefited tremendously from federal investment in technology. Think of the boom in software firms near Dulles airport, the development of biotechnology along Route 270 or the technology enclave along the Philadelphia-Princeton corridor. Much of this development owes its genesis to federal investment in technology.
- We have fought to protect basic research and development funding. In addition, we have forged technology partnerships with private industry through the Advanced Technology Program and the Manufacturing Extension Partnership to increase pre-competitive research in promising civilian industrial technologies.

Fifth and finally, the 21st Century economy has to be flexible. Not only is it important to provide for the ingredients for economic growth--training, investment, R&D and open markets--but it is equally important for the economy to be able to use those ingredients as effectively as possible.

- The Administration is working to remove the heavy hand of regulation from our economy. Through Vice President Gore's reinventing government efforts, we have cut 100,000 workers from the federal payroll. We are cutting regulations where they are no longer needed. The new telecommunications bill, for example overhauls outdated laws in order to increase competition and cut prices to enable all Americans to enjoy the benefits of the information highway.
- It is imperative that people have the security they need in a flexible economy. Accordingly, the Administration has worked hard to make health insurance and pensions more portable. Not only does portability enhance health and retirement security, it enhances growth. Improved portability will encourage workers to make the most of their skills and to take full advantage of new opportunities. We are very hopeful that a compromise can be reached on the Kennedy-Kassebaum legislation, which is an important first step in this direction.

V. Conclusion

Let me end where I began. The United States has no speed limit to growth. We have the right strategy based on the principles of the 21st Century economy, a strategy based on what has worked around the world. It is not based on the naive idea that the public sector can drive the economy fast by directing action, running deficits or printing money. Nor is it a strategy based on the idea that somehow government abdication will eliminate all our economic problems. It is a strategy that can make sure that like the Twentieth Century, the 21st Century will also be an American century.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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FOR IMMEDIATE RELEASE
June 20, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 52-WEEK BILLS

Tenders for $19,413 million of 52-week bills to be issued June 27, 1996 and to mature June 26, 1997 were accepted today (CUSIP: 9127942R4).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.55%	5.88%	94.388
High	5.57%	5.90%	94.368
Average	5.56%	5.89%	94.378

Tenders at the high discount rate were allotted 7%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$56,143,522	$19,413,382
Type		
Competitive	$48,836,496	$12,106,356
Noncompetitive	979,526	979,526
Subtotal, Public	$49,816,022	$13,085,882
Federal Reserve	4,800,000	4,800,000
Foreign Official Institutions	1,527,500	1,527,500
TOTALS	$56,143,522	$19,413,382

An additional $165,000 thousand of bills will be issued to foreign official institutions for new cash.

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DEPARTMENT OF THE TREASURY

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FOR IMMEDIATE RELEASE
June 21, 1996

Contact: Joyce McDonald, FinCEN
(703) 905-3770

Media Advisory

Global Money Laundering Problem to be Addressed at
Meeting of the Financial Action Task Force (FATF)

The FATF is a 26-nation organization created by the G-7 to address the global problem of money laundering. It serves as the world leader in promoting the development of effective anti-money laundering controls and cooperation in counter-money laundering investigations among its membership and around the globe.

From June 25-28, the FATF will hold a meeting in Washington, D.C., attended by 200 delegates. The organization, which is based in Paris, France, is holding its first-ever meeting in the United States. Since July 1995, the United States has held the Presidency of the FATF under the leadership of former Treasury Under Secretary for Enforcement Ronald K. Noble. Treasury's Financial Crimes Enforcement Network (FinCEN) is serving as the lead agency for coordinating the U.S. role within the FATF.

This year, for the first time since it was created, the FATF undertook a major examination of its anti-money laundering standards, making significant revisions to adjust to changing global money laundering trends.

The following is a schedule of events open to the media:

Monday, June 24

Background Briefing

Participants:
FATF President Ronald K. Noble
FinCEN Director Stanley E. Morris
FATF Secretary Patrick Moulette
Incoming FATF President Fernando Carpentieri,
(Director General, Ministry of the Treasury, Italy)

(more)

Subject: Description of FATF; its accomplishments under the U.S. Presidency; and upcoming announcements planned for Friday's news conference.
Time and Location: 10:00 a.m.
National Press Club, Lisagor Room
529 14th Street, N.W.
Washington, D.C.

Tuesday, June 25

Opening Remarks to the
Financial Action Task Force Plenary,

Deputy Secretary of the Treasury
Lawrence H. Summers

Time and Location: 9:30 a.m.
Renaissance Mayflower Hotel, Grand Ballroom
1127 Connecticut Avenue, N.W.
Washington, D.C.

Friday, June 28

Press Conference

Participants:
FATF President Ronald K. Noble
FinCEN Director Stanley E. Morris
FATF Secretary Patrick Moulette
Incoming FATF President Fernando Carpentieri,
(Director General, Ministry of the Treasury, Italy)

Subject: Accomplishments of the FATF; announcement of revised 40 Recommendations; and release of FATF's annual report.
Time and Location: 1:00 p.m.
Renaissance Mayflower Hotel, Grand Ballroom
1127 Connecticut Avenue, N.W.
Washington, D.C.

(Press credentials are requested. Cameras should be in place by 12:45 p.m.)

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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As Prepared for Delivery
Sunday, June 23, 1996

**REMARKS BY TREASURY SECRETARY ROBERT E. RUBIN
SECOND ANNUAL 14TH CONGRESSIONAL DISTRICT ISSUES CONFERENCE
SPONSORED BY CONGRESSWOMAN CAROLYN MALONEY**

Good afternoon, and thank you Carolyn. It's always a pleasure to appear with my Congresswoman.

We've had a great deal of opportunity to work together in the past four years -- on capital access, on the debt limit and interstate banking and our agenda for the international financial institutions. We've also worked closely on the legislation she sponsored and the President has now signed to improve government debt collection. And of course, she was an important part of the coalition which passed the president's economic plan -- a plan that has halved the federal deficit in under four years and helped the economy create 9.7 million net new jobs. As this conference demonstrates, she takes economic issues very seriously and is an effective member of Congress as a result.

I'm glad to see the turnout this afternoon, because that's a sign that New Yorkers care very deeply about the future of our city and the future of this region.

I've lived here most of my life, and I've had an interest in the affairs of New York for quite some time. But my commitment to the problems of the inner city deepened about 14 years ago when I read a book called "The Underclass." It described the inter-generational cycle of poverty, despair and alienation that was then and still is a personal tragedy for so many residents of the inner cities, and a central problem for our entire society.

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Recent reports show the seriousness of the problem. The Committee for Economic Development reports that one third of the neighborhoods in our 100 largest cities are distressed or in danger. The Organization for Economic Cooperation and Development in Paris, the OECD, ranks us at the top of a list of 16 industrialized nations in income disparity. That same study shows that poor U.S. children are poorer than the children in about all other Western industrialized nations. That is not a formula for a healthy economy or social fabric for any of us.

I believe, and more importantly the president believes, that unless we succeed in bringing the residents of the inner cities into the economic mainstream, our economy will be seriously impaired for all of us because of the social costs and lost productivity, and our social fabric will be increasingly torn, again for all of us. It is critical that all Americans understand that no matter where they live or work, they have a vital stake in reviving our inner cities.

The problems of urban America are deep seated and were created over decades. The solutions will take time. They will not come overnight.

Today, it is fashionable to say that government has no role to play, and that programs to help the inner cities don't work. As Treasury Secretary, let me simply say that is purely and unequivocally not so. It is true that failures are easy to see and that we still have much to do. But it is also true that there are effective federal, state and local programs all across America, and Americans need to know that. I've seen first-hand how these efforts can help revive neighborhoods and empower individuals, and this Administration has worked hard to ensure that effective actions are taken.

First, I'm speaking of what I would describe as human capital initiatives: Head Start, the Jobs Corps, educational assistance and educational tax incentives, skills training, infant and maternal health programs. It is a fundamental fact that investment in people can pay dividends in terms of higher living standards and foregone public sector costs in later years.

Second, we need order on our streets. We need police, laws that prevent guns from being in the hands of criminals, and prompt and credible justice. At Treasury, our bureau of Alcohol, Tobacco and Firearms helps to shut down pipelines of guns coming into our cities. And ATF runs a program called GREAT, or Gang Resistance, Education and Training, that helps steer youngsters away from gangs and guns and drugs.

Third, the residents of the inner cities need to get jobs and earn a living wage. They, like all working Americans, need an increase in the minimum wage. They need the Earned Income Tax Credit that rewards work and helps families stay off welfare, not a tax increase, as under the congressional majority's budget.

Fourth, our inner cities need access to private sector capital. If I might quote Robert Kennedy, he said, "To ignore the potential contribution of private enterprise is to fight the war on poverty with a single platoon, while great armies are left to stand aside."

I know markets, and private capital is indispensable for creating the kind of jobs and growth communities need to put poverty behind them and prosperity before them. But I also know markets well enough to know that capital doesn't flow equally everywhere it is needed. We need to help get capital into places like this so that communities can get back on their feet again. We have such programs, but they are under heavy political attack.

From Bedford-Stuyvesant and the South Bronx to South Chicago I have seen the Community Reinvestment Act and the Low Income Housing Tax Credit making a tremendous difference in neighborhoods that have been denied investment capital in the past. Loans to creditworthy minority borrowers are on the rise around the country, and banks and other financial institutions have pledged billions in community lending. Some 100,000 housing units a year have been created nationwide by the tax credit.

Soon, Treasury's Community Development Financial Institutions Fund, CDFI, will begin providing seed and expansion capital to community-based banks, credit unions, community loan funds, and microenterprise lenders, and it is helping to marry volunteer business mentoring with access to capital. In his most recent budget the President asked Congress for an additional $125 million for the CDFI Fund because of its importance in encouraging economic development and growth in distressed areas.

Let me say a few additional words about the concept of micro-lending, which has worked well from Quezon City in the Philippines to Grameen Bank in Bangladesh, and right here in the United States. It is a concept that I believe holds serious potential for low-income residents of our cities, and rural areas for that matter, if it is expanded.

Microlending -- small loans, often just a few hundred dollars to budding entrepreneurs -- is centered in community-based banks, credit unions, community loan funds and other local institutions. Despite the odds, loan repayment rates often exceed those in the commercial sector.

The President has asked the Treasury Department to establish a Presidential Awards program for microlending, and the First Lady and I launched this program last month. The awards will recognize outstanding and innovative programs that provide access to credit, technical help and entrepreneurial training.

Safe streets, education and health care, work that pays, and a well-capitalized and vital private sector -- these are what it takes to revitalize communities across our country.

If I might draw upon Robert Kennedy a second time: Kennedy once remarked that our nation has a peculiar genius to focus our resources, attention and effort to solve any problem before us. That is what is required for our cities, and I would challenge each of you today to respond to the challenges facing this city and this region. Government can provide programs, and government can offer direction, but government alone cannot make the ultimate difference. Particularly in a time of shrinking resources, it is incumbent upon all of us, whether we're in government, finance, transportation, social services, or community organizing, to do our part. For example, those of you in the business sector can become partners in community development with investments of your expertise through business mentoring -- or investment of your capital in CDFIs.

We in the Clinton Administration have tried to do our part. The President's economic plan has helped the economy create 9.7 million new jobs, mostly in high paying sectors or positions; and unemployment is down in the nation's largest central cities.

We have expanded Head Start, increased educational funding for poor children, expanded school-to-work opportunities, and advanced safe and drug free schools. We have helped local communities put more cops on the beat and take guns off the street. We have expanded the Earned Income Tax Credit and the Job Corps, and opened up new job opportunities through Empowerment Zones and Enterprise Communities. We've made the low income housing tax credit permanent, reformed the CRA regulations and launched CDFI to bring capital and credit to distressed areas of our nation, including the inner cities. The list is extensive, and we have a strong agenda for the coming year, from a second round of Empowerment Zones to a new brownfields tax credit to encourage environmental clean up in distressed areas.

I want to close with a some words on the church fires that have been in the news of late, and make a point that I think is very important, both as it relates to the fires and as it relates to our cities.

As you well know, there have been a number of church fires, primarily at churches in the south with predominantly black congregations. This is terrible and reprehensible. Treasury's Bureau of Alcohol, Tobacco and Firearms is working on these investigations, and is making real progress, although there is an enormous amount to do. There have been 11 arrests thus far, and we are determined not to rest until all cases are solved and all the arsonists are brought to justice.

Last week I was with the President in South Carolina taking part in the dedication of a replacement structure for the Mt. Zion AME Church which had been burned. The Pastor repeated how his daughter had asked him, "Daddy. Why did those people burn our church?" He answered: "They didn't burn our church, they burned a building. The church is inside us."

That is the point we must take with us, both in overcoming the rash of church fires and in rebuilding our cities. Ultimately, the answers we are looking for <u>are</u> inside us. And together, I believe we can make a difference, not just for New York but for all Americans.

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U.S. Policy Toward the International Monetary System
on the Eve of the Lyon Summit
Remarks to the Emerging Markets Traders Association
June 24, 1996
Lawrence Summers, Deputy Secretary of the Treasury

Introduction

Thank you for giving me the opportunity to address the New York financial community.

I thought this was a fitting group to talk to about the G-7, since the G-7 message over the past year has been not simply "it's the markets, stupid" but "it's the emerging markets, stupid."

Although the roots of the G-7 process were in the field of international monetary cooperation, it has come to be associated with a much broader mandate -- the drive for successive multilateral trade rounds, the developing country debt crisis of the 1980s, the promotion of stabilization and reform in Russia and the transition economies, and reconstruction in Bosnia.

These successful initiatives have for some time eclipsed the popular association of the G-7 with monetary cooperation. Over the last several years, however, we have seen a resurgence of interest in financial issues, monetary arrangements and exchange market volatility. And this has been accompanied by nostalgia for a return to some lost era of stability and revived interest in broader reform of the system.

In this context, I thought it would be useful to address the core monetary mandate of this group and to outline our views on the major challenges facing the international monetary system and our approach in the G-7 process to meeting these challenges.

I want to focus on the two main elements of our approach:

First, on macroeconomic policy and exchange market cooperation among the major industrial countries. Our approach of a strong focus on economic fundamentals has produced a reasonably good record of economic achievements -- relative exchange rate stability without inflexibility, and improved fundamentals in terms of low inflation, increased fiscal discipline,smaller external imbalances.

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And, second, on cooperation among the G-7 to deal with broader challenges in the international monetary system. We have begun to put in place a set of important reforms to help ensure that our institutional arrangements to deal with new risks in the global financial system are, to use Secretary Rubin's phrase, as "modern as the markets."

Before I start, let me make it clear that I have nothing new to say on U.S. exchange rate policy. We believe a strong dollar is in America's economic interest, and exchange rates should reflect economic fundamentals.

Macroeconomic and Exchange Market Cooperation in the G-7

The G-7 process, as it has evolved over the past two decades, is anchored in meetings of Finance Ministers, generally once a quarter. Three times a year, on every occasion except at the annual G-7 economic Summit, the Central Bank Governors participate in the meetings. These Ministerial meetings are supplemented by a more intensive set of interactions among finance deputies, which now meet around eight to ten times a year, frequently with senior officials from the seven central banks.

The Ministerial meetings customarily begin with a review of the main economic policy challenges in the major industrial countries, and this "surveillance" exercise remains the core issue on the agenda for every meeting. The Managing Director of the IMF is normally invited to make a presentation on the economic outlook and to participate in that part of the discussion. The Research Director of the IMF provides a similar function for the G-7 finance and central bank deputies on selected occasions.

Our approach to the G-7 is based on the following main elements:

- First, we have tried to focus the cooperative process more on economic policies and the underlying economic fundamentals in each of our economies than on explicit, formalized exchange rate arrangements.

  This approach may convey less drama and excitement than the alternatives, but it is based on the fundamental reality that the only path to enduring exchange market stability is through the pursuit of sound economic policies. In view of the fact that all the major sustained exchange rate misalignments of the floating rate period, at least with the benefit of hindsight, have been the consequence of some adverse policy mix or fundamental shift in one of the major countries, we think the right starting point for the G-7 process is to focus on getting our policies right.

  As part of this approach, we have adopted a series of innovations to the G-7 process over the past several years. We have sought to include the central banks more systematically into our discussion on surveillance of the economic outlook. We have invited the IMF to provide a more regular, confidential assessment of the economic outlook. We have focussed the Deputies and Ministerial discussions on key risks to the outlook and the policy requirements in that context. These are not revolutionary, but they are practical and of significant value to the effectiveness of our dialogue.

- Second, we have been more selective in our use of the tool of exchange market intervention.

  Our view is that intervention is more effective when it is least expected, when it is used in the context of supportive monetary or other economic policy actions within the G-7, and when it conveys a strong signal of a common approach among the principal monetary authorities. Intervention is less effective when it is widely telegraphed and anticipated, when its perceived as a substitute for action on the fundamentals, and when employed in the face of strong market pressure in the other direction.

  I think it is worth pointing out that during the successful G-7 effort to reverse the potentially damaging moves in the major currencies of early 1995, the U.S. monetary authorities intervened on only four occasions, less often than during any other year over the past decade. This does not mean that we would not be more active if the circumstances warranted, only that sometimes less is more.

- Third, we have tried to make the G-7 process more effective by making it less formal, reducing the distraction of artificial, but consuming, debates about communique language, and less public.

  We've produced fewer communiques, but when we chose to send a formal coordinated signal -- as we did in April 1995 when we called for an "orderly reversal" of exchange rate movements -- we made sure it meant something. By avoiding the overly strident locomotive debates of the past, we've made it easier to work constructively on collective approaches to common problems.

The Record

This approach has produced a good record of accomplishment by the G-7 Ministers and Governors over the last several years.

First, the G-7 strategy of focussing on the sound policies necessary for sustained growth and exchange market stability has contributed to a general improvement in our fundamentals.

Let me start with the United States.

- We are now in the sixth year month of an expansion which has been driven to a significant degree by rapid export growth. Exports have contributed than one third of the increased output over this period of time.

- The President's commitment to fiscal discipline has cut the deficit in half, to the lowest level in the G-7.

- This combination of strong and credible policies has been rewarded by the markets, and has helped produce the first investment led, low inflation U.S. recovery in a generation. Long-term interest rates are lower than when the President took office, despite the strength of the expansion.

We have also seen over this period a general improvement in the underlying fundamentals across the G-7, which reflects first and foremost the remarkable consensus that now exists on the importance of non-inflationary policies and fiscal discipline.

- Inflation is now lower on average in the G-7 than it has been for more than a generation.

- Significant progress has been achieved toward more sustainable fiscal positions in most of the G-7.

- External imbalances have fallen or are on a path to fall to levels that are more sustainable and present less of a risk to exchange market stability. The Japanese surplus, which many identified as the major asymmetry in the world economy three years ago, has been cut from a level of 3.5 percent of GDP and rising to less than two percent and still falling.

As this record suggests, the G-7 process has at times played an important part in influencing the policy debate in each of the major countries, despite the limits on the potential for coordination imposed by the fact that we live in a world of sovereign governments with democratically elected legislatures. This is true of the deficit reduction effort in the United States. It's true of the increased acceptance in Continental Europe of the need for structural reforms to increase flexibility, which was encouraged by the Detroit and Lille conferences on employment. And it's true of the adoption by Japan of growth-oriented policies and more liberal trade policies.

It is also true that many economic problems remain in the G-7. Private savings are still too low in the United States. Europe is still structurally too rigid. And Japan faces a series challenge in strengthening its financial system. It is difficult, however, to see these problems as failures of the G-7 process. They are domestic problems with domestic solutions.

The G-7 process has also produced greater stability among the major currencies, largely because of the achievements in strengthening our fundamentals.

If you look a graph of the trade-weighted dollar over the last fifteen years, you'll see the mountain of the dollar's appreciation of the mid-1980s has been followed by years of small foot hills and valleys of variability. By some measures, volatility among the major currencies has fallen by one-third to one half over this period. Trade, direct investment, and capital flows have continued to expand rapidly despite the fact that we now exist in a flexible exchange rate system among the major currencies.

Finally, our police-centered approach has also proven effective in addressing potentially damaging misalignments in exchange markets. In the fourteen months since the April 1995 G-7 communique called for an orderly reversal of the preceding moves in each of the major currencies, a combination of greater credibility in the policy stances of the major countries, important policy shifts in Japan and Germany, and a series of concerted exchange market operations helped bring the trade-weighted dollar, mark and yen back to levels prevailing in 1993 and 1994. Implied volatilities have fallen to the levels we have not seen in some time, indeed to the lowest levels in almost ten years for $/DM. The cloud of uncertainly and crisis has receded. The outlook in all our economies has improved.

The False Promise of Greater Coordination

There are those who argue that the next frontier for the G-7 is to move to a more formalized system of exchange rate arrangements for the major currencies. But just as we have to come to recognize in recent years that more effective government is not a matter of more government or more programs, more effective G-7 cooperation need not and should not mean more formalized processes of policy coordination and exchange rate management. I do not believe that a more formalized process of exchange rate management would be desirable or feasible in the present economic environment.

The arguments on the other side of this debate rest on essentially three propositions, each of which I believe is mistaken.

- First, there are those who maintain that by simply wishing exchange rates into a band we can keep them there with adroit use of smoke and mirrors at no real cost. This was a debatable proposition twenty years ago. In today's capital markets, it's not remotely credible. What evidence there is of intervention's efficacy comes from cases here it was a surprise and a signal of policy intention.

- Second, there are those who that maintain that we should be prepared to devote economic policy to the achievement of a specific exchange rate objective. Even if this were desirable it would be difficult given that the speed with which exchange rates move and the time in which legislatures take to act essentially render fiscal policy unavailable for this purpose. Moreover, for large economies for whom external trade is a relatively small share of output, directing monetary policy at an exchange rate objective would entail real costs, costs in the form of misguided macroeconomic policies, and costs in the loss of flexibility to respond to unanticipated shocks.

Would it have made sense, for example, to have forced the Fed to ease in late 1984 to contain the dollar's rise despite the inflation risks still evident then? Would Europe and Japan have preferred to have been forced to tighten monetary policies at that time to prevent a fall in the value of their currencies that was driven by a clash of fiscal and monetary policies in the United States? Would it have made sense to have forced the Fed to tighten in early 1995 to contain the dollar's fall despite the sharp slowdown in growth at that time?

I am aware of no evidence on balance that a more exchange rate attentive monetary policy would have produce a better record of output and price stability than the monetary policy that was in fact pursued. And there is at least a body of econometric evidence that suggests the opposite.

- A third common argument among the proponents of more formalized exchange rate and policy commitments is the need for a source of external discipline. Yet, at no time during the post war period has there been a greater acceptance of the fundamental importance of sound monetary policy and fiscal discipline as there is now.

I think it is also easy to forget in the nostalgia for past eras of greater stability and fixed rates the degree to which the constraints of those past systems imposed real and sometimes absurd burdens on policy makers. It was only a generation ago that people sat in my office at the Treasury writing an extraordinary volume of memoranda for President Kennedy on the accounting of trivially small balance of payments transactions, while designing ways regulate capital flows that did serious damage to U.S. financial markets for a decade. There was even a time when President Kennedy was said to have had to review drafts of the Survey of Current Business.

It's also worth remembering that one of the major problems that arose under the Bretton Woods system was the pressure for protection that were engendered by misaligned exchange rates. I would dare to suggest that far more exchange rate have become misaligned historically as a byproduct of the quest for stability than as a consequence of speculative pressures.

It's tempting in defending the system of flexible exchange rates against its critics to invoke the Churchillian defense of democracy -- far from perfect but better than the known alternatives. I believe our record supports this view -- that the current system is the best system for the American economy and the best system for the world economy.

Of course the international monetary system has to constantly adapt to change. The principles that I have outline above can guide us as we work with Europe in developing new modalities for international economic policy cooperation in a post-EMU Europe. The United States has been a strong and consistent supporter of European integration. A prospering, integrated Europe is as important to our economic and strategic interests today as it was fifty years ago. Successful monetary union in Europe would be good for the world and good for America.

Addressing New Challenges in the Global Capital Markets

While we expect to see substantial continuity in the key elements of the present exchange rate system among the major currencies, the international community faces a variety of new challenges with respect to global capital markets.

The most dramatic of these changes arise from the rapid growth and rapid integration of the emerging markets into the world economy and the international financial system.

- Growth rates in emerging market economies long ago surpassed those of the G-7.

- Net private capital flows to developing countries have risen dramatically over the last 10 years from about $25 billion in 1986 to over $165 billion in 1995.

- The composition of flows to emerging markets has changed fundamentally from the world of the early 1980s when syndicated bank loans were the predominant form of private finance to developing countries, to the world of 1995 where foreign direct investment accounted for over one-half of private flows and funds raised in security markets comprised another one-third.

The New Policy Consensus

Sometimes lost in the novelty of these changes is the fundamental reality that policies matter. The United States and the G-7 have been active in helping to forge a new consensus about the macroeconomic policy requirements for financial stability and the appropriate macroeconomic policy response to the too much of a good thing problem of managing capital inflows. This consensus, drawing on the experience of Mexico and that of other emerging markets, has the following key elements:

- Sound policies matter. In a world of capital mobility, the difference between having the right and the wrong polices has never been greater. The right policies mean sound monetary and fiscal policies aimed at achieving sustainable growth with low inflation, strong fiscal positions, strong and sustainable current account positions, high levels of domestic savings, open trade policies, and structural reforms that reduce the risks that inflows are misallocate.

- Exchange rate flexibility is a good thing. Although there may be a case for the use of fixed exchange rates as nominal anchors in certain circumstances -- such as countries trying to restore price stability after a period of hyperinflation, as a general rule, it's a good idea to give the exchange rate regime the flexibility to adjust, whether its to absorb part of the effects of a large and sustained capital inflow or to accommodate some shift in economic fundamentals, domestically or externally. Experience has shown that exchange rates, once fixed, are difficult to unfix, and very few countries have orchestrated a smooth and successful exit.

- Capital controls cannot substitute for good policies, and they are unlikely to be a helpful complement. Despite the theoretical appeal of speed bumps to dampen inflows, taxes or other measures to transform short-term presumably volatile money into long-term secure investment, and other silver bullets, the experience of these measures in practice still suggests that the economic distortions and macroeconomic costs induced by controls are more costly than the potential benefits. To us, the most reasonable exception to this general rule is the limited case where inadequate prudential regulation of the banking system may justify, for a transitional period, the maintenance for prudential reasons of capital controls on flows into banks.

The fact that private capital has returned to the emerging markets in substantial amounts is a tribute not just to the success of the Mexican support package, but also to the increase in confidence produced by this new policy consensus.

Strengthening the Financial System

While strong policies are the critical determinant of financial stability in this new age of capital mobility, we also believe it is important to ensure the international community is adequately equipped to deal with the risks.

The international community, galvanized by the Mexican crisis and led by the G-7, has adopted a program of institutional reforms to strengthen the system in response to these challenges.

Early Warning and Prevention

First, we have initiated a series of reforms to improve early warning and prevention mechanisms to reduce the risk of future crises, the most important of which is the adoption by the IMF of strong standards for the public disclosure of economic and financial data and a new focus on strengthening supervisory standards in the financial systems in emerging markets.

For some of the same reasons that strong disclosure standards make U.S. capital markets the deepest and most effective in the world, we think the international financial system would benefit from better access to better information on the underlying financial conditions of major emerging market borrowers. Better information alone won't prevent crises, but it can help reduce the risk that wishful thinking and bandwagon enthusiasm would sustain the unsustainable, and thereby magnify the intensity of a crisis when it occurs. A significant number of major emerging market economies have already signed up for these standards. It would not surprise me if countries that chose not to be as forthcoming paid a penalty for that decision in the price they pay for capital they raise internationally.

Stronger Surveillance

The IMF has also strengthened is surveillance procedures to improve the prospects for early intervention to address potential problems. And, recognizing the reality that in many new entrants to the global capital markets weak banking systems are a potential source of macroeconomic vulnerability, there is a new consensus on the importance of strengthening supervisory systems and the regulatory infrastructure necessary for a well functioning capital market in emerging economies. There has already been considerable work done on identifying appropriate guidelines for bank capital and supervisory regimes. The real challenge lies in making those standards operational, in training supervisors to implement them, and in adopting complementary changes that have to occur in bankruptcy regimes, accounting systems, and the examination infrastructure.

The Market's Role in Facilitating the Resolution of Crises

The third key element of the post-Mexico consensus for strengthening the system is to encourage a set of changes in the market that might help facility the resolution of future sovereign liquidity crises without necessarily requiring the mobilization of official finance.

In April 1996, the G-10 endorsed a report stating:

> we are unlikely to be willing to provide substantial amounts of official financial assistance to deal with all sovereign liquidity crises;
>
> public money should not be readily available to guarantee private sector investments;
>
> the public sector will not want to intervene without private investors absorbing some costs; and
>
> it is in the interests of both lenders and borrowers to take steps now to prepare to deal with a future crisis.

The specific recommendations in the report include changes to sovereign bond contracts designed to facilitate consultation and cooperation between sovereign debtors and their private creditors in the event of crisis, and changes to the IMF's lending policy, which in effect, make clear that there will be occasions when we will support IMF lending without lifting the burden on private creditors in the workout process.

I think it is important for investors to realize that sovereign, dollar-denominated paper trading at 500 basis point spreads over U.S. Treasuries carries risk, and that it is not the responsibility of the IMF or the U.S. Treasury insulate them from that risk. To assume otherwise would be a mistake.

The Financial Safety Net

The final element in this broad strategy for dealing with the changes in the financial system is to expand the resources available to the IMF in crisis.

However successful the above changes may be in preventing future crisis and encouraging market based alternatives to official intervention, we believe it would be prudent to ensure that, if things fall apart in the future, we have the option of calling on adequate financial resources to avert a threat to the stability of the international monetary system.

In Halifax, the G-7 endorsed a doubling of the amount of resources available under the $25 billion General Arrangements to Borrow, in part by including a new group of countries with the financial capacity to support the system. Late last month, we reached an agreement in principle with some 24 countries on a framework for new supplemental extraordinary financial arrangements for the IMF. The arrangements, modeled on the existing GAB, contain very strong conditions for activation, with greater burden sharing than in the existing GAB. It involves no cost to the U.S. budget. As Secretary Rubin has said on many occasion, the United States cannot be the lender of last resort to the world economy. We think this is a prudent step that will help ensure that the United States does not have to bear a disproportionate burden of any future financial crises.

These institutional changes are good for the system, and we believe they will make the world less prone to shocks and better able to absorb those that occur.

Conclusion

One of the paradoxes of the present is, that while we are in a period of almost unprecedented prosperity, the forces of liberalization and integration that have provided so much of that prosperity are also viewed as responsible for many of the problems plaguing the industrial world.

Our challenge, and the challenge for the G-7, is to continue to find ways to maximize the benefits of these changes in the world economy and the international financial markets, while continuing to find ways to effectively address the challenges they bring.

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
June 24, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $13,080 million of 13-week bills to be issued June 27, 1996 and to mature September 26, 1996 were accepted today (CUSIP: 9127943H5).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.08%	5.22%	98.716
High	5.10%	5.24%	98.711
Average	5.10%	5.24%	98.711

$5,100,000 was accepted at lower yields.
Tenders at the high discount rate were allotted 26%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$58,271,744	$13,079,752
Type		
Competitive	$51,486,012	$6,294,020
Noncompetitive	1,391,997	1,391,997
Subtotal, Public	$52,878,009	$7,686,017
Federal Reserve	3,629,235	3,629,235
Foreign Official Institutions	1,764,500	1,764,500
TOTALS	$58,271,744	$13,079,752

4.95 - 98.749   5.09 - 98.713

RR-1146

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
June 24, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $13,126 million of 26-week bills to be issued June 27, 1996 and to mature December 26, 1996 were accepted today (CUSIP: 9127943T9).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.21%	5.43%	97.366
High	5.23%	5.45%	97.356
Average	5.23%	5.45%	97.356

Tenders at the high discount rate were allotted 26%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$50,760,274	$13,125,977
Type		
Competitive	$42,666,382	$5,032,085
Noncompetitive	1,109,592	1,109,592
Subtotal, Public	$43,775,974	$6,141,677
Federal Reserve	2,900,000	2,900,000
Foreign Official Institutions	4,084,300	4,084,300
TOTALS	$50,760,274	$13,125,977

5.22 - 97.361

RR-1147

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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Financial Action Task Force Plenary Session
Lawrence H. Summers, Deputy Secretary
United States Treasury
Washington, DC
June 25, 1996

Good morning. FATF President Noble, Director General Carpentieri, former President Verwoerd, distinguished guests. I am honored to address this plenary session of the Financial Action Task Force. An old crimefighting adage holds that to find the crook, follow the money. There is no question in my mind that money laundering is the life blood of narcotics trafficking, organized crime and international terrorism. You stand at the front lines of that battle and I want to commend you for it.

Before discussing the challenges we face, I would like to say a few words on the progress we have already made. In 1989 when the Financial Action Task Force was founded, only a handful of countries had criminalized money laundering. Seven years later, the organization has grown to 26 country members, 25 of which have taken the step of criminalizing the laundering of money. But at the very moment that the world economy is expanding and integrating, creating vast new opportunities for business, so the technology and capacity at the disposal of criminals is greater than ever before.

My topic today is whether four years from today, in the year 2000, we will look back on the actions we take as sufficient or whether we will have failed to meet our obligations. For I believe that we stand at the threshold of a tremendous global opportunity. I am convinced that when the history of our era is told that the end of the Cold War will be the second most important story. The most important story will be that this was the period when 3 billion people boarded the escalator to modernity. Throughout the world, nations are liberalizing, modernizing and opening their doors to international trade creating a new level of global prosperity.

Yet at the very moment that we face this great opportunity, we also face a grave new threat--not from a single superpower--but from criminals, terrorists and other bad guys who may strike anywhere at any time.

- Think of the ability of organized crime in some regions to openly flout elected officials and make a mockery of the rule of law.

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- Think of the threat to our financial and political system that terrorists in possession of a nuclear weapon would pose.

These new groups, dependent on money laundering for their survival represent the new threat to the world's political and economic security.

President Clinton recognized these stakes when he chose the occasion of the 50th anniversary of the United Nations last October to highlight the problem of money laundering. He observed that criminal enterprises are moving vast sums of ill-gotten gains through the international financial system with absolute impunity. He said "We must not allow them to wash the blood off profits from the sale of drugs from terror or organized crime."

Over the last few years, the FATF has helped shut the door on money laundering through traditional financial institutions in its 26 member countries. But far more work remains to be done, some of it to extend the work of the FATF to other regions and some of it within the FATF itself.

Extending Enforcement to Other Regions

While the twenty-six countries that belong to the FATF have made significant progress towards shutting down money laundering and, by some estimates, raised its cost, other countries are still open for business.

Concerted action is needed to extend the principles of the FATF to other regions, in particular, Latin American and Asia.

Recognizing this need, President Clinton issued an order for the United States to identify and put on notice nations that tolerate money laundering, and assist them in bringing their banks and financial systems into conformity with international anti-money laundering standards.

This task was taken up at the Summit of the Americas Ministerial Conference on Money Laundering in Buenos Aires last December, chaired by Secretary Rubin and attended by Ministers from 29 of the 34 nations of the Western hemisphere. The ministers issued a communique which outlines concrete steps that each country in the hemisphere agreed to take to combat money laundering. The FATF's efforts provided the foundation for the ministers's communique.

Secretary Rubin built on this effort at his meeting with the hemisphere's finance ministers last month in New Orleans. We have also undertaken similar initiatives as part of the Asia Pacific Economic Council--APEC--focusing on anti-money laundering controls in that part of the world.

Anticipating the Future Within the FATF

There are other challenges that FATF itself must face. Quite frankly, I am concerned about the proliferation of new technologies that threaten the progress we have made.

- I am concerned when I hear about the potential of money launderers to utilize encrypted e-cash. While to some extent electronic transfer of funds will enhance the electronic trail, we must be vigilant that e-cash does not make it easier to launder money.
- I am concerned about the ability of money launderers to use smart card technologies to transfer funds around the world. While smart cards have been used for smaller amounts of money so far, the potential exists to use this technology for larger transactions.

- I am also concerned about the challenges posed by the very volume of currency transactions. A decade ago, daily trading currency equaled about $200 billion. Today it is six times that amount, making tracing illegal transactions more difficult.

In addition, I am concerned about the ability of criminals other than drug dealers to continue to launder money.

- Extending the crime of money laundering to include non drug cases will make it harder for terrorists, those who deal in human lives and every other serious criminal, to profit from their crimes. Ignoring the non drug dimension of money laundering is tantamount to sanctioning the serious crimes it supports.

Finally, mandating reporting of suspicious transactions by financial institutions would reduce the likelihood of inconsistent compliance.

- I have no doubt that the vast majority of financial institutions take their responsibility to root out potential criminal conduct seriously. Still, a voluntary system is less effective than a mandatatory one.

At this plenary session you will have the opportunity to anticipate the future as you update the FATF 40 Recommendations.

Without action to anticipate these new technologies in a world where traditional financial institutions can be entirely by-passed, many of the enforcement measures that we have so strenuously put in place may prove inadequate.

- As you look to improve the 40 Recommendations, I know that you are looking beyond banks to new technology issues and their impact on money laundering.
- And as you move to extend the money laundering offense beyond drugs and to establish mandatory suspicious transaction reporting requirements, I believe that you will close loopholes that the bad guys use.

Four years from now as we cross the millennium, I hope we can look back on the actions taken here and see that the right choices were made. There are two possible scenarios. In one, the criminals, using new technologies and migrating to outlaw countries gain the upper hand. The system of financial institution based controls proves inadequate as more financial transactions move outside the financial institutions.

In another scenario, you anticipate these trends and foreclose those options for the criminals and terrorists. The principles of the FATF, meanwhile are extended to other regions to create a seamless global enforcement web.

I am convinced that the second scenario will happen if you take the right actions here and we continue our work together. In a time of exponential change, incremental action is not enough. I urge you to look forward as you weigh the matters before you.

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
June 25, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 2-YEAR NOTES

Tenders for $18,790 million of 2-year notes, Series AG-1998, to be issued July 1, 1996 and to mature June 30, 1998 were accepted today (CUSIP: 912827Y30).

The interest rate on the notes will be 6 1/4%. All competitive tenders at yields lower than 6.300% were accepted in full. Tenders at 6.300% were allotted 17%. All noncompetitive and successful competitive bidders were allotted securities at the yield of 6.300%, with an equivalent price of 99.908. The median yield was 6.280%; that is, 50% of the amount of accepted competitive bids were tendered at or below that yield. The low yield was 6.240%; that is, 5% of the amount of accepted competitive bids were tendered at or below that yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$48,032,181	$18,790,031

The $18,790 million of accepted tenders includes $1,585 million of noncompetitive tenders and $17,205 million of competitive tenders from the public.

In addition, $2,018 million of tenders was awarded at the high yield to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $1,177 million of tenders was also accepted at the high yield from Federal Reserve Banks for their own account in exchange for maturing securities.

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DEPARTMENT OF THE TREASURY

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EMBARGOED UNTIL 2:30 P.M.
June 25, 1996

CONTACT: Office of Financing
202/219-3350

TREASURY'S WEEKLY BILL OFFERING

The Treasury will auction two series of Treasury bills totaling approximately $29,000 million, to be issued July 5, 1996. This offering will provide about $1,250 million of new cash for the Treasury, as the maturing weekly bills are outstanding in the amount of $27,743 million.

Federal Reserve Banks hold $7,006 million of the maturing bills for their own accounts, which may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders.

Federal Reserve Banks hold $4,501 million as agents for foreign and international monetary authorities, which may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders. Additional amounts may be issued for such accounts if the aggregate amount of new bids exceeds the aggregate amount of maturing bills.

Tenders for the bills will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

Details about each of the new securities are given in the attached offering highlights.

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Attachment

RR-1150

HIGHLIGHTS OF TREASURY OFFERINGS OF WEEKLY BILLS TO BE ISSUED JULY 5, 1996

June 25, 1996

<u>Offering Amount</u>	$14,500 million	$14,500 million
<u>Description of Offering</u>:		
Term and type of security	90-day bill	181-day bill
CUSIP number	912794 3J 1	912794 3U 6
Auction date	July 1, 1996	July 1, 1996
Issue date	July 5, 1996	July 5, 1996
Maturity date	October 3, 1996	January 2, 1997
Original issue date	April 4, 1996	July 5, 1996
Currently outstanding	$13,590 million	- - -
Minimum bid amount	$10,000	$10,000
Multiples	$ 1,000	$ 1,000

<u>The following rules apply to all securities mentioned above</u>:

<u>Submission of Bids</u>:

Noncompetitive bids . . . . Accepted in full up to $1,000,000 at the average discount rate of accepted competitive bids

Competitive bids . . . .
(1) Must be expressed as a discount rate with two decimals, e.g., 7.10%.
(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position is $2 billion or greater.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

<u>Maximum Recognized Bid at a Single Yield</u> . . . . 35% of public offering

<u>Maximum Award</u> . . . . 35% of public offering

<u>Receipt of Tenders</u>:

Noncompetitive tenders . . . . Prior to 12:00 noon Eastern Daylight Saving time on auction day

Competitive tenders . . . . Prior to 1:00 p.m. Eastern Daylight Saving time on auction day

<u>Payment Terms</u> . . . . Full payment with tender or by charge to a funds account at a Federal Reserve Bank on issue date

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FOR IMMEDIATE RELEASE
June 27, 1996

Contact: Joyce McDonald, FinCEN
(703) 905-3770

Media Advisory

Global Anti-Money Laundering Standards Updated at Meeting of Financial Action Task Force (FATF)

At a news conference tomorrow, the FATF, a 26 member organization created by the G-7 to address the international problem of money laundering, will release revised standards for countries to follow to combat the laundering of criminal proceeds around the world. The standards, known as the 40 Recommendations, were revised to adjust to changing global money laundering trends as well as technological advances in the financial services industry.

The news conference takes place on Friday, June 28 at 1:00 in the Renaissance Mayflower Hotel's Grand Ballroom, 1127 Connecticut Avenue, NW in Washington.

In addition to the release of the 40 Recommendations, FATF also will disseminate the results of a "typologies exercise" which highlights new money laundering methods and patterns of activities used by criminals. This is the first time the typologies report will be made public.

The release of the revised recommendations will conclude FATF's annual meeting, which was held for the first time in the United States. Since July 1995, the U.S. has held the Presidency of FATF under the leadership of former Treasury Under Secretary for Enforcement Ronald K. Noble.

Participants at the news conference will include FATF President Noble; the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) Director Stanley E. Morris; FATF Secretary Patrick Moulette; and incoming FATF President Fernando Carpentieri, Italy's Director General and Ministry of the Treasury.

Press credentials are requested. Cameras should be in place by 12:45 p.m.

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RR-1151

G7 Finances Ministers report

to the Heads of State and Government

on international monetary stability

LYON, 28 June 1996

The dramatic increase in trade and capital flows in the world has deepened economic and financial integration among all countries, and it creates a more complex financial environment, with a greater diversity of capital flows, creditors and borrowers. This process of globalisation creates new opportunities but also challenges for our countries and the international community, especially with regard to our international monetary and financial system.

In this context, the Heads of State and Government concluded at the Halifax summit that : "Close consultation and effective cooperation on macroeconomic policies among the G7 are important elements in promoting sustained non-inflationary growth avoiding the emergence of large external imbalances, and promoting greater exchange market stability", that "we have a shared interest in ensuring the international community remains able to manage the risks inherent in the growth of private capital flows, the increased integration of domestic capital markets, and the accelerating pace of financial innovation" and that "closer international cooperation in the regulation and supervision of financial institutions and markets is essential to safeguard the financial system and prevent an erosion of prudential standards."

In our discussions in Halifax last year we concluded, more specifically, that :

- the most important foundation for exchange rate stability is the maintainance of sound macroeconomic policies aimed at achieving sustained non-inflationary growth and avoiding the emergence of large external or internal imbalances ;

- flexibility in exchange rates of the major currencies is a basic feature of the system because unanticipated events occur, economic fundamentals change, and national financial and economic developments are sufficiently different that they require that policies be able to respond to them ;

- exchange market intervention can be effective and even decisive in specific circumstances, but those circumstances are difficult to determine in advance ;

- there is no effective regulatory structure or tax mechanism that will produce greater exchange rate stability without major costs in terms of other economic objectives.

These conclusions remain valid today.

Our overriding objective is to promote sustained non-inflationary growth. In this context, the G7 can best promote greater stability in exchange markets through the pursuit of appropriate macroeconomic policies along with close cooperation in the exchange markets where appropriate.

For the past two decades, the international monetary system has been based on a flexible exchange rate system among major currencies. There are circumstances when it is appropriate to allow exchange rates among major currencies to fluctuate rather than to adjust monetary and fiscal policies in a manner inconsistent with the needs of the economy.

Experience since 1973 suggests that major exchange rate adjustments have been caused by clearly identifiable changes or distortions in the underlying economic fundamentals or in macroeconomic policies. Efforts to preserve an exchange rate that is inconsistent with underlying fundamentals are likely to introduce distortions to and constraints on central instruments of economic management. At the same time, financial authorities cannot be indifferent to exchange rate fluctuations that do not appear justified on the basis of macro-economic policies or fundamentals and as a consequence could adversely affect output or prices. There are circumstances where close cooperation in exchange markets can reinforce sound economic policies and enhance stability in exchange markets.

The G7 has an important responsibility in promoting an effective and stable monetary system by advancing policies that will strengthen our capacity to manage risk and prevent crises and improve our ability to respond to such events when they occur. Towards this objective, we have adopted a number of initiatives over the past several years and improvements were initiated at Halifax. This paper reviews the main initiatives, and proposes, where appropriate, further improvements.

■ More effective macro-economic surveillance in the G7 meetings

It is important to pursue sound domestic economic policies aimed at achieving sustained non-inflationary growth and at avoiding the emergence of excessive external imbalances. Such policies are also a necessary condition for more exchange rate stability and for avoiding -or reducing- exchange rate misalignment. The dramatic deepening in economic integration increases the need for sound economic policies but also the potential gains from cooperation on macro-economic policies. The G7 surveillance process provides a framework for identifying and formulating appropriate responses to risks for our economies and for the stability of the international financial and monetary system.

◆ Surveillance has been improved by the G7 in the past years, and some encouraging results have been reached in this informal framework :

- we have already achieved some important progress in articulating common economic policy objectives : we have agreed on the critical importance of reducing inflation and have made great progress to this end ; we agreed on the medium-term strategy for fiscal consolidation, which we will continue to pursue vigorously to increase national savings, and to reduce external imbalances. Increased convergence should improve the outlook for sustained exchange rate stability and low long-term interest rates in our countries ;

- in the aftermath of the Mexican crisis, G7 have encouraged an important enhancement of IMF surveillance, which is being implemented (see below).

◆ We have adopted a number of steps to improve the effectiveness of the G7 surveillance process. Building on these improvements, we would support the following additional steps :

- concentrate the discussion on potential risks to the outlook in the G7 and the appropriate policy response to those challenges. More attention could also be paid to medium-term economic and structural issues ;

- focus more attention on potential risks outside the G7 that could affect the international monetary and financial system, based in part on a presentation by the IMF Managing Director ;

- strengthen cooperation at the Deputies level in preparation for Ministerial meetings with appropriate involvement of central bank deputies and the IMF staff.

■ <u>Continuing G7 close cooperation in exchange markets</u>

Exchange rate misalignments can heighten uncertainty in the global economy and can be detrimental to growth and trade. When exchange rates appear to move out of line with underlying fundamentals, close monitoring is necessary and coordinated responses may be required.

• The "orderly reversal" in key exchange rates since April 1995 is a positive and promising development. Several factors lie behind it. Most important were changes in economic policies and fundamentals, but the signals given to the markets by the G7 in 1995, through communiqués and -under appropriate circumstances- concerted intervention, were helpful in providing impetus to bringing exchange rates better in line with fundamental trends.

• We should continue our close cooperation in exchange markets on this foundation, taking into account the fact that :

- a clear and consistent articulation of a common G7 view can have a stabilizing influence and help reinforce the credibility of our commitment to cooperate in the exchange market when circumstances warrant ;

- interventions can be effective in certain circumstances, especially when they reinforce changes in policies and/or underlying fundamentals that lead to changes in market expectations about future exchange rates ;

- the instrument of intervention must be used judiciously given its implications for monetary policy and the amount that the authorities can mobilize relative to the size of international capital markets. Nevertheless, these factors do not impede our joint ability to send a clear message to the markets, if and when appropriate ;

- interventions are more likely to be effective when they are concerted and reflect a common assessment :

- an important condition for success is the appropriate timing of intervention.

■ <u>Better prudential safeguards in international financial markets</u>

The globalisation of financial markets and the substantial increase in cross-border capital flows have created a more complex financial environment. Comprehensive and effective financial regulation, market-reinforced prudential supervision and enhanced international cooperation among regulators are among the keystones for maintaining stability of the international financial and monetary system.

• Industrial countries have been cooperating in the development of prudential frameworks for many years. The BIS/Basle Committees have taken important steps to develop international standards for prudential supervision of banks and to strengthen payments and settlements systems which link international markets. IOSCO has undertaken similar work for prudential regulation of securities firms and markets. In recent years, banking and securities regulators have increased their contacts at the international level to address supervisory concerns that cut across markets.

- We recognise the substantial recent and ongoing cooperative work between the Basle and IOSCO Committees on derivatives to promote improved risk management, a common reporting framework and improved disclosure practices ;
- We welcome the publication in December 1995 of the Basle Committee capital adequacy standards for bank's exposure to market risk, which will be a very useful complement to existing prudential ratios.

• Nevertheless, the changes in the structure of global finance and the emergence of new participants and markets require the supervisory response, including international cooperation, to evolve continually. We welcome the Basle and IOSCO Committees' reports on prudential regulation and supervisory cooperation. These reports should pave the way for continuing progress on current initiatives and expanding efforts in the following directions :

- Enhance cooperation across markets to strengthen supervision of financial institutions. In this context, we welcome the joint efforts of the Basle and IOSCO Committees to enhance their collaborative arrangements and the work of the Joint Forum of banks, securities and insurance supervisors. Suitable arrangements should be established within which that cooperation can be better organised. It would be useful to clarify the role and responsibilities of the relevant supervisors to foster an appropriate degree of cooperation in the supervision of internationally-active financial institutions, and to establish a more comprehensive network of bilateral arrangements between authorities.

- Strengthen prudential standards in, and supervisory cooperation with, emerging markets. Effective prudential regulation and supervision must cover all important financial marketplaces, particularly those which are experiencing high growth rates and/or substantial capital flows. The Basle and IOSCO Committees are performing work in this area which reinforces bilateral and regional efforts underway. Because emerging markets are growing in significance, these Committees, and other appropriate fora should be encouraged to strengthen their outreach to and cooperation with emerging market supervisors in order to promote high prudential standards. The International Financial Institutions should give more attention to promoting effective regulatory and supervisory structures in emerging markets ;

- Encourage private sector efforts to enhance market transparency. Notwithstanding past or future regulatory activities, primary responsibility for risk management rests with market participants. Regulators should encourage -and where necessary exert pressure to induce- private sector efforts to enhance market transparency in order to strengthen market forces' capacity for sound and responsible risk taking and control ;

- Improve reporting and disclosure of derivatives activities. Effective monitoring of derivatives activities is crucial, and requires closer cooperation among supervisors. In this regard, we welcome the global market survey conducted in the spring of 1995 by the BIS, and the follow-up action which is being planned. We also look forward to the conclusion this year of a joint Basle/IOSCO approach to reporting standards for derivatives exposure and to further progress in improving derivatives disclosure practices ;

- Enhance cooperation among exchanges. We look forward to implementation of the recommendations in the Windsor Declaration for increasing cooperation among futures exchanges and regulators. We also note with approval the development of information sharing arrangements among securities exchanges and welcome conclusion of an information sharing arrangement among major futures exchanges and relevant regulatory authorities. We also look forward to the IOSCO study of methods to identify large firm exposures that may have an effect on the market and to protect market participants from potential defaults by firms.

■ Strengthening of our collective ability to respond to financial crises

The increased integration of global capital markets, the change in magnitude and composition of capital flows, and the increase in the diversity and number of creditors and borrowers present new opportunities and challenges to the financial system. At Halifax, Heads proposed a range of initiatives to strengthen the global financial system, with particular attention to the IMF's role. We strongly welcome their implementation :

- Improvement of the early warning system is being implemented : the IMF's surveillance capabilities have been enhanced ; the IMF has established standards for timely publication of economic and financial data, and subscription on a voluntary basis is underway.

- In order to better respond to crises, an emergency financing mechanism, aiming at faster procedures, has been set up in the IMF ;

- We welcome the agreement in principle reached on a doubling of the resources currently available to the IMF under the General Arrangements to Borrow. These arrangements will include a broader group of countries with the capacity to support the international monetary system. We welcome this sharing of monetary responsibilities, thereby adapting our cooperation to new economic circumstances ;

- We welcome the report of the G-10 Working Party on the Resolution of Sovereign Liquidity Crises ;

- We fully support the ongoing 11th review of IMF quotas to ensure that the IMF continues to have sufficient resources to meet its ongoing responsibilities. We believe it is important for the IMF to remain a quota based institution with the resources necessary to fulfill its important role in the global financial system.

DEPARTMENT OF THE TREASURY

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FOR IMMEDIATE RELEASE
June 28, 1996

Contact: Joyce McDonald
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(703) 905-3770

FATF UPDATES ANTI-MONEY LAUNDERING STANDARDS

The Financial Action Task Force (FATF), a 26-nation organization created by the G-7 to address the global problem of money laundering, today issued revised standards for countries to follow in combating the laundering of criminal proceeds. The revisions to the standards, known as the 40 Recommendations, were made to adjust to changing global money laundering trends as well as technological advances in the financial services industry. This is the first update to the recommendations since they were issued in 1990.

The United States has held the Presidency of the FATF since July 1995 under the leadership of former Treasury Under Secretary for Enforcement Ronald K. Noble. The 40 Recommendations were revised as part of the 1995-1996 round of discussions that concluded with a meeting this week in Washington, D.C. Following the session, Secretary of the Treasury Robert E. Rubin stressed the importance of FATF's work:

"For all countries to succeed and enjoy the benefits of a global economy, strong alliances must be built to combat money laundering. Drug traffickers and terrorists depend on money laundering for cash. The 40 Recommendations released by the FATF will go hand-in-hand with the work being done in Lyon, France today in developing ways to fight crime and terrorism around the world."

The major changes to the 40 Recommendations relate to the following issues:

- the extension of money laundering predicate offenses to serious crimes beyond drug trafficking (Recommendation 4);
- the mandatory reporting of suspicious transactions by financial institutions (Recommendation 15);
- the inclusion of non-financial businesses as part of counter money laundering measures (Recommendation 9);
- the focusing of attention on the money laundering implications of emerging cyberpayment technologies (Recommendation 13); and

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(more)

- a new statement of support for more effective investigative techniques in following the illicit proceeds from the street to the kingpin of the criminal organization (Recommendation 36).

The annual report highlights the efforts of FATF during the U.S. Presidency. In addition to updating the recommendations, FATF conducted the first-ever meeting of the Financial Services Forum. At this meeting, international financial industry experts discussed ways to promote better cooperation between law enforcement agencies and the financial sector. Representatives at the Forum also suggested changes to the 40 recommendations which in part have been included in the revisions.

"In 1990, when the original 40 Recommendations were issued, the FATF established itself firmly in the forefront of the battle against money laundering. Today, it remains in the forefront by adapting to ever-changing money laundering methods," said FATF President Noble. "This ability to look beyond immediate problems and assess future contingencies in the fast-paced world of global finance would not be possible without the cooperation and insight of all the FATF members. I appreciate their support of the U.S. FATF Presidency and wish them continued success."

In addition to the revised 40 Recommendations released as part of its annual report, FATF also disseminated the results of a "typologies exercise" which highlights new money laundering methods and patterns of activities used by criminals. This is the first time the typologies report has been made public.

Copies of FATF's annual and typologies reports are available from the Treasury's Financial Crimes Enforcement Network (FinCEN) which has coordinated the U.S. role within the FATF this year. FinCEN's Office of Communications can be reached at (703) 905-3770.

-30-

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
June 26, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 5-YEAR NOTES

Tenders for $12,501 million of 5-year notes, Series K-2001, to be issued July 1, 1996 and to mature June 30, 2001 were accepted today (CUSIP: 912827Y48).

The interest rate on the notes will be 6 5/8%. All competitive tenders at yields lower than 6.674% were accepted in full. Tenders at 6.674% were allotted 50%. All noncompetitive and successful competitive bidders were allotted securities at the yield of 6.674%, with an equivalent price of 99.795. The median yield was 6.660%; that is, 50% of the amount of accepted competitive bids were tendered at or below that yield. The low yield was 6.620%; that is, 5% of the amount of accepted competitive bids were tendered at or below that yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$29,389,768	$12,500,648

The $12,501 million of accepted tenders includes $657 million of noncompetitive tenders and $11,844 million of competitive tenders from the public.

In addition, $750 million of tenders was awarded at the high yield to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $1,000 million of tenders was also accepted at the high yield from Federal Reserve Banks for their own account in exchange for maturing securities.

DEPARTMENT OF THE TREASURY

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FOR IMMEDIATE RELEASE
June 28, 1996

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KELLY SWORN IN AS UNDER SECRETARY FOR ENFORCEMENT

Former New York City Police Commissioner Raymond W. Kelly was sworn in as the Treasury Department's Under Secretary for Enforcement on Thursday.

Under Secretary Kelly will be responsible for overall operation of the Department's several enforcement bureaus including the Bureau of Alcohol, Tobacco and Firearms, U.S. Customs Service, U.S. Secret Service and the Federal Law Enforcement Training Center.

Kelly brings to the position more than 30 years' worth of experience and commitment to public service. Following combat service with the Marine Corps in Vietnam, Kelly rose through the ranks of the New York Police Department to ultimately serve as Police Commissioner. His leadership was critical in the successful investigation of the World Trade Center bombing in 1993 and in directing the largest increase in uniform ranks in the department's history. His retirement from the commissioner's post in January of 1994 capped a 25-year career that included service in every rank and 25 commands.

More recently, Kelly served as director of the International Police Monitors of the Multinational Force in Haiti from October 1994 through March 1995. While there, he and the monitors helped establish Haiti's interim public security force. President Clinton awarded Kelly a commendation for "exceptionally meritorious service" for his work in Haiti, and Chairman of the Joint Chiefs of Staff Gen. Shalikashvili awarded him the Commander's Medal for Public Service.

Kelly is an attorney with law degrees from St. John's University and New York University, where he has lectured on the law, public policy and crisis management. He is a graduate of Manhattan College and holds a master's in public administration from the Kennedy School of Government at Harvard University.

Kelly's nomination was confirmed Wednesday by the Senate.

RR-1154

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DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
July 1, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $14,630 million of 13-week bills to be issued July 5, 1996 and to mature October 3, 1996 were accepted today (CUSIP: 9127943J1).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.09%	5.23%	98.728
High	5.13%	5.27%	98.718
Average	5.12%	5.26%	98.720

Tenders at the high discount rate were allotted 19%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$52,697,543	$14,630,190
Type		
Competitive	$46,943,474	$8,876,121
Noncompetitive	1,403,431	1,403,431
Subtotal, Public	$48,346,905	$10,279,552
Federal Reserve	3,406,430	3,406,430
Foreign Official Institutions	944,208	944,208
TOTALS	$52,697,543	$14,630,190

An additional $133,892 thousand of bills will be issued to foreign official institutions for new cash.

5.10 - 98.725 5.11 - 98.723

RR-1155

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
July 3, 1996

MEDIA ADVISORY

Due to rain, Treasury Secretary Robert E. Rubin's address to employees returning to the Main Treasury building following last week's fire, scheduled for 10 a.m. this morning, has been postponed. The press availability with a senior Treasury official has also been postponed.

Secretary Rubin will address staff on Hamilton Place adjacent to the Treasury building on Monday, July 8, at 10 am, weather permitting.

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RR-1156

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
July 1, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $14,582 million of 26-week bills to be issued July 5, 1996 and to mature January 2, 1997 were accepted today (CUSIP: 9127943U6).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.20%	5.41%	97.386
High	5.22%	5.43%	97.376
Average	5.22%	5.43%	97.376

Tenders at the high discount rate were allotted 37%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$48,650,110	$14,582,469
Type		
Competitive	$40,647,272	$6,579,631
Noncompetitive	1,310,246	1,310,246
Subtotal, Public	$41,957,518	$7,889,877
Federal Reserve	3,600,000	3,600,000
Foreign Official Institutions	3,092,592	3,092,592
TOTALS	$48,650,110	$14,582,469

An additional $439,008 thousand of bills will be issued to foreign official institutions for new cash.

5.21 -- 97.381

RR-1157

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGOED UNTIL 2:30 P.M.
July 3, 1996

CONTACT: Office of Financing
202/219-3350

TREASURY TO AUCTION $10,000 MILLION OF 10-YEAR NOTES

The Treasury will auction $10,000 million of 10-year notes to refund $7,004 million of publicly held securities maturing July 15, 1996, and to raise about $3,000 million new cash.

In addition to the public holdings, Federal Reserve Banks hold $721 million of the maturing securities for their own accounts, which may be refunded by issuing additional amounts of the new securities.

The maturing securities held by the public include $170 million held by Federal Reserve Banks as agents for foreign and international monetary authorities. Amounts bid for these accounts by Federal Reserve Banks will be added to the offering.

The 10-year note being offered today is eligible for the STRIPS program.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

Details about the new security are given in the attached offering highlights.

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Attachment

RR-1158

HIGHLIGHTS OF TREASURY OFFERING TO THE PUBLIC
OF 10-YEAR NOTES TO BE ISSUED JULY 15, 1996

July 3, 1996

<u>Offering Amount</u>	$10,000 million
<u>Description of Offering</u>:	
Term and type of security	10-year notes
Series	C-2006
CUSIP number	912827 Y5 5
Auction date	July 9, 1996
Issue date	July 15, 1996
Dated date	July 15, 1996
Maturity date	July 15, 2006
Interest rate	Determined based on the average of accepted competitive bids
Yield	Determined at auction
Interest payment dates	January 15 and July 15
Minimum bid amount	$1,000
Multiples	$1,000
Accrued interest payable by investor	None
Premium or discount	Determined at auction
<u>STRIPS Information</u>:	
Minimum amount required	Determined at auction
Corpus CUSIP number	912820 BT 3

<u>STRIPS Information</u>:
Due dates and CUSIP numbers for additional TINTs:

	912833
January 15, 1997	MA 5
July 15, 1997	MC 1
January 15, 1998	ME 7
July 15, 1998	MG 2
January 15, 1999	MJ 6
July 15, 1999	ML 1
January 15, 2000	MN 7
July 15, 2000	MQ 0
January 15, 2001	MS 6
July 15, 2001	MU 1
January 15, 2002	MW 7
July 15, 2002	MY 3
January 15, 2003	NA 4
July 15, 2003	NC 0
January 15, 2004	NE 6
July 15, 2004	NG 1
January 15, 2005	NJ 5
July 15, 2005	NL 0
January 15, 2006	NN 6
July 15, 2006	NQ 9

<u>The following rules apply to the security referred to above</u>:

<u>Submission of Bids</u>:	
Noncompetitive bids	Accepted in full up to $5,000,000 at the average yield of accepted competitive bids.
Competitive bids	(1) Must be expressed as a yield with three decimals, e.g., 7.160%. (2) Net long position for each bidder must be reported when the sum of the total bid amount, at all yields, and the net long position is $2 billion or greater. (3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.
<u>Maximum Recognized Bid at a Single Yield</u>	35% of public offering
<u>Maximum Award</u>	35% of public offering
<u>Receipt of Tenders</u>:	
Noncompetitive tenders	Prior to 12:00 noon Eastern Daylight Saving time on auction day
Competitive tenders	Prior to 1:00 p.m. Eastern Daylight Saving time on auction day
<u>Payment Terms</u>	Full payment with tender or by charge to a funds account at a Federal Reserve Bank on issue date

federal financing bank NEWS
WASHINGTON, D.C. 20220
Press 202-622-2960
FFB 202-622-2450

July 8, 1996

FEDERAL FINANCING BANK

Charles D. Haworth, Secretary, Federal Financing Bank (FFB) announced the following activity for the month of May 1996.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $64.9 billion on May 31, 1996, posting a decrease of $1,148.4 million from the level on April 30, 1996. This net change was the result of a decrease in holdings of agency debt of $558.6 million, in agency assets of $580.0 million, and in agency guaranteed loans of $9.9 million. FFB made 12 disbursements during the month of May. FFB also received 9 prepayments in May.

Attached to this release are tables presenting FFB May loan activity and FFB holdings as of May 31, 1996.

RR-1159

FEDERAL FINANCING BANK
MAY 1996 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE
GOVERNMENT - GUARANTEED LOANS				
GENERAL SERVICES ADMINISTRATION				
Atlanta CDC Office Bldg.	5/1	$745.71	9/2/25	7.041% S/A
Miami Law Enforcement	5/1	$733.01	1/3/22	7.043% S/A
Oakland Office Building	5/1	$201,146.04	9/5/23	7.045% S/A
HCFA Headquarters	5/10	$140,938.00	7/1/25	7.190% S/A
Chamblee Office Building	5/13	$1,036,339.48	4/1/97	5.685% S/A
Atlanta CDC Office Bldg.	5/24	$122,523.60	9/2/25	7.035% S/A
Foley Square Courthouse	5/28	$480,673.00	7/31/25	7.004% S/A
Foley Square Office Bldg.	5/30	$209,079.00	7/31/25	7.103% S/A
Memphis IRS Service Cent.	5/31	$496,890.58	1/2/25	7.091% S/A
GSA/PADC				
ICTC Building	5/17	$11,092,013.09	11/2/26	7.065% S/A
RURAL UTILITIES SERVICE				
Yelm Telephone #407	5/17	$327,434.00	12/31/14	6.832% Qtr.
Johnson County Elec. #203	5/29	$3,547,000.00	12/31/96	5.483% Qtr.

S/A is a Semi-annual rate: Qtr. is a Quarterly rate.

FEDERAL FINANCING BANK
(in millions)

Program	May 31, 1996	April 30, 1996	Net Change 5/1/96-5/31/96	FY '96 Net Change 10/1/95-5/31/96
Agency Debt:				
Export-Import Bank	$ 2,008.3	$ 2,008.3	$ 0.0	$ -498.0
Resolution Trust Corporation	6,946.8	7,205.3	-258.6	-6,261.8
Tennessee Valley Authority	0.0	0.0	0.0	-3,200.0
U.S. Postal Service	0.0	300.0	-300.0	-7,264.7
sub-total*	8,955.0	9,513.6	-558.6	-17,224.5
Agency Assets:				
FmHA-ACIF	595.0	1,175.0	-580.0	-875.0
FmHA-RDIF	3,675.0	3,675.0	0.0	0.0
FmHA-RHIF	21,015.0	21,015.0	0.0	-685.0
DHHS-Health Maintenance Org.	8.1	8.1	0.0	0.0
DHHS-Medical Facilities	23.8	23.8	0.0	0.0
Rural Utilities Service-CBO	4,598.9	4,598.9	0.0	0.0
Small Business Administration	0.1	0.1	0.0	0.0
sub-total*	29,915.9	30,495.9	-580.0	-1,560.0
Government-Guaranteed Loans:				
DOD-Foreign Military Sales	3,335.8	3,351.3	-15.5	-157.2
DHUD-Community Dev. Block Grant	81.0	81.0	-0.1	-8.1
DHUD-Public Housing Notes	1,626.8	1,626.8	0.0	-61.7
General Services Administration +	2,324.8	2,319.7	5.1	58.0
DOI-Virgin Islands	20.2	20.2	0.0	-0.8
DON-Ship Lease Financing	1,382.8	1,382.8	0.0	-49.3
Rural Utilities Service	16,944.3	16,940.4	3.9	-331.3
SBA-Small Business Investment Cos.	0.0	0.0	0.0	-5.5
SBA-State/Local Development Cos.	331.0	333.9	-2.9	-24.8
DOT-Section 511	13.1	13.5	-0.4	-1.4
sub-total*	26,059.8	26,069.6	-9.9	-582.1
	=========	=========	=========	=========
grand-total*	$ 64,930.7	$ 66,079.1	$ -1,148.4	$-19,366.6

*figures may not total due to rounding
+does not include capitalized interest

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR RELEASE AT NOON EDT
July 8, 1996

REMARKS OF ROBERT E. RUBIN
SECRETARY OF THE TREASURY
THE WHITE HOUSE
JULY 8, 1996

Thank you, Under Secretary Kelly.

Mr. President, today we begin a crime prevention program to interrupt the flow of guns before they reach young hands and eradicate young lives.

In neighborhoods across our country, illegal firearms are passed from criminals to kids. Too often, police departments are able to focus only on violent crimes already committed with these weapons.

In 17 American cities, we are starting the Youth Crime Gun Interdiction Initiative, a plan aimed at preventing gun violence. Under this plan, we will learn how guns are getting to young people and we will disrupt those flows.

Treasury and its Bureau of Alcohol, Tobacco and Firearms -- the federal government's lead organization in enforcing our federal firearms statutes -- welcome the President's mandate for action because our society has such a profound social interest in stopping gun violence.

But Treasury has another perspective as well: Anti-crime policy is good economic policy. To address the problems of the inner cities, and to bring their residents into the economic mainstream, public safety and economic development must be acted on as mutually reinforcing.

In this initiative that we begin today, as in so many other areas of law enforcement, our country benefits enormously from the good cooperative relationship between the Justice Department and Treasury. It is my pleasure to introduce my partner in this cooperative spirit and in this initiative, the senior law enforcement official of the United States, Attorney General Janet Reno.

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RR-1160

DEPARTMENT OF THE TREASURY
TREASURY NEWS
OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR RELEASE AT NOON EDT
July 8, 1996

REMARKS OF RAYMOND W. KELLY
UNDER SECRETARY FOR ENFORCEMENT
DEPARTMENT OF THE TREASURY
JULY 8, 1996
THE WHITE HOUSE

Mr. President, Mr. Vice President, Secretary Rubin, Attorney General Reno, we are here today to focus on what our government can do to prevent young people from gaining illegal access to firearms.

Certainly, an illegal market exists, fed by a number of channels. There are criminal chains of gun transfers, including illegal sales, re-sales, and purchases, as well as thefts.

These weapons pass along the links of the chain, until they land in the hands of adolescents.

We must and we will break that chain.

As Under Secretary for Enforcement at the Treasury Department, overseeing the Bureau of Alcohol, Tobacco and Firearms, one of my greatest responsibilities is to ensure that the firearms laws of this country are enforced as effectively as possible. There is no more serious aspect of this mandate than preventing the illegal transfer of weapons to youths.

Firearms are deeply implicated in the threat to our children. From 1980 to 1994, homicides of juveniles in which a firearm was involved nearly tripled.

Mr. President, the Brady Law and other reforms you have spearheaded in our system of licensing firearms dealers are making it more and more difficult for criminals to buy guns from legitimate gun dealers.

But criminals always have and always will try to get guns illegally. And such weapons often will fall into the hands of kids.

RR-1161

In St. Louis, for example, juveniles used a TEC-9 to fire on St. Louis patrol officers. The officers recovered and traced one of the firearms, and identified the licensed dealer who had received the firearm for retail sale. The dealer had bought and illegally disposed of about 450 weapons, which were routinely supplied to St. Louis street gangs. The dealer was convicted and sentenced to seven years imprisonment.

We must build more of these cases to stop the illegal flow of guns to kids and to put behind bars those who illegally traffic in weapons to them. That is what brings us here today. ATF, the Justice Department, and state and local law enforcement are embarking on a new enforcement strategy, focusing on identifying illegal gun markets and prosecuting those who traffic in them.

Mr. President, Mr. Vice President, Mr. Secretary, Attorney General Reno, we know that the illegal chain of weapons transfers can be broken. Today's announcement once again reflects our commitment to work together to combine our ideas and energies to solve this problem. Together, we <u>will</u> make a difference.

It is now my pleasure to introduce the Secretary of the Treasury, Robert E. Rubin.

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AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
July 8, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $14,580 million of 13-week bills to be issued July 11, 1996 and to mature October 10, 1996 were accepted today (CUSIP: 9127943K8).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.19%	5.33%	98.688
High	5.21%	5.35%	98.683
Average	5.21%	5.35%	98.683

Tenders at the high discount rate were allotted 63%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$43,456,701	$14,580,471
Type		
Competitive	$37,873,729	$8,997,499
Noncompetitive	1,376,263	1,376,263
Subtotal, Public	$39,249,992	$10,373,762
Federal Reserve	3,207,320	3,207,320
Foreign Official Institutions	999,389	999,389
TOTALS	$43,456,701	$14,580,471

An additional $16,011 thousand of bills will be issued to foreign official institutions for new cash.

5.20 - 98.686

RR-1162

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
July 8, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $14,591 million of 26-week bills to be issued July 11, 1996 and to mature January 9, 1997 were accepted today (CUSIP: 9127942K9).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.38%	5.61%	97.280
High	5.41%	5.64%	97.265
Average	5.41%	5.64%	97.265

Tenders at the high discount rate were allotted 40%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$46,226,893	$14,591,393
Type		
Competitive	$38,258,142	$6,622,642
Noncompetitive	1,340,140	1,340,140
Subtotal, Public	$39,598,282	$7,962,782
Federal Reserve	3,500,000	3,500,000
Foreign Official Institutions	3,128,611	3,128,611
TOTALS	$46,226,893	$14,591,393

An additional $50,189 thousand of bills will be issued to foreign official institutions for new cash.

5.39 -- 97.275 5.40 -- 97.270

RR-1163

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
July 9, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 10-YEAR NOTES

Tenders for $10,005 million of 10-year notes, Series C-2006, to be issued July 15, 1996 and to mature July 15, 2006 were accepted today (CUSIP: 912827Y55).

The interest rate on the notes will be 7%. The range of accepted bids and corresponding prices are as follows:

	Yield	Price
Low	7.005%	99.964
High	7.019%	99.865
Average	7.016%	99.886

Tenders at the high yield were allotted 86%.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$26,617,501	$10,004,896

The $10,005 million of accepted tenders includes $385 million of noncompetitive tenders and $9,620 million of competitive tenders from the public.

In addition, $800 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $721 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

The minimum par amount required for STRIPS is $200,000. Larger amounts must be in multiples of that amount.

RR-1164

HIGHLIGHTS OF TREASURY OFFERINGS OF WEEKLY BILLS
TO BE ISSUED JULY 18, 1996

July 9, 1996

Offering Amount	$14,000 million	$14,000 million
Description of Offering:		
Term and type of security	91-day bill	182-day bill
CUSIP number	912794 Z9 8	912794 3V 4
Auction date	July 15, 1996	July 15, 1996
Issue date	July 18, 1996	July 18, 1996
Maturity date	October 17, 1996	January 16, 1997
Original issue date	October 19, 1995	July 18, 1996
Currently outstanding	$29,051 million	---
Minimum bid amount	$10,000	$10,000
Multiples	$ 1,000	$ 1,000

The following rules apply to all securities mentioned above:

Submission of Bids:

Noncompetitive bids . . . . Accepted in full up to $1,000,000 at the average discount rate of accepted competitive bids

Competitive bids . . . . (1) Must be expressed as a discount rate with two decimals, e.g., 7.10%.
(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position is $2 billion or greater.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Maximum Recognized Bid at a Single Yield . . . . 35% of public offering

Maximum Award . . . . 35% of public offering

Receipt of Tenders:

Noncompetitive tenders . . . . . . Prior to 12:00 noon Eastern Daylight Saving time on auction day

Competitive tenders . . . . Prior to 1:00 p.m. Eastern Daylight Saving time on auction day

Payment Terms . . . . Full payment with tender or by charge to a funds account at a Federal Reserve Bank on issue date

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGOED UNTIL 2:30 P.M.
July 9, 1996

CONTACT: Office of Financing
202/219-3350

TREASURY'S WEEKLY BILL OFFERING

The Treasury will auction two series of Treasury bills totaling approximately $28,000 million, to be issued July 18, 1996. This offering will provide about $5,300 million of new cash for the Treasury, as the maturing weekly bills are outstanding in the amount of $22,704 million.

Federal Reserve Banks hold $7,172 million of the maturing bills for their own accounts, which may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders.

Federal Reserve Banks hold $3,807 million as agents for foreign and international monetary authorities, which may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders. Additional amounts may be issued for such accounts if the aggregate amount of new bids exceeds the aggregate amount of maturing bills.

Tenders for the bills will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

Details about each of the new securities are given in the attached offering highlights.

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Attachment

RR-1165

PUBLIC DEBT NEWS

epartment of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR RELEASE AT 3:00 PM
July 5, 1996

Contact: Peter Hollenbach
(202) 219-3302

PUBLIC DEBT ANNOUNCES ACTIVITY FOR SECURITIES IN THE STRIPS PROGRAM FOR JUNE 1996

Treasury's Bureau of the Public Debt announced activity figures for the month of June 1996, of securities within the Separate Trading of Registered Interest and Principal of Securities program (STRIPS).

Dollar Amounts in Thousands

Principal Outstanding (Eligible Securities)	$880,811,348
Held in Unstripped Form	$653,775,348
Held in Stripped Form	$227,036,000
Reconstituted in June	$12,261,564

The accompanying table gives a breakdown of STRIPS activity by individual loan description. The balances in this table are subject to audit and subsequent revision. These monthly figures are included in Table VI of the Monthly Statement of the Public Debt, entitled "Holdings of Treasury Securities in Stripped Form."

Information about "Holdings of Treasury Securities in Stripped Form" is now available on the Department of Commerce's Economic Bulletin Board (EBB). The EBB, which can be accessed using personal computers, is an inexpensive service provided by the Department of Commerce. For more information concerning this service call 202-482-1986.

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PA-226
RR-1166

TABLE VI -- HOLDINGS OF TREASURY SECURITIES IN STRIPPED FORM, JUNE 30, 1996
(in thousands)

Loan Description	Maturity Date	Principal Amount Outstanding: Total	Principal Amount Outstanding: Portion Held in Unstripped Form	Principal Amount Outstanding: Portion Held in Stripped Form	Reconstituted This Month #1
7-1/4% Note D-1996 ...	11/15/96 ...	20,258,810	16,254,010	4,004,800	10,400
8-1/2% Note A-1997 ...	05/15/97 ...	9,921,237	7,674,837	2,246,400	54,000
8-5/8% Note B-1997 ...	08/15/97	9,362,836	7,060,436	2,302,400	89,600
8-7/8% Note C-1997 ...	11/15/97	9,808,329	6,768,329	3,040,000	51,200
8-1/8% Note A-1998	02/15/98.....	9,159,068	7,874,908	1,284,160	14,400
9% Note B-1998	05/15/98.....	9,165,387	6,994,187	2,171,200	11,200
9-1/4% Note C-1998. ...	08/15/98 ..	11,342,646	8,564,246	2,778,400	10,400
8-7/8% Note D-1998	11/15/98....	9,902,875	6,658,075	3,244,800	36,800
8-7/8% Note A-1999 ...	02/15/99.....	9,719,623	8,230,023	1,489,600	139,200
9-1/8% Note B-1999....	05/15/99.....	10,047,103	6,954,303	3,092,800	54,400
8% Note C-1999.......	08/15/99....	10,163,644	7,490,619	2,673,025	28,500
7-7/8% Note D-1999.....	11/15/99.....	10,773,960	7,337,160	3,436,800	38,400
8-1/2% Note A-2000.....	02/15/00.....	10,673,033	8,007,433	2,665,600	18,800
8-7/8% Note B-2000....	05/15/00.....	10,496,230	5,693,030	4,803,200	49,600
8-3/4% Note C-2000....	08/15/00.....	11,080,646	7,032,166	4,048,480	20,000
8-1/2% Note D-2000.....	11/15/00....	11,519,682	7,427,282	4,092,400	12,400
7-3/4% Note A-2001......	02/15/01.....	11,312,802	8,065,602	3,247,200	78,400
8% Note B-2001.........	05/15/01.....	12,398,083	8,626,958	3,771,125	58,100
7-7/8% Note C-2001.....	08/15/01.....	12,339,185	9,684,785	2,654,400	12,800
7-1/2% Note D-2001.....	11/15/01.	24,226,102	21,372,422	2,853,680	615,440
7-1/2% Note A-2002.....	05/15/02.....	11,714,397	10,223,197	1,491,200	144,240
6-3/8% Note B-2002.....	08/15/02.....	23,859,015	22,788,615	1,070,400	20,800
6-1/4% Note A-2003	02/15/03.....	23,562,691	23,073,603	489,088	263,200
5-3/4% Note B-2003	08/15/03.....	28,011,028	27,621,428	389,600	23,200
5-7/8% Note A-2004	02/15/04.....	12,955,077	12,774,277	180,800	142,400
7-1/4% Note B-2004......	05/15/04.....	14,440,472	14,435,572	4,900	0
7-1/4% Note C-2004.....	08/15/04.....	13,346,467	13,306,467	40,000	0
7-7/8% Note D-2004.....	11/15/04.....	14,373,760	14,373,760	0	0
7-1/2% Note A-2005.....	02/15/05.....	13,834,754	13,834,354	400	0
6-1/2% Note B-2005......	05/15/05.....	14,739,504	14,739,504	0	0
6-1/2% Note C-2005.....	08/15/05.....	15,002,580	15,002,580	0	0
5-7/8% Note D-2005.....	11/15/05.....	15,209,920	15,209,920	0	0
5-5/8% Note A-2006.....	02/15/06.....	15,513,587	15,513,587	0	0
6-7/8% Note B-2006.....	05/15/06.....	16,015,475	16,015,475	0	0
11-5/8% Bond 2004......	11/15/04.....	8,301,806	4,015,406	4,286,400	84,400
12% Bond 2005	05/15/05.....	4,260,758	2,144,108	2,116,650	20,0
10-3/4% Bond 2005......	08/15/05.....	9,269,713	6,427,313	2,842,400	244,
9-3/8% Bond 2006.......	02/15/06.....	4,755,916	4,740,556	15,360	
11-3/4% Bond 2009-14...	11/15/14.....	6,005,584	1,938,384	4,067,200	140,800
11-1/4% Bond 2015......	02/15/15.....	12,667,799	8,808,919	3,858,880	1,361,920
10-5/8% Bond 2015......	08/15/15.....	7,149,916	2,403,036	4,746,880	78,400
9-7/8% Bond 2015.......	11/15/15.....	6,899,859	3,611,859	3,288,000	257,600
9-1/4% Bond 2016.......	02/15/16.....	7,266,854	6,483,654	783,200	204,800
7-1/4% Bond 2016.......	05/15/16.....	18,823,551	18,553,151	270,400	272,800
7-1/2% Bond 2016.......	11/15/16.....	18,864,448	17,846,608	1,017,840	357,120
8-3/4% Bond 2017.......	05/15/17.....	18,194,169	9,455,289	8,738,880	609,920
8-7/8% Bond 2017	08/15/17.....	14,016,858	7,981,658	6,035,200	198,400
9-1/8% Bond 2018.......	05/15/18.....	8,708,639	2,225,439	6,483,200	288,000
9% Bond 2018...........	11/15/18.....	9,032,870	2,341,670	6,691,200	176,000
8-7/8% Bond 2019.......	02/15/19.....	19,250,798	5,450,798	13,800,000	923,200
8-1/8% Bond 2019.......	08/15/19.....	20,213,832	18,165,832	2,048,000	679,040
8-1/2% Bond 2020.......	02/15/20.....	10,228,868	6,526,868	3,702,000	198,400
8-3/4% Bond 2020.......	05/15/20.....	10,158,883	4,241,443	5,917,440	268,640
8-3/4% Bond 2020.......	08/15/20	21,418,606	6,839,886	14,578,720	1,318,720
7-7/8% Bond 2021.......	02/15/21.....	11,113,373	10,111,773	1,001,600	190,400
8-1/8% Bond 2021	05/15/21...	11,958,888	4,963,368	6,995,520	88,320
8-1/8% Bond 2021 ...	08/15/21. ...	12,163,482	4,053,402	8,110,080	344,960
8% Bond 2021.	11/15/21 ...	32,798,394	7,235,194	25,563,200	604,500
7-1/4% Bond 2022. ...	08/15/22	10,352,790	8,564,790	1,788,000	165,600
7-5/8% Bond 2022 ...	11/15/22. ...	10,699,626	3,381,226	7,318,400	9,600
7-1/8% Bond 2023	02/15/23. ...	18,374,361	14,785,561	3,588,800	273,600
6-1/4% Bond 2023	08/15/23 ...	22,909,044	22,531,412	377,632	213,984
7-1/2% Bond 2024	11/15/24	11,469,662	4,282,382	7,187,280	315,040
7-5/8% Bond 2025	02/15/25. ...	11,725,170	5,689,970	6,035,200	363,200
6-7/8% Bond 2025 ..	08/15/25. ...	12,602,007	12,386,327	215,680	3,520
6% Bond 2026 ..	02/15/26 ...	12,904,916	12,904,916	0	0
Total	....	880,811,348	653,775,348	227,036,000	12,261,564

#1 Effective May 1, 1987, securities held in stripped form were eligible for reconstitution to their unstripped form.

Note: On the 4th workday of each month Table VI will be available after 3:00 p.m. eastern time on the Commerce Department's Economic Bulletin Board (EBB). The telephone number for more information about EBB is (202) 482-1986. The balances in this table are subject to audit and subsequent adjustments.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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For Release at 8:15 A.M., MDT
July 10, 1996

REMARKS OF THE HONORABLE ROBERT E. RUBIN,
SECRETARY OF THE TREASURY
AT THE SOUTHWEST BORDER CONFERENCE
EL PASO, TEXAS
JULY 10, 1996

Thank you General McCaffrey. It's a pleasure to be at this very important gathering with you, Attorney General Reno, and the nation's Southwest border officials.

I am pleased to serve as co-chair of this conference. It represents the joint view of all law enforcement officials -- at the federal, state, and local levels -- on the importance of the anti-drug mission and the need to constantly re-assess our methods to effectively combat the national problem of drug abuse.

I think this conference is particularly useful because it gives those of us in Washington who set federal policy the opportunity to hear from those who are closest to many of these issues, specifically you who work at or near the Southwest border. I look forward to hearing your views on those matters that work well -- as well as those that may not -- and to build on our current efforts.

RR-1167

The gravity of this problem can not be overstated. Drugs poison our youth, lead to violence throughout our society, and adversely affect our economy. Our government has no greater priority for public safety and public health than stopping the smuggling, trafficking, and use of illicit narcotics.

It is the determined policy of the United States Government to fight drugs, and to bring to bear the greatest possible weight of resources and expertise to wage that fight successfully. The Defense Department, Treasury, Justice, the Coast Guard, ONDCP, and other agencies as well, are joined in a partnership to get at every facet of this problem. What I would like to do this morning is discuss the substantial role played by the Treasury Department's bureaus in interdiction, money laundering investigations and other law enforcement efforts -- all aimed at fighting drugs.

Let me also say that while I'll be focusing on Treasury, the key to effective enforcement is cooperation, both among federal agencies and between the federal agencies and state and local authorities. This Conference symbolizes that coordination, and the continued role played by the ONDCP in accomplishing it. As part of that discussion, I will also stress demand reduction and the need for sound economic policies to better pursue anti-narcotics goals, both within the United States and in Mexico, our neighbor on the Southwest border.

Now, as to interdiction, I joined my colleagues here when the President announced the National Strategy in Miami in April. There, the President again reaffirmed the Administration's commitment to interdiction at the border. Based on this commitment, interdiction is a principal mission of the Treasury Department, and remains the number one priority of the U.S. Customs

Service.

This priority is reflected most notably in Customs' Operation Hard Line, an initiative that is putting additional agents and inspection resources on the front lines here at the Southwest border.

Thus far, $55 million have been allocated to Hard Line, allowing for more inspections, as well as greater collection and use of intelligence to build complex anti-smuggling cases. This allocation has financed enhanced technology, including a second truck x-ray system right here in El Paso, as well as the construction of stronger physical barriers, such as border wide installation of jersey barriers and pneumatic bollards.

The results of Hard Line to date are impressive: In just one fiscal year, Hard Line has increased Customs' seizures of illicit narcotics by 24 percent on the southwest border. It has also resulted in an over 50 percent decrease in instances of "port running," the practice used by smugglers to run right through a Customs inspection site rather than submitting to a secondary inspection that would reveal their contraband.

The Administration and Customs are building on this success. The President's FY 97 budget includes an additional $65 million for Hard Line. These funds will pay for more x-ray equipment for examination of cargo, more and better targeted examination of passenger vehicles, and more agents for the collection of intelligence and the building of cases against trafficking organizations. By the end of 1997, 657 additional Customs agents and inspectors will be on the job to better stop the smuggling of narcotics across the Southwest border.

Additional resources for Customs means that it can interdict more drugs in current threat areas, and constantly assess new and emerging smuggling threats. Let me give you an example. This spring, based on advice from DEA, FDA, and Customs, Treasury prohibited the importation of Rohypnol before the influx of that drug became epidemic. As the people of this state know well, Texas was one of the states most affected by the use of Rohypnol, which is often introduced into the country over the Southwest border from Mexico. Now this drug is prohibited from importation into the country, even under the guise of personal use, and that is an important protection for our nation's young people.

So we're making progress on interdiction, particularly at the Southwest border, and we are committed to moving even further ahead. However, we remain aware, as General McCaffrey has pointed out repeatedly, that interdiction remains but one part of the comprehensive Strategy needed to fight drugs. Treasury contributes to those other elements of the National Strategy, as well.

We have a powerful program to combat money laundering, because hitting traffickers in the pocketbook and preventing them from laundering drug profits is an effective way to undermine the activities of the trafficking organizations themselves.

For one thing, the money trail can lead to prosecution of the upper levels of the trafficking organizations. Drug lords can keep themselves far removed from street-level deals, but they cannot divorce themselves from their profits. In addition, denying traffickers access to their profits robs them of the benefit of their trafficking and thereby creates an enormous problem for drug traffickers.

Treasury calls on several of its bureaus and offices in this anti-money laundering fight, including Customs and the IRS Criminal Investigation Division, which conduct sophisticated anti-money laundering investigations, and the Financial Crimes Enforcement Network, called FINCEN, which is a technology sophisticated expert unit, which collects and disseminates critical financial information in connection with such investigations. But I want to stress that the U.S. anti-money laundering effort is an interagency one, involving the resources of ONDCP, the Departments of Treasury, State, and Justice, and local and state law enforcement.

I also want to take a moment on the enforcement efforts against the traffickers by Treasury's Bureau of Alcohol, Tobacco and Firearms. ATF attacks armed drug traffickers through its enforcement of our nation's federal firearms and explosives laws. The majority of arrests made by ATF's Achilles program were for narcotics-related charges, and the bureau remains a vital participant in Organized Crime Drug Enforcement Task Forces ("OCDETF") and High Intensity Drug Trafficking Areas ("HIDTA's").

Let me also say that ATF has been doing a powerful job pursuing other aspects of its anti-crime mission, as we have seen with the recent Viper's militia case in Arizona, its close work with the FBI on the Oklahoma City and World Trade Center investigations, and its role investigating and trying to stop the recent upsurge in the African American church fire burnings.

Now that I've described some of our efforts at interdiction and other counter-narcotics matters that you pursue at on the US side of the border, I would like to briefly address issues relating to the efforts of Mexico. I know that those of you who have worked tirelessly on all of these counter-narcotics issues have at times expressed concern over this issue.

But I also strongly believe that we are seeing real change in Mexico due greatly to the leadership of President Zedillio in coming to grips with the law enforcement issues, but also due to the strengthening of US-Mexico relations that occurred in the wake of NAFTA and the US financial assistance package last year. Let me deal with each of those issues in turn.

As to the enforcement issues, we are heartened by President Zedillo and Attorney General Lozano's commitment to anti-narcotics matters. Over the last year, this commitment has manifested itself in a new law criminalizing money laundering, the expulsion of a leading narco-trafficker to the United States, and the record number of eradicated hectares of certain narcotics crops.

Our dialogue with Mexico reflects our mutual understanding that, notwithstanding improved efforts, some of the problems associated with narcotics crossing from Mexico into the

United States persist. While we are pleased by some of the recent measures, we view them as a starting point for even more vigorous actions -- within Mexico and in coordination with the U.S. -- to stop the flow of drugs across our Southwest border.

We're fortunate to have Gen. McCaffrey lead our High Level Contact Group to further our anti-narcotics discussions with Mexican authorities. Treasury is a full participant, with ONDCP, Justice, Defense, and the State Department, on such work. We look forward to maintaining our close inter-agency working relationship with these Departments as we look to build on current efforts by and with Mexico.

However, just as our own anti-narcotics fight depends in great part on a healthy underlying economy and society, Mexico's counter-drug efforts in the future also depend on its remaining financially stable and economically strong. Instability and poverty would render Mexico less able to enforce its laws and more susceptible to the corrupting influence of drug traffickers. Had we not provided assistance and had Mexico defaulted on its obligations in late 1994 and early 1995, we would be facing an even more serious drug problem today.

The same general link can be drawn between our own economic conditions and counter-drug efforts, particularly with respect to demand reduction efforts at home. As to the importance of demand reduction, let me reiterate what General McCaffrey and Attorney General Reno have consistently emphasized: while law enforcement is critical, and we need to promote it with the utmost vigor, demand reduction, including treatment and early prevention, is our greatest long term hope for freeing the American people from the scourge of drugs. Treasury works directly on this front through such initiatives as Project Outreach and the ATF Gang Resistance Education and Training ("G.R.E.A.T.") program.

However, while stressing to our youth the need to reject drug use, we must also help them move toward those things -- education, hard work, responsibility -- that will help them build productive lives. And we can best do that by providing growth and opportunity for all of our citizens. In short, economic opportunity is critical to combating drugs.

The Administration's record on this issue is strong. Over the last four years, the unemployment rate has fallen from 7.6 to 5.3 percent, and nearly 10 million additional jobs have been created. Moreover, through the President's expansion of the earned income tax credit, a tax cut has been provided for 15 million of our nation's working poor. In addition, the President has proposed other policies to enhance opportunity, such as a targeted middle income tax cut and a fifteen hundred dollar education based tax cut.

So, we're making progress on many fronts. However, we must continue to build on such progress. Conferences like this, which reflect our continuing cooperative work with ONDCP, Justice, and the other federal agencies, will help us do so.

Of course, this commitment to productive collaborative relationships at the border also extends to state and local officials. Through formal programs or informal sharing of information and processes, each of the Treasury bureaus will ensure that they continue to work closely with state and local officials who represent most of the nation's law enforcement officers, make the majority of arrests, and deal daily with the crime and social destruction connected with the drug problem.

The problem of drugs in our society is not going to be solved quickly. And while there are some who have said that it is beyond our ability to solve, conferences such as this reflect our joint view that such pessimists are wrong. Working together, we are making a difference, at the Southwest border and throughout society. And by working together, we will continue to do so. Thank you.

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SUMMARY

Created by Congress to provide stability and liquidity to the secondary mortgage market, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) are privately owned companies known as government-sponsored enterprises (GSEs). Like other GSEs[1], Fannie Mae and Freddie Mac have corporate charters granted by the federal government. To promote a public purpose, those charters limit Fannie Mae and Freddie Mac to a particular line of business -- operating in the secondary mortgage market -- and provide various government benefits that lower their operating costs and enable them to borrow at rates much lower than other financial institutions.

As a result of over three generations of U.S. government policy supporting homeownership, the United States now has the strongest housing finance market in the world. To make housing available to more Americans, Congress made an explicit judgment to direct credit toward home mortgages. One way it sought to do so was by creating intermediaries such as Fannie Mae and Freddie Mac that would buy and resell mortgages. Fannie Mae and Freddie Mac have played critical roles in building a liquid secondary market for home mortgages. This system has helped make homeownership possible for millions.

Despite this enormous progress, many low- and moderate-income and minority families continue to face substantial barriers to homeownership. President Clinton has made increased homeownership a national priority, and with the help of his National Homeownership Strategy, the homeownership rate has reached 65.1 percent this year, the highest level in fifteen years. Both GSEs have made, and continue to make, important contributions toward meeting the national goal of increased homeownership.

Fannie Mae and Freddie Mac are privately owned. Their stock trades actively on the New York Stock Exchange, and had a total market value of over $48.7 billion at the end of 1995. Last year they paid a total of $957 million in common stock dividends. As a result, in part, of their government sponsorship, Fannie Mae and Freddie Mac can participate in the mortgage market at lower costs and in ways that other private financial institutions cannot. Clearly Fannie Mae and Freddie Mac must serve their shareholders, but they must also comply with their federal charters. This ambiguity of responsibility, characteristic of GSEs, continually raises issues of accountability: To what extent is a particular GSE responding to its federal mandate and to what extent to the need to generate returns for its stockholders? What tradeoffs does it make between these objectives?

In the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, Congress recognized these issues, and recognized that many of the circumstances that had led

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[1] The other GSEs include the Federal Home Loan Bank System, the Farm Credit System, the Student Loan Marketing Association, and the College Construction Loan Corporation. See U.S. Department of the Treasury (1990,1991) for more information on GSEs.

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the government's full faith and credit. In addition to giving the GSEs the advantages mentioned above, federal law gives special status to GSE securities. It permits national banks to hold them in unlimited amounts. It makes them lawful investments for federal fiduciary and public funds and lawful collateral for public deposits. It authorizes the Secretary of the Treasury to purchase up to $2.25 billion of each GSE's obligations (and thus extend credit to the GSE). In addition, GSE securities are eligible collateral for loans from Federal Reserve Banks and Federal Home Loan Banks, and the Federal Reserve buys and sells such securities in its open market operations. The federal government does not guarantee GSE securities -- in fact, federal law requires a disclaimer of any U.S. obligation. Investors nonetheless believe that federal sponsorship provides a *de facto* guarantee -- because they believe that Congress would not permit either GSE to fail. This perception, in turn, enables Fannie Mae and Freddie Mac to borrow at rates lower than any private financial institution.

Third, the two GSEs hold less capital than comparable fully private firms, without incurring higher borrowing costs. At the end of 1995, the two GSEs had a combined $1.4 trillion in mortgage-backed securities outstanding, mortgages in portfolio, and other assets, but only $16.8 billion in capital. The two GSEs had an average capital-to-assets ratio of 3.9 percent. That ratio falls to 2.75 percent if one allocates capital, at the minimum rate currently required by the GSEs' safety and soundness regulator, to the $972 billion in mortgage-backed securities that the GSEs have guaranteed but do not carry on their balance sheets. By contrast, FDIC-insured savings institutions, which invest predominantly in mortgage-related assets, had an average capital-to-assets ratio of 7.8 percent.

We estimate the benefits of federal sponsorship are worth almost $6 billion annually to Fannie Mae and Freddie Mac. Of this amount, reduced operating costs (i.e., exemption from SEC filing fees and from state and local income taxes) represent approximately $500 million annually and the borrowing cost advantage over $5 billion annually. These estimates are broadly consistent with the magnitudes estimated by the Congressional Budget Office and General Accounting Office. As we discuss below, Fannie Mae and Freddie Mac appear to pass through part of these benefits to consumers through reduced mortgage costs and retain part for their own stockholders.

These three types of benefits aid Fannie Mae and Freddie Mac in both aspects of their business -- securitizing mortgages and retaining mortgages in portfolio. The benefits currently involve no direct government payments to the two GSEs and under current rules are not reported in the federal budget. Nonetheless, they have real economic value to the GSEs and involve real costs for the government to provide, a conclusion readily accepted by economic and financial experts. While fully private firms frequently pay fees to third-party guarantors to provide credit enhancement for their securities, the GSEs receive at no cost to them a package of benefits that makes the credit standing of their securities superior to anything available in the marketplace.

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Most discussions of pass-through focus on the differences between the market rates for the fixed-rate conforming mortgages that Fannie Mae and Freddie Mac can and do purchase, compared to non-conforming mortgages (generally larger "jumbo" mortgages) that can be purchased only by other private financial institutions. Some comparisons have been made based upon the advertised on-offer rates for the two types of mortgages. These comparisons typically show a rate advantage for conforming mortgages. Other studies have compared the Federal Housing Finance Board's data on mortgages that actually have closed and have found average rates on jumbo loans lower than on conforming loans.

However, raw comparisons may mislead, because other factors could affect the price differential between conforming and jumbo loans; the size and terms of the mortgages, their geographic location and credit quality, or the depth and liquidity of the market for larger versus smaller homes may have independent effects. After attempting to control for some of these factors statistically, recent studies suggest that the GSEs reduce interest rates on fixed-rate conforming, conventional mortgages by roughly 20 to 40 basis points. It is unclear how much of such a differential results from pass-through of GSE benefits rather than from such other factors as the GSEs' technical and managerial efficiency; furthermore, the differential may change over time. A plausible estimate of 30 basis points, the midpoint of this range, suggests that in 1995 the GSEs passed through approximately $4 billion of pre-tax benefits.

This calculation necessarily omits certain factors. It does not include the value of the stability the GSEs may give the conforming, conventional mortgage market. Nor does it place a value on the extent to which the GSEs make affordable housing finance more available than it otherwise would be (an issue discussed below).

It is even more difficult to estimate with certainty how modifying or ending government sponsorship would affect mortgage interest rates. Although some increase seems likely, certain factors suggest that the increase in rates might be less than the pass-through estimate given above. Fannie Mae and Freddie Mac currently have no effective competition in the conforming, conventional secondary mortgage market except each other. Nonetheless, many financial institutions compete vigorously in other secondary markets, for both mortgages and other types of obligations. Depending upon how changes were undertaken, competition from other financial institutions could moderate the effects of privatization. These issues have, however, received very little analysis; further research is necessary before definitive conclusions can be drawn.

Supporting Affordable Housing

Last year, the Department of Housing and Urban Development (HUD) released the Administration's blueprint for increasing homeownership, the *National Homeownership Strategy: Partners in the American Dream*. Many of the nation's critical unmet housing needs today differ from those of the past. Mortgages are now widely available, and so the Administration and Congress have focused on the needs of borrowers who continue to find

Most discussions of pass-through focus on the differences between the market rates for the fixed-rate conforming mortgages that Fannie Mae and Freddie Mac can and do purchase, compared to non-conforming mortgages (generally larger "jumbo" mortgages) that can be purchased only by other private financial institutions. Some comparisons have been made based upon the advertised on-offer rates for the two types of mortgages. These comparisons typically show a rate advantage for conforming mortgages. Other studies have compared the Federal Housing Finance Board's data on mortgages that actually have closed and have found average rates on jumbo loans lower than on conforming loans.

However, raw comparisons may mislead, because other factors could affect the price differential between conforming and jumbo loans; the size and terms of the mortgages, their geographic location and credit quality, or the depth and liquidity of the market for larger versus smaller homes may have independent effects. After attempting to control for some of these factors statistically, recent studies suggest that the GSEs reduce interest rates on fixed-rate conforming, conventional mortgages by roughly 20 to 40 basis points. It is unclear how much of such a differential results from pass-through of GSE benefits rather than from such other factors as the GSEs' technical and managerial efficiency; furthermore, the differential may change over time. A plausible estimate of 30 basis points, the midpoint of this range, suggests that in 1995 the GSEs passed through approximately $4 billion of pre-tax benefits.

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HUD reports that it designed the affordable housing goals to be achievable under economic conditions more adverse than the recent period of high affordability, and notes that they may become binding constraints as market conditions change. The goals may themselves be revised periodically to encourage the GSEs to increase their affordable housing activities beyond what the fully private sector might otherwise do.

Ending government sponsorship would in all probability have some effect on the GSEs' contributions to affordable housing. Without being able to estimate the extent to which the GSEs undertake affordable housing activities because of federal requirements, rather than for other reasons, one cannot estimate how rescinding or revising HUD's goals would affect their activities. As HUD and the GSEs gain more experience with the goals, we should have better understanding of the effects of these programs.

Expanding opportunities for homeownership should remain one of our highest priorities. The actions of GSEs and other financial institutions in this crucial area will merit continued attention from HUD and Congress.

Implications of the *Status Quo*

Effect on Treasury Borrowing Costs

Together, Fannie Mae and Freddie Mac have over $1.4 trillion in debt and mortgage-backed securities outstanding -- an amount equal to nearly two-fifths of the Treasury securities held by the public. Since GSE securities may be substituted for Treasury securities for many purposes (as discussed above), and since they benefit from investors' perception that the federal government implicitly stands behind them, those securities underserved areas (as defined in HUD's 1995 final rule on GSE housing goals) from 22.9 percent in 1993 to 31.2 percent in 1995, while Freddie Mac's activity increased from 21.3 percent to 25.1 percent during the same period. Although this improved performance obviously results in part from HUD's oversight and encouragement, it is not possible to ascertain the extent to which it represents a response to that oversight, to the affordable housing activities of mortgage originators, or to diversification of the GSEs' business activities as their basic market becomes more saturated. For example, the majority of single-family mortgages that counted toward meeting the HUD goals in 1995 (64 percent or more for each goal and each GSE) went to borrowers who made downpayments of at least 20 percent. Since a lack of funds for downpayments constitutes one of the main impediments to homeownership in lower-income communities, it is unclear to what extent the goals have stimulated mortgage originators to make loans that they would not otherwise have made. However, affordable housing loans often entail higher marketing, servicing, and credit costs than other GSE-purchased loans, so these historical loan-to-value (LTV) ratios may understate the GSEs' effect on affordable housing. It is too early to evaluate fully whether a trend toward more flexible underwriting practices will increase the availability of higher LTV loans and spur additional mortgage originations to low- and moderate-income homebuyers.

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OFHEO's mission is unquestionably important. Overseeing the GSE's safety and soundness diminishes the likelihood of financial difficulties that could raise any question of government assistance. The stringency and effectiveness of OFHEO's regulatory policies will therefore be critical.

Further Analysis Required

As noted above, further analysis of many of these issues is necessary for any informed conclusions. Research on both the current conforming mortgage market and the affordable housing market would help clarify both the risks and benefits of any action by Congress.

There should also be detailed analysis of the operational and market implications of any particular action that Congress considers. If Congress decided to maintain the GSE status of Fannie Mae and Freddie Mac, but sought to increase the public benefits they provide or reduce the government benefits they receive, it could pursue a wide range of options. Illustrative of the many options that have been suggested are: strengthening the affordable housing goals by requiring Fannie Mae and Freddie Mac to increase their market shares or to direct more activity to targeted areas or borrowers; requiring the GSEs to subsidize affordable housing directly, through programs analogous to the Federal Home Loan Banks' Affordable Housing Program; requiring increased involvement in financing multifamily mortgages; requiring more directed assistance (both educational and financial) to lower-income borrowers, state and local governments, and non-profit organizations; limiting the size of the GSEs' retained mortgage portfolios; freezing or reducing the conforming loan limit; removing certain benefits of GSE status, such as the exemption from registering securities with the SEC; and requiring periodic estimation and public disclosure of the value of the government benefits that the GSEs receive. These options need further analysis before a decision can be made on whether or how to adjust government sponsorship.

Conclusions

Fannie Mae and Freddie Mac have succeeded in developing a liquid secondary mortgage market for conforming, conventional mortgages. Congress, while recognizing the important benefits provided by the GSEs' activities, has asked whether it is now both feasible and advisable to change their status.

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Although the analysis undertaken in this report and others is substantial, we believe firm conclusions regarding the desirability of ending or modifying government sponsorship of Fannie Mae and Freddie Mac are premature. The GSEs' experience under the 1992 Act is relatively short, and many of the most important issues could benefit from further study. Furthermore, should Congress decide to act, there are several possible approaches, each with different implications that should be analyzed and reviewed.

Fannie Mae and Freddie Mac are important institutions participating in markets that affect the homeownership of millions of Americans. Ultimately no change will be made without rigorous public discussion and a broad consensus. We hope this report is helpful to that process.

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Chapter I reviews the legislative history of Fannie Mae and Freddie Mac and describes their business operations. Chapter II examines the benefits and constraints of government sponsorship in relation to the two GSEs' business operations. Chapter III discusses the GSEs' activities, both in the general secondary mortgage market and in financing affordable housing. Chapter IV considers potential effects -- both for housing finance and for the GSEs themselves -- of ending the GSEs' government sponsorship and provides a brief review of issues for further study that could alter the federal government's relationship with the GSEs.

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INTRODUCTION

Two private companies created by the federal government supplement the flow of credit to the residential mortgage market. The Federal National Mortgage Association (Fannie Mae), established in 1938, and the Federal Home Loan Mortgage Corporation (Freddie Mac), established in 1970, purchase mortgages originated by banks, savings associations, mortgage bankers, and other lenders. Combined, the two enterprises had approximately $1.4 trillion in assets and outstanding mortgage-backed securities at the end of 1995.

Fannie Mae and Freddie Mac are known as government-sponsored enterprises (GSEs).[1] GSEs are privately owned financial intermediaries with federal charters that limit their corporate activity to a specific credit function. The government has created GSEs to overcome perceived shortcomings in various credit markets, mainly those for housing, agriculture, and higher education loans. As financial intermediaries, the GSEs raise funds in the capital market to make or purchase loans, issue pass-through securities, or guarantee the liabilities of others.

The federal government does not guarantee or stand behind the liabilities of any GSE. Nonetheless, capital-market investors believe that the federal government implicitly backs the GSEs, enabling the GSEs to operate under favorable terms. The GSEs also receive other substantial benefits from federal sponsorship, such as their securities having equal standing with Treasury securities as permissible investments for national banks.

Shortly after the savings and loan debacle, Congress requested several government studies on the extent to which GSEs pose risks to the taxpayers. Although the reports identified no immediate problems with the GSEs' safety and soundness or federal oversight,[2] they focused attention on the need to strengthen the federal government's oversight of Fannie Mae and Freddie Mac. At the time, these two GSEs -- huge institutions with capital ratios lower than most financial firms -- lacked a true safety-and-soundness regulator.

Partially in response to these reports, Congress enacted the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 [P.L. 102-550], which created the Office of Federal Housing Enterprise Oversight (OFHEO). As the safety and soundness

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This report considers the following questions: To what extent have Fannie Mae and Freddie Mac accomplished their public purposes? Do public policy reasons exist for continuing the benefits and constraints that GSE status imposes on Fannie Mae and Freddie Mac? What would be the broader potential effects of ending the government's sponsorship of Fannie Mae and Freddie Mac? What would be the consequences of maintaining the *status quo*?

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CHAPTER I

FANNIE MAE, FREDDIE MAC, AND THE HOUSING CREDIT MARKET

Fannie Mae has undergone several significant changes over the course of its history, but its primary public purpose remains the same: providing liquidity to housing finance by maintaining an active presence in the secondary mortgage market. Freddie Mac serves the same basic public purpose. The federal government saw a need for such institutions because of market imperfections in the supply of credit to housing finance. Depression-era economic conditions highlighted these imperfections, as did the inflation-driven problems of the financial system during the 1960s through 1980s.

A. THE CREATION AND EVOLUTION OF FANNIE MAE AND FREDDIE MAC: A HISTORICAL OVERVIEW

Financial turbulence during the Great Depression overwhelmed the housing finance system. At the time, the most common form of housing finance was a balloon mortgage, which required a large downpayment and periodic interest-only payments over a relatively short repayment period (generally between one and six years). When the full principal became due at the end of that period, the lender (usually a bank or savings and loan) decided whether to renew the loan. As the Depression deepened, borrowers often could not make their balloon payments, lenders often could not refinance loans, and home prices fell. The cumulative result was a precipitous drop in new financing activity and a collapse of home construction.

In 1932, Congress responded by creating the Federal Home Loan Bank System to support the local institutions that specialized in housing finance -- savings associations and savings banks. The Federal Home Loan Banks were designed to provide liquidity for long-term mortgages that replaced balloon mortgages. Using their mortgage portfolios as collateral, member institutions could fund greater lending activity by borrowing money from their regional Federal Home Loan Banks.

To encourage mortgage lending by shielding lenders from default risk, the government created the Federal Housing Administration (FHA) in 1934. The FHA provided mortgage default insurance and promoted the long-term fully amortizing mortgage. FHA insurance also expanded access to credit by facilitating lower downpayments.

But lenders remained reluctant to tie up their funds in illiquid long-term mortgages, a problem the government addressed in 1938 by creating Fannie Mae to support a secondary market in FHA-insured mortgages. Fannie Mae raised funds in the national capital markets and purchased FHA-insured mortgages nationwide, primarily from banks and mortgage bankers. It also resold such mortgages to other investors. Fannie Mae's activities made the

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In response to the credit crunch of 1969-70 and to regional disparities in mortgage credit availability, Congress adopted two changes in 1970. First, Congress permitted Fannie Mae to begin purchasing "conventional" mortgage loans (that is, non-FHA, non-VA mortgages). Second, Congress created the Federal Home Loan Mortgage Corporation (Freddie Mac) within the Federal Home Loan Bank System (which was owned cooperatively by thrift institutions) to provide a secondary market for conventional loans, many of which were held by savings and loans. By fostering a secondary market in conventional mortgages, Congress sought to make mortgage credit more available, mitigate the effect on savings and loans of Regulation Q-related credit crunches, and improve the regional distribution of housing finance credit.

Fannie Mae responded to its new powers by rapidly building its mortgage portfolio, which soon exceeded that of even the largest savings and loan institution.[4] Indeed, Fannie Mae's balance sheet looked much like that of a savings and loan, with its assets nearly all in long-term, fixed-rate mortgages and its liabilities relatively short-term. When interest rates soared in the late 1970s and early 1980s, Fannie Mae encountered some of the same difficulties as did savings and loans, and by 1981 had a negative net worth of almost $11 billion.

Freddie Mac's initial business strategy differed from Fannie Mae's. Instead of competing with its thrift-institution owners by holding mortgages in portfolio, Freddie Mac followed Ginnie Mae's lead and focused on securitizing mortgages.[5]

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[3] The Federal Reserve Board's Regulation Q, adopted pursuant to a 1933 Act of Congress, limited the interest rates banks paid on deposits. In 1966, Congress authorized the Federal Home Loan Bank Board to impose similar limits on the interest rates savings and loan institutions paid on deposits (although in practice the limits for savings and loans were slightly higher than those for banks). The remainder of this report will use "Regulation Q" to refer to both the Federal Reserve's limits on banks and the Federal Home Loan Bank Board's limits on savings and loans.

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[5] A basic description of securitization follows in the next section. Ginnie Mae does not actually securitize or purchase mortgages but facilitates the securitization of FHA and VA mortgages by guaranteeing the timely payment of principal and interest on the underlying pool of FHA and VA mortgages that make up mortgage-backed securities issued by approved private sector entities. Ginnie Mae's guarantee carries the full faith and credit of the United States. In what follows in this study, the term "securitize" or "purchase" in relation to Ginnie Mae will refer to this guarantee function.

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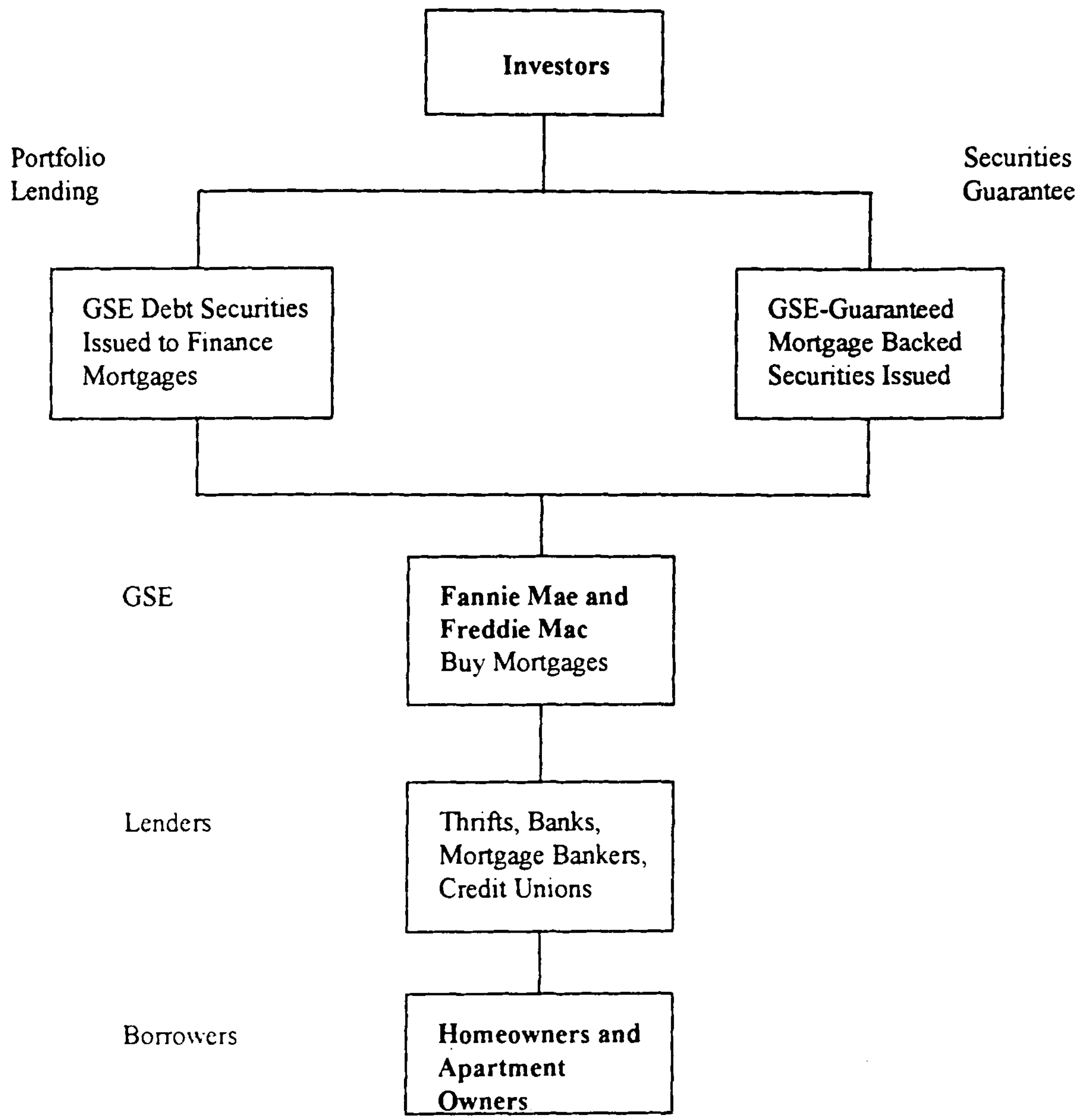
Figure I.1: Secondary Market Operations of Fannie Mae and Freddie Mac



Source: GAO (1990, p. 26).

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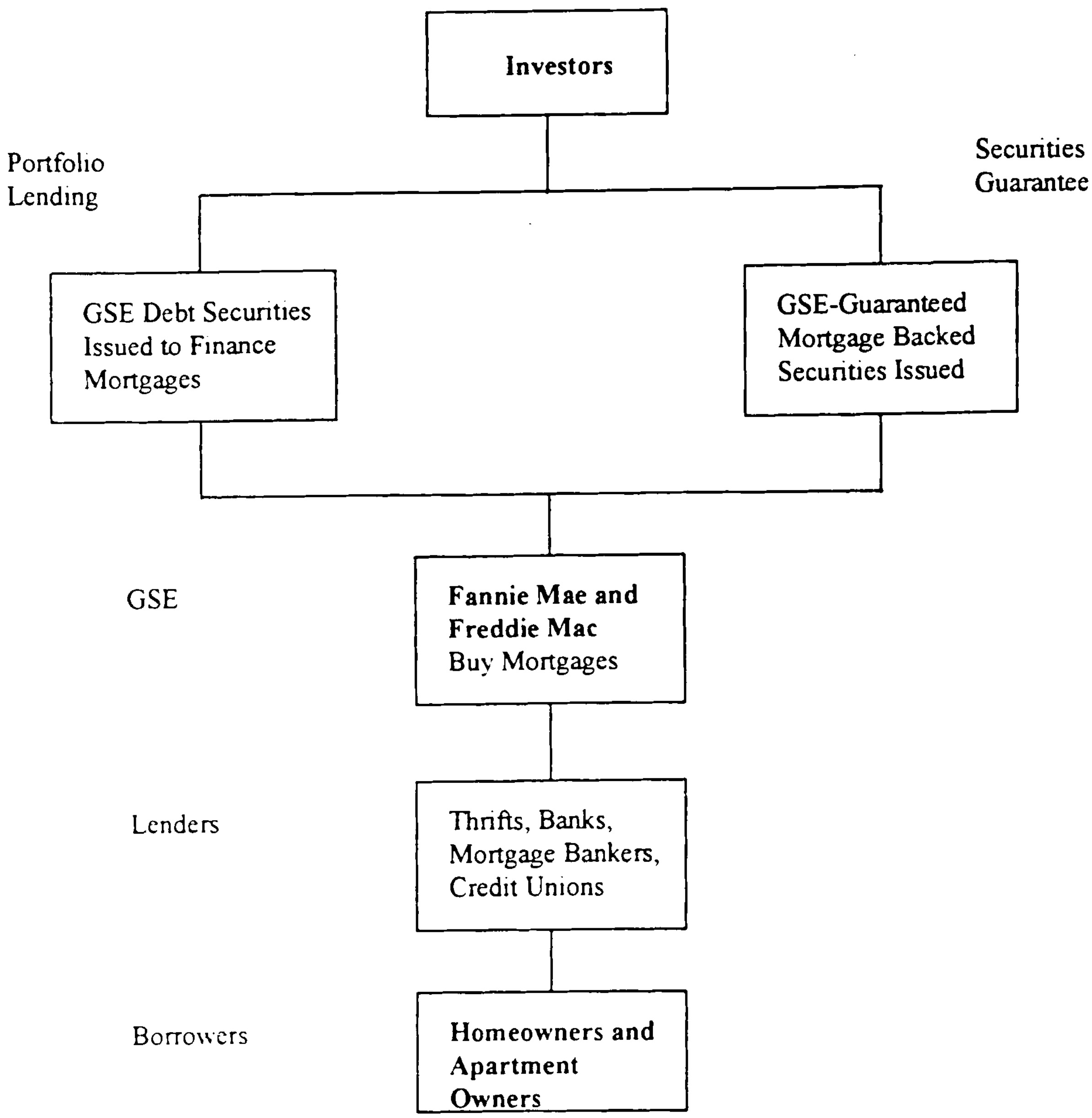

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depository institutions, which fund their mortgage portfolios primarily by taking deposits, the two GSEs fund their portfolios by issuing an array of debt securities.

C. SUMMARY

Fannie Mae and Freddie Mac serve a public purpose: providing stability and liquidity to the secondary market for conforming home mortgage loans, including affordable housing loans. As secondary market institutions, Fannie Mae and Freddie Mac purchase conforming residential mortgage loans from banks, thrifts, mortgage banks, and other mortgage loan originators. The GSEs finance these purchases by securitizing groups of mortgages or by holding the mortgages in portfolios funded by issuing debt securities. Securitization involves pooling groups of mortgages and issuing securities backed by the pooled mortgages to investors. Mortgage-backed securities represent interests in the underlying mortgages, and use borrowers' monthly payments of interest and principal to pay the investors. The GSEs guarantee these payments and, in return, collect a guarantee fee. To help the GSEs pursue these activities while keeping within their public mission, government sponsorship confers a range of benefits and constraints, discussed in Chapter II.

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C. SUMMARY

Fannie Mae and Freddie Mac serve a public purpose: providing stability and liquidity to the secondary market for conforming home mortgage loans, including affordable housing loans. As secondary market institutions, Fannie Mae and Freddie Mac purchase conforming residential mortgage loans from banks, thrifts, mortgage banks, and other mortgage loan originators. The GSEs finance these purchases by securitizing groups of mortgages or by holding the mortgages in portfolios funded by issuing debt securities. Securitization involves pooling groups of mortgages and issuing securities backed by the pooled mortgages to investors. Mortgage-backed securities represent interests in the underlying mortgages, and use borrowers' monthly payments of interest and principal to pay the investors. The GSEs guarantee these payments and, in return, collect a guarantee fee. To help the GSEs pursue these activities while keeping within their public mission, government sponsorship confers a range of benefits and constraints, discussed in Chapter II.

CHAPTER II

GOVERNMENT SPONSORSHIP OF FANNIE MAE AND FREDDIE MAC

In establishing Fannie Mae and Freddie Mac, Congress imposed a set of constraints in their charters that limit them to certain business activities and keep them focused on housing.

Government sponsorship also includes a range of benefits to Fannie Mae and Freddie Mac that assist them in these efforts. These include exemption from costs that other financial institutions must bear, an ability to borrow at costs lower than other financial institutions, and the freedom to operate with less equity capital than a comparable fully private firm. These benefits are not reported in the federal budget because they do not take the form of direct payments to either GSE. Nonetheless, the benefits are extremely valuable. This chapter describes the benefits, and attempts to quantify them and to assess what portion of them the two GSEs pass through to consumers in the form of lower mortgage rates and what portion the GSEs' shareholders retain.

A. BENEFITS AND CONSTRAINTS OF GOVERNMENT SPONSORSHIP

Although they are federally chartered, Fannie Mae and Freddie Mac receive no funds from the federal government and the government does not guarantee their securities. However, government sponsorship does provide a set of benefits that would command a high price if offered to fully private firms. Thus, while the GSEs pose no direct budgetary cost to taxpayers, taxpayers provide the GSEs with benefits that have substantial value, an estimate of which is provided in Section B.

Government sponsorship also involves certain constraints -- most significantly, those limiting the firms' operations to the specific areas permitted by their charters. Thus, the GSEs forego the opportunity to invest their shareholders' capital in activities outside the boundaries of their charters.

1. Benefits of Government Sponsorship

Government sponsorship provides Fannie Mae and Freddie Mac with three types of benefits that help them fulfill their public mission. First, it lowers their operating costs and makes their securities more liquid and more attractive to investors. Second, it enables them to operate with relatively less capital than other market participants. Third, it enables their debt securities and mortgage-backed securities to receive preferential treatment in financial markets. These benefits help to support the GSEs' securitization and portfolio-holding activities.

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saving associations have a financial incentive to sell and/or securitize mortgages rather than hold them as portfolio investments.[1]

Government sponsorship also enables the GSEs to operate with less capital than a comparable fully private firm, without incurring higher borrowing costs. How much capital such a firm would hold is speculative, because no fully private firm just like Fannie Mae and Freddie Mac exists. Depository institutions are currently the GSEs' principal competitors for portfolio funding of residential mortgages. The regulatory capital requirements for mortgages currently imposed on Fannie Mae and Freddie Mac are low relative to those imposed on FDIC-insured depository institutions. At the end of 1995, the two GSEs had an average capital-to-assets ratio of 3.9 percent. That ratio falls to 2.75 percent if one allocates capital, at the minimum rate currently required by the GSEs' safety and soundness regulator, to the $972 billion in mortgage-backed securities that the GSEs have guaranteed but do not carry on their balance sheets. By contrast, FDIC-insured savings institutions, with investments predominantly in mortgage-related assets, had an average capital-to-assets ratio of 7.8 percent. Although the differences may largely, or completely, reflect broad differences in the average credit and interest rate risk exposures of GSEs and depository institutions, the differences would provide a substantial competitive advantage to the GSEs even over depository institutions with essentially equal risks. Both depository institutions and the GSEs fund their mortgage portfolios using a mix of capital and debt, and capital is generally a more expensive funding source than debt. By having lower relative capital requirements than depository institutions, while simultaneously having an advantage in issuing debt as described below, the GSEs can finance a given mortgage or group of mortgages in their portfolio with less capital -- and hence at lower cost -- than can depository institutions.

The third type of benefit associated with GSE status is the preferential treatment that financial markets accord to debt and mortgage-backed securities issued by Fannie Mae and Freddie Mac relative to securities issued by potentially higher-capitalized, fully private, but otherwise comparable firms.

By law, all GSE-issued securities carry a disclaimer stating that the security is not guaranteed by, or otherwise an obligation of, the federal government. Yet the market prices for those securities, and the fact that the market does not require that those securities be rated by a national rating agency, suggest that investors believe the government implicitly guarantees those securities. This perception of an implicit guarantee -- growing out of the numerous ties between the GSEs and the federal government -- enables Fannie Mae and

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- The Treasury Department has statutory authority to approve the GSEs' new debt issues, and has used this authority to coordinate new debt issues of the GSEs to prevent market congestion.

- The GSEs are subject to regulatory oversight and will be subject to risk-based capital requirements.

B. Estimating the Value of Government Sponsorship

The benefits that Fannie Mae and Freddie Mac receive from government sponsorship have real economic value, and thus provide an in-kind subsidy. The GSEs also pass through benefits of such sponsorship to the homebuying public in the form of lower mortgage interest rates. How do the benefits that the GSEs receive compare in value to the benefits they pass through to the public? Relying on the best data available to us, we present a conservative estimate of the most significant governmental benefits that the GSEs receive and an estimate of those they confer (lower interest rates on fixed-rate, conforming, conventional single-family mortgages).

As estimated here, the gross value (that is, the value before considering any pass-through to homebuyers) includes the value of GSE benefits related to mortgage securitization, the retained mortgage portfolio, and reduced operating costs. From the gross value of these benefits, we subtract an estimate of the value passed on to homeowners to arrive at the net subsidy retained by the GSEs. These estimates reflect the value of GSE benefits based on the GSEs' current operations and do not imply that the GSEs' would operate in the same way they do today if Congress ended their government sponsorship. Nor do these estimates imply how a change in their government sponsorship would affect the GSEs' future operations or profitability.

1. Benefits Related to Securitizing Mortgages

Investors pay a premium (accept a lower yield -- effectively a lower interest rate) to purchase Fannie Mae and Freddie Mac mortgage-backed securities in comparison to securities with comparable asset-backing issued by non-GSEs (private conduits).[6] This advantage to the GSEs derives primarily from investors' perception that the government implicitly guarantees such securities even though no formal guarantee exists. An estimate of the value of the GSE benefits relating to mortgage-backed securitization should at least equal the extent to which investors are willing to accept lower yields because of that perception.

Goodman and Passmore (1992, p. 5) found a yield difference of 45 to 60 basis points between the GSEs' mortgage-backed securities and AA-rated private mortgage-backed securities. Based in part on this result and other sources, CBO (1996) cited a range of 25 to

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yield advantage in the market.[8] This estimate is necessarily only approximate. A more precise estimate would require extensive gathering and analysis of market data on outstanding mortgage-backed securities. Even then, the inherent structural differences between GSE-issued mortgage-backed securities and privately issued mortgage-backed securities would continue to complicate such comparisons. And, the size of the GSEs' advantage may change over time in response to changing market conditions and growing market acceptance of privately issued mortgage-backed securities.

2. Benefits Related to Retaining Mortgages in Portfolio

To finance their retained mortgage portfolios, Fannie Mae and Freddie Mac issue debt securities. Investors purchase these securities in the bond market at interest rates much lower than those paid by institutions with similar risks and more capital. The perception of an implicit guarantee makes them appear safer to investors, and some of their characteristics as GSE securities enhance their liquidity -- in essence lowering the GSEs' borrowing costs. One way to estimate these benefits is to compare the GSEs' borrowing costs to those of large high-quality financial firms with large portfolios of residential mortgages. Such firms (primarily large thrifts and commercial banks) are typically rated about A.

Using market price data reported by Bloomberg Financial Services, we examined yield spreads between the two GSEs' debt securities and similar securities of fully private, A-rated financial firms. Bloomberg adjusts its data for the specific characteristics of the bonds and reports average yield spreads for various maturity ranges.[9] Comparing yield differences on intermediate and long-term securities outstanding over the period from

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In comments provided to the Treasury, Freddie Mac stated that a funding advantage of 30 basis points in issuing mortgage-backed securities was reasonable, but this was not a fair measure of their GSE benefits since their securities also benefit from a liquidity advantage. Any liquidity premium accruing to the GSEs' mortgage-backed securities however, reflects to some (probably large) degree, liquidity advantages derived from their GSE status.

[9] Bloomberg Financial Services reports the market value of bonds calculated using the Bloomberg Fair Value Model. According to Bloomberg, "Bloomberg Fair Value (BFV) is the model level or calculation that provides an indication of a bond's market value, based on the trading levels of other debt in its sector, as defined by issuer type and perceived credit quality. To account for embedded options BFV quantifies the value of any options and depending on option type, adds or subtracts them from the value, effectively allowing you to compare bonds with different structures on an equal basis. This model-predicted value is free of short-term supply and demand considerations."

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GSE status attenuates this normal disciplining function of the marketplace, reducing the GSEs' borrowing costs without requiring commensurately higher levels of capital. Since capital is more costly than debt, operating with relatively less capital than private firms adds to the GSEs competitive advantages in funding a portfolio of mortgages.

3. Benefits That Reduce the GSEs' Operating Costs

Several GSE benefits, such as the exemption from SEC registration, directly reduce Fannie Mae's and Freddie Mac's operating expenses relative to other firms. In addition, the GSEs' income is exempt from state and local income taxes. Although we did not attempt to identify and value every aspect of GSE status that may reduce the GSEs' operating costs, the SEC registration exemption and the state and local income tax exemption are the most significant. GAO (1996-B, p. 7) estimated that in 1995 the state and local income tax exemption saved the GSEs a combined \$367 million, and the SEC registration exemption saved the GSEs \$102 million. Rounded off, the GSEs' combined operating cost subsidies totaled roughly \$500 million last year. Among other things, this estimate does not include any operating-cost subsidies that may arise from use of the Federal Reserve's book-entry system. Nor does it include savings from issuing securities without obtaining private rating agency ratings.

4. Estimating the Gross and Net Value of Government Sponsorship

The cumulative value of GSE status to Fannie Mae and Freddie Mac may be estimated by combining the value of the benefits they receive in securitizing mortgages, funding mortgages in portfolio, and operating at lower costs. The GSEs' so-called gross subsidy measures these benefits before considering the extent to which the GSEs pass them on to homebuyers in the form of lower mortgage rates. The pre-tax net value of the benefits retained by the GSEs is the gross subsidy minus the projected reduction in mortgage rates resulting from the GSEs' operations.

Our analysis assumes that in 1995, government sponsorship gave the GSEs: (1) a 35 basis point advantage in securitizing mortgages; (2) a 55 basis point advantage in issuing

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[11] See Stanton (1996, pp. 80-83) for comparisons between the GSEs and other financial firms, and between the GSEs and other major providers of mortgage credit.

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Although estimates such as that presented above do give a general sense of the magnitude of the subsidies involved, no single point estimate should be viewed as a firm indicator of the benefits the GSEs receive or pass through. The calculations described above, for example, omit important elements of both benefits received and benefits passed through. The estimates do not place a value on the added stability the GSEs may give the conforming, conventional mortgage market. Nor do they place a value on the extent to which the GSEs may make affordable housing finance more available through consumer education activities, outreach efforts, and special products.

By the same token, the estimates do not include such other benefits to the GSEs as the use of the book-entry system maintained by the Federal Reserve or the ability to issue securities without obtaining private rating-agency ratings. The estimates also credit the GSEs for passing through lower rates on all the mortgages they purchase (including adjustable-rate mortgages and multifamily mortgages), not just on fixed-rate mortgages[16]. And the estimates do not include any additional competitive advantage that may result from government sponsorship.

Nevertheless, these estimates do provide a foundation for assessing how Fannie Mae and Freddie Mac work within the overall secondary mortgage market.

C. THE GSEs' CURRENT BUSINESS OPERATIONS AND PROFITABILITY

Although valuing the benefits of government sponsorship involves uncertainties, our estimates suggest that those benefits are substantial, a conclusion consistent with a basic review of the financial performance of Fannie Mae and Freddie Mac. In addition to enabling the GSEs to fulfill their public purpose, government sponsorship appears to shape their operations and opportunities in significant ways.

1. Mortgages Outstanding

Fannie Mae and Freddie Mac are two of the largest financial companies in the United States. Table II.1 shows each GSE's outstanding mortgage-backed securities and retained portfolio from 1989 through 1995. At the end of 1995, the two GSEs held some or all of the credit risk for more than $1.3 trillion in mortgages -- 34 percent of the $3.9 trillion in total outstanding residential mortgage debt in the country and 2.7 times the $491 billion of mortgages and mortgage-backed securities held by OTS-regulated savings associations.

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[16] We estimate that for single-family mortgages originated in 1994, the GSEs financed 83 percent of the conforming, conventional fixed-rate mortgages and 17 percent of the conforming, conventional adjustable-rate mortgages. The fully private sector financed 17 percent of the fixed-rate, and 83 percent of the adjustable-rate conforming, conventional mortgages originated that year.

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percent in 1992 to over 55 percent by 1995.[17] Fee income from guaranteeing mortgage-backed securities still makes up a substantial portion of total income but may diminish in importance if Fannie Mae and Freddie Mac pursue portfolio growth as the key to expanding profits. Other income, consisting primarily of REMIC fees, tends to fluctuate greatly from year to year in response to originations and investor demand for these products.

Table II.2: Fannie Mae and Freddie Mac Percentages of Total Revenue by Sources of Income

	1995	1994	1993	1992
Fannie Mae				
Net Interest Income	72.2%	69.7%	67.5%	67.3%
Guarantee Fee Income	25.7%	26.7%	25.6%	27.3%
Other Fee Income	2.1%	3.6%	6.9%	5.5%
Freddie Mac				
Net Interest Income	55.6%	48.6%	40.4%	38.9%
Guarantee Fee Income	43.1%	48.5%	52.9%	57.6%
Other Fee Income	1.5%	2.9%	6.7%	3.5%

Source: Fannie Mae and Freddie Mac Investor/Analyst Reports

Table II.3 presents summary statistics that indicate the GSEs' increased focus on building their retained portfolio. For both Fannie Mae and Freddie Mac, the retained portfolio growth rate in recent years has exceeded the outstanding mortgage-backed securities growth rate. The growth in Freddie Mac's retained portfolio is especially marked. In 1995,

[17] A better standard for gauging the importance of different business activities would be percentages of net income by income source. Considering only total revenue by income source ignores the allocation of costs among various business activities. For example, managing the interest rate risk associated with the retained portfolio of Fannie Mae and Freddie Mac may require greater resources than managing the credit risk associated with the outstanding portfolio of mortgage-backed securities. Fannie Mae does report statistics similar to Table 2.2 based on net income by line of business. In 1995 (before special contributions to the Fannie Mae Foundation), portfolio investment made up 57.7 percent of net income, credit guarantees made up 40.8 percent, and fee-based services made up 1.4 percent. Freddie Mac only recently (first quarter of 1996) adopted reporting practices that allow calculations of the percentage of net income by income source, and it told us that this information was not publicly available for previous time periods.

percent in 1992 to over 55 percent by 1995.[17] Fee income from guaranteeing mortgage-backed securities still makes up a substantial portion of total income but may diminish in importance if Fannie Mae and Freddie Mac pursue portfolio growth as the key to expanding profits. Other income, consisting primarily of REMIC fees, tends to fluctuate greatly from year to year in response to originations and investor demand for these products.

Table II.2: Fannie Mae and Freddie Mac Percentages of Total Revenue by Sources of Income

	1995	1994	1993	1992
Fannie Mae				
Net Interest Income	72.2%	69.7%	67.5%	67.3%
Guarantee Fee Income	25.7%	26.7%	25.6%	27.3%
Other Fee Income	2.1%	3.6%	6.9%	5.5%
Freddie Mac				
Net Interest Income	55.6%	48.6%	40.4%	38.9%
Guarantee Fee Income	43.1%	48.5%	52.9%	57.6%
Other Fee Income	1.5%	2.9%	6.7%	3.5%

Source: Fannie Mae and Freddie Mac Investor/Analyst Reports

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mortgage market. However, new product development could be achieved with a much smaller retained mortgage portfolio.

The recent history of Freddie Mac suggests that the former explanation rather than the latter may better explain the growth in its retained mortgage portfolio. Before 1989, the thrift industry held Freddie Mac's stock and Freddie Mac securitized almost all the mortgages it purchased. By all accounts, Freddie Mac succeeded in accomplishing its mission of developing a liquid secondary market. Freddie Mac began to pursue an aggressive strategy of building its retained portfolio after Congress changed its corporate structure in 1989 to one resembling Fannie Mae's.

3. The Profitability of Fannie Mae and Freddie Mac

The special benefits of GSE status outlined earlier in this chapter have not only aided Fannie Mae and Freddie Mac in fulfilling their mission of developing a secondary market, but also helped them dominate certain sectors of the mortgage market, contributing to their profitability. Table II.4 compares the after-tax returns on equity for Fannie Mae, Freddie Mac, other financial firms, and the market return as measured by the S&P 500.[18] By this measure, Fannie Mae and Freddie Mac have outperformed much of the market. The comparison suggests that, if other market participants are earning normal profits, Fannie Mae and Freddie Mac are earning above-normal (i.e., economic) profits.[19] Hermalin and Jaffee (1996, pp. 250-253) discuss other measures of economic performance that support the conclusion that Fannie Mae and Freddie Mac earn above-normal market returns. One explanation for such added profits is the cumulative effect of the subsidies the enterprises receive from their government sponsorship. Another explanation is the efficiency of the two enterprises, perhaps aided by economies of scale in their operations.

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[18] It should be noted that the average return on equity for the S&P 500 in Table II.4 is pre-tax and the other measures are after-tax. Thus, if the S&P 500 measure were measured on an after-tax basis, the performance of Fannie Mae and Freddie Mac relative to the market would be even better.

[19] Higher returns to equity do not necessarily imply excess or economic profits if the business risks are greater. However, given that Fannie Mae and Freddie Mac have had relatively stable returns on equity and consistently lower credit losses than other mortgage lenders, and that their mortgage-backed securities and debt securities receive preferential regulatory treatment, it would seem implausible that the return on equity differentials from Table II.4 could be explained by risk.

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Fannie Mae and Freddie Mac perform a valuable function in our nation's housing markets at no explicit budgetary cost to the taxpayers. The government benefits granted to the GSEs do, however, have a real, uncompensated opportunity cost. A baseline estimate suggests that these benefits amounted to almost $6 billion last year. Based on estimates that the GSEs lower mortgage interest rates on conforming, conventional fixed-rate mortgages by 20 to 40 basis points, the GSEs provided benefits to home buyers of $2.6 billion to $5.1 billion. A midpoint (baseline) estimate of the benefits provided to home buyers is about $4 billion. While no point estimate can avoid uncertainty in measuring governmental benefits received and public benefits conferred, estimates such as these convey a general order of magnitude for considering the value of the subsidies involved.

Despite constraining their business activities, GSE status has helped make Fannie Mae and Freddie Mac large and profitable. Together, at the end of 1995, their retained portfolio and outstanding mortgage-backed securities exceeded $1.3 trillion, which was 2.7 times more than the entire OTS-regulated thrift industry's holdings of mortgages and mortgage-backed securities. A comparison of the GSEs' profitability to other firms suggests that GSE benefits enabled Fannie Mae's and Freddie Mac's shareholders to earn increased profits.

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CHAPTER III

THE GSES' PUBLIC PURPOSE

Traditionally, the government has established GSEs when it perceives the need to correct a specific market failure. For example, Congress created the Farm Credit System, a cooperative lending system, in 1916 to help make credit more available for farmers. Similarly, Fannie Mae was created in 1938 to help establish a secondary market for the new federally guaranteed home mortgage loans and to reinvigorate a housing finance market that the Great Depression had brought to the brink of collapse. However, both capital markets and financial institutions have changed dramatically since that time, making it appropriate for Congress to periodically evaluate whether and on what basis government sponsorship remains justified.

In this chapter, we consider two ways in which Fannie Mae and Freddie Mac advance public policy. The first is by participating in the secondary market for residential mortgages, the purpose for which Congress originally established them. The second is by carrying out the series of affordable housing initiatives directed by Congress in 1992. In each case, we compare the efforts of Fannie Mae and Freddie Mac with those of private financial institutions.

A. THE CURRENT STRUCTURE OF THE HOUSING FINANCE MARKET

Before we can assess the private market characteristics that may or may not make continued government sponsorship desirable, we need to review the current characteristics of the mortgage market.

We focus our research here and in the rest of the chapter on the single-family mortgage market because that is where Fannie Mae and Freddie Mac are most active. In 1994, the two GSEs purchased approximately 57 percent of single-family conventional conforming mortgages, compared with only 14 percent of multifamily originations.[1] We recognize, however, that multifamily loans represent a relatively large share of the GSEs' affordable housing loans, which are described in more detail in Section B.[2]

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[1] Of the two GSEs, Fannie Mae is much more active in the multifamily market. Freddie Mac left the multifamily market in the early 1990s because of sustained losses, but has recently re-entered the market.

[2] HUD (1996-C) also comments on the limited role Fannie Mae and Freddie Mac currently play in financing multifamily housing. In addition, Wachter et. al. (1996, p. 366) conclude that concerns about multifamily finance should not be determinative in evaluating the merits of ending the two GSEs' government sponsorship.

Government involvement has helped create some clear dividing lines in today's mortgage market. Table III.1 shows the dollar value of single-family mortgage originations in 1994 for both conforming and nonconforming loans. The table also divides the conforming mortgage market into four segments: (1) the FHA/VA market (with the vast majority of these loans guaranteed by Ginnie Mae); (2) Fannie Mae purchases; (3) Freddie Mac purchases; and (4) loans not sold in the government-sponsored secondary market.

Table III.1: Distribution of Single-Family Mortgage Loan Originations, 1994
(Dollars in billions)

	Volume	Share
Conforming Loans[1]	$643.6	84%
FHA/VA	$143.1	19%
Fannie Mae Purchases	$162.5	21%
Freddie Mac Purchases	$123.4	16%
Loans not Sold in the Government Sponsored Secondary Market[2]	$214.6	28%
Non-Conforming Loans[3]	$125.1	16%
Total	$768.7	100%

Source: HUD (1996-D) and *Mortgage Market Statistical Annual for 1995*.

[1] Conforming loans are defined as loans below the conforming loan limit of $203,150 in 1994.
[2] Conforming loans not sold in the government sponsored secondary market include adjustable rate mortgages, affordable housing mortgages, and B-C credit mortgages.
[3] The estimate for originations of non-conforming loans is obtained from *Inside Mortgage Finance*, assuming that non-conforming loans account for 20 percent of the conventional (non-FHA/VA) market. HUD (1995-B) reports a similar estimate of 19 percent for the share of non-conforming loans in the conventional market.

The Fannie Mae/Freddie Mac portion of the conforming loan market is commonly referred to as the "A" credit market. Conventional mortgages that do not meet the two GSEs' underwriting standards include certain affordable housing loans and the small but growing portion of the conventional mortgage market made up of "B" and "C" credit loans--loans made to borrowers with credit history problems.

Loans not sold into the government-sponsored secondary market may be held in portfolio by financial institutions, securitized by private-sector secondary-market companies, or held by individuals or other investors. Financial institutions' portfolio holdings also include adjustable rate mortgages and mortgages that do not meet the two GSEs' underwriting standards.

B. System-Wide Imperfections in the Housing Finance Market

The financial system generally, and the housing finance system in particular, have undergone enormous change since the creation of Fannie Mae and Freddie Mac. Today's housing finance market does not suffer from the problems that prevailed thirty years ago.

Regulatory and statutory factors that contributed to inefficiency in this market are no longer an issue. In the early 1980s, the federal government phased out Regulation Q and permitted depository institutions to offer adjustable rate mortgages, which addressed the fundamental problem of funding long-term assets with short-term liabilities. In 1994, Congress repealed restrictions on interstate banking and branching that had long inhibited geographic diversification.

Mortgage securitization, which began with Ginnie Mae's creation of the first mortgage-backed security, has also made the mortgage market more liquid and linked it to the capital markets. Ginnie Mae, Fannie Mae, and Freddie Mac have each contributed to the growth of mortgage securitization. Fully private institutions have successfully replicated these efforts. Other segments of the mortgage market and the asset-backed security market demonstrate the ability of today's capital markets and private financial institutions to maintain liquid secondary markets without government support. In addition, the sheer size of the mortgage market, together with the participation of large national and regional firms, gives the market substantial stability.

1. The Capability of the Private Sector Secondary Market

One way to assess the private sector's ability to perform the secondary market function currently undertaken by Fannie Mae and Freddie Mac is to look at the development of other secondary mortgage markets and at overall trends in asset securitization. This helps provide a sense of the extent to which other financial markets have developed and the private sector's capacity to sustain a secondary market.

Today a wide array of financial assets -- from credit card receivables to aircraft leases -- are securitized without GSE or other government support. Financial institutions -- such as commercial banks, investment banks, private mortgage insurers, mortgage banks, and finance companies -- have worked together in developing these markets, which have grown dramatically over the past decade. These secondary markets share at least two common characteristics. First, somewhat uniform underwriting standards are necessary for rapid market development, since individual assets (i.e., loans) must be combined into one security. Second, credit rating agencies must be able to evaluate the credit risk of the pool of assets underlying the publicly issued securities.

Secondary markets for jumbo/non-conforming and B-C (lower credit quality) mortgages are well developed. Table III.2 compares the securitization rates in the non-conforming market and the conventional, conforming market.[3] These two segments of the conventional secondary mortgage market have very different market structures. The conventional, conforming secondary market for A-credit mortgages, consisting of Fannie Mae and Freddie Mac, is what economists call a duopoly.[4] By contrast, during 1994 the jumbo/non-conforming market had 37 active corporate participants, 16 of which issued over $1 billion of private-label mortgage-backed securities. The three largest companies were GE Capital Mortgage Services ($10.5 billion issued), Prudential Home MSCI ($7.2 billion issued), and Countrywide/CWMBS ($5 billion issued).[5]

The annual securitization rates in Table III.2 (calculated by dividing the mortgage-backed securities issued by the estimated dollar value of mortgages originated in each market) provide an estimate of how much of the business volume the secondary market securitizes.

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[3] The jumbo/non-conforming market consists primarily of loans above the conforming loan limit but the available data may include a small proportion of loans below the conforming loan limit that do not meet the underwriting standards of Fannie Mae and Freddie Mac.

[4] See Hermalin and Jaffee (1996) for a technical description of how Fannie Mae and Freddie Mac constitute a duopoly in their market and the characteristics of various types of duopoly market structures.

[5] Complete historical statistics on the private label mortgage-backed securities market can be found in the *Mortgage Market Statistical Annual for 1995*.

Table III.2: Comparison of Mortgage-Backed Securities Issued and Securitization Rates for Conforming and Jumbo Mortgages[1]
(Dollars in billions)

	Non-FHA/VA Conforming Loans		Jumbo/Non-Conforming Loans[2]	
Year	MBS Issuance[3]	Securitization Rate	MBS Issuance[3]	Securitization Rate
1989	$142.6	47.2%	$14.2	15.7%
1990	$170.5	57.6%	$24.4	26.6%
1991	$205.4	53.0%	$39.8	35.4%
1992	$372.4	58.2%	$74.4	41.6%
1993	$430.2	62.6%	$97.3	48.2%
1994	$247.7	51.9%	$62.9	46.3%

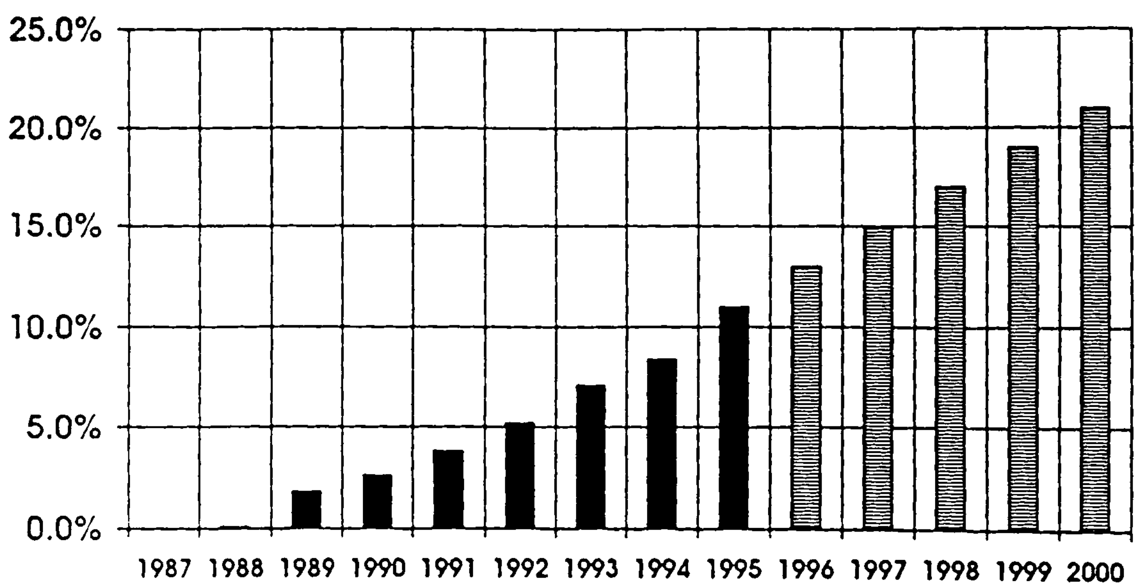
Source: *Mortgage Market Statistical Annual for 1995* (pp. 161-62).

[1] Conventional (non FHA/VA) conforming originations and jumbo/non-conforming originations are estimated by Inside Mortgage Finance. The starting point is data from HUD on the dollar value of total originations, from which FHA/VA origination dollar volume is subtracted to obtain conventional originations. A 20 percent rule is applied to the dollar volume of conventional originations to calculate the dollar share of the jumbo/non-conforming market. This estimate was based on a 1990 National Association of Realtors Survey and has recently received support from HMDA data. HUD (1995-B) reports a similar estimate of 19 percent for the dollar share of non-conforming loans in conventional market originations.
[2] The jumbo/non-conforming private label issues of mortgage-backed securities include some conforming loans that do not meet the underwriting standards of Fannie Mae and Freddie Mac. Since this is a small portion of the market the 20 percent estimate for originations would not be changed substantially and the same general trend pattern would be evident.
[3] Virtually all securitized conforming loans were securitized by the GSEs. Securitization rates do not include mortgages sold in the secondary market to the GSEs or another entity that were not pooled and resold as mortgage-backed securities.

The securitization rate for jumbo/non-conforming mortgages increased from approximately 15 percent of originations in 1989 to almost 50 percent by 1994. By contrast, the securitization rate for non-FHA/VA conforming loans varied between 47 percent and 62 percent during this period. The rapid growth of secondary market activity in the jumbo/non-conforming market reflects the private sector's growing ability to operate a liquid secondary market. That such growth occurred while home prices were weak in the regions with the largest concentration of jumbo loans -- the Northeast and California -- suggests that the private secondary market can operate despite difficult economic circumstances.

Primary lenders searching for profitable market opportunities have increased originations of B-C loans made to higher risk borrowers -- most of whom have a history of significant credit problems -- spurring the development of a secondary market for these loans. Unlike jumbo mortgages, which Fannie Mae and Freddie Mac cannot legally purchase, B-C loans stretch underwriting criteria beyond the limits currently acceptable to Fannie Mae and Freddie Mac. (The GSEs' charters limit them to purchasing investment grade loans.) Figure III.1 presents estimates for securitization rates in the B-C market and projections through the year 2000. The B-C secondary market has grown from virtually nothing in 1988 to approximately 10 percent to 15 percent of B-C originations in 1995.[6]

Figure III.1: Share of Total Non-Conforming and B-C Credit Closed-End (Fixed Amortization Schedule) Mortgage Originations Securitized



Source: Historical data (1989-1995) are from Asset Sales Report (New York, New York). Projections from 1996 to 2000 were done by David Olson Research (Columbia, Maryland).

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[6] Estimates of the securitization rate in the B-C credit market may vary by what is included in the B-C origination pool. *The Mortgage Market Statistical Annual for 1995* (p.350) reports a securitization rate of 14.9 percent in 1994.

Surveys by America's Community Bankers have also documented increased activity in the jumbo and B-C credit markets. Private secondary market organizations accounted for approximately 32 percent of the dollar volume of secondary market loan sales by thrifts in a 1994-95 survey, up from 28 percent in the 1993-94 survey and 17 percent in 1992-93. In 1994-95, private conduits bought 11 percent of the dollar volume of thrifts' originations sold in the secondary market, surpassing Freddie Mac (at about 10 percent), for the first time.

As indicated earlier, the private sector has recently also developed secondary markets in other financial instruments. Table III.3 compares the percentages of outstanding debt in the home mortgage market with that in other securitized financial markets. (A better measure would be the securitization rate as presented in Table III.2, but data on originations in some of these asset categories are not available.[7]) While the percentages of outstanding debt that have been securitized in other financial markets remain below that in the home mortgage market, they have grown rapidly since 1989. These other markets are still relatively young, and standardization of the underlying assets may never reach the degree of uniformity of certain other segments of the home mortgage market.

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[7] The securitization rate is a flow variable measuring the amount of originations that are transformed into another security in a given year. The percentage of outstanding debt that has been securitized measures the outstanding stock of asset-backed securities relative to outstanding stock of debt at a given time.

Table III.3: Share of Home Mortgage, Revolving Credit, Automobile, and Commercial Real Estate Debt Securitized
(Percentage of total debt outstanding)

	1989	1990	1991	1992	1993	1994	1995[2]
Home Mortgage Debt (1-4 Family)[1]	36.8	39.9	43.7	46.6	47.5	48.7	48.4
Revolving Credit	11.2	19.1	24.5	27.6	26.5	26.8	30.5
Automobile Credit	6.3	8.6	11.0	13.1	14.0	11.0	11.0
Commercial Real Estate	0.6	0.7	0.9	2.1	3.6	5.2	5.3

Source: Federal Reserve Board (1995-A), *Federal Reserve Bulletin* (various issues, Table 1.55)

[1] The calculation of outstanding MBS for this category is obtained by adding Flow of Funds outstanding levels for federally related home mortgage pools (Ginnie Mae, Fannie Mae, and Freddie Mac) to the private label issuance of MBS recorded in the Flow of Funds.
[2] Shares for 1995 are calculated through the end of the second quarter.

Securitization of commercial real estate loans, small business loans, and distressed assets has also become more common. Table III.3 shows that the percentage of outstanding securitized commercial real estate debt has increased from under 1 percent in 1989 to over 5 percent in 1995. Small business asset-backed securities are also being issued, although they still account for less than 1 percent of outstanding small business debt.[8] According to Fabozzi and Modigliani (1992, p. 312), asset-backed securities based on boat loans, recreational vehicle loans, computer leases, senior bank loans, and accounts receivable have also appeared in the market.

These rapidly growing secondary markets -- operating without government sponsorship -- are more competitive and involve loans with more diverse credit quality and borrower characteristics than the A-credit mortgages Fannie Mae and Freddie Mac purchase. Numerous firms of varying size vie for profitable business, with large market leaders like GE Capital, Countrywide, and Citicorp assuming prominent roles in the financial system and mortgage markets. The success of these markets suggests that Fannie Mae, Freddie Mac, and other firms may be able to adequately maintain liquid, regionally responsive secondary mortgage markets without government sponsorship.

[8] For details on the small business market, see Feldman (1995).

Given the characteristics of secondary markets operating without government sponsorship, what explains the lack of direct competition to Fannie Mae and Freddie Mac in the conventional, conforming secondary market? One possible explanation is that the competitive advantage of GSE status, described in Chapter II, inhibits competitors from entering this market: the premium investors are willing to pay for GSE securities and the cost advantages of government sponsorship may enable the GSEs to price below the level at which potential competitors find it profitable to enter the market.

Another possible explanation for the lack of direct competition to Fannie Mae and Freddie Mac involves possible economies of scale in their business operations, and an attendant cost structure low enough so that other firms do not find it profitable to enter the market. Economies of scale exist where average total costs (per unit) decline as output increases. But such economies seem an unlikely explanation here because other segments of the mortgage market do not have a highly concentrated market structure.

If, however, economies of scale did explain the lack of direct competition to Fannie Mae and Freddie Mac, ending government sponsorship need not affect their market share or mortgage rates. Even without such sponsorship, the two firms' favorable cost structure would probably enable them to compete effectively in the secondary market. Any economic benefits resulting from economies of scale that accrue to certain borrowers would continue, and borrowers in other segments of the market could also benefit if restrictions on other activities were lifted.[9]

2. Withstanding Tight Credit Markets

Another concern warranting attention is whether a secondary market without GSE support would excessively retreat from funding mortgages when credit is tight.[10] The overall size of the mortgage market, the number and size of national and regional participants in various aspects of that market, and the technical capability to link that market with the capital markets should mitigate this concern.

As illustrated by Table III.4, home mortgage debt outstanding falls only slightly short of outstanding publicly held U.S. Treasury securities. In 1995, the mortgage-backed securities market was: just under 50 percent of the size of the U.S. Treasury security market; almost 65 percent of the size of the private bond market; and considerably larger than the tax-exempt and open market (commercial) paper markets. These other large

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[9] Any resulting market structure that has a small number of firms, even if this is the result of economies of scale, should be evaluated for possible anti-competitive issues.

[10] Some studies have questioned whether the GSEs have been able to exert a significant counter-cyclical impact. For example, Kaufman (1988) provides evidence that the counter-cyclical impact provided by Fannie Mae diminished in the eighties as a result of changes in the financial system and their operating procedures.

financial markets suggest that government sponsorship is not necessary to promote active, liquid markets.

Table III.4: Size of the Home Mortgage Market Relative to Other Financial Markets
(Billions of dollars of debt outstanding, year end)

	1989	1990	1991	1992	1993	1994	1995[2]
U.S. Treasury Securities (publicly held)	2227.0	2465.8	2757.8	3061.6	3309.9	3465.6	3556.7
Total Home Mortgage Debt (1-4 Family)	2407.8	2616.3	2780.0	2959.6	3149.6	3344.8	3431.8
Corporate and Foreign Bonds	1581.3	1695.8	1856.3	2026.4	2301.5	2438.4	2568.9
Securitized Home Mortgage Debt[1]	885.6	1043.7	1214.4	1380.2	1497.2	1628.9	1660.1
Tax Exempt Securities and Loans	991.2	1039.9	1108.6	1139.7	1215.2	1185.2	1164.6
Open Market Paper	579.2	609.9	565.9	579.0	580.0	623.5	673.8

Source: Federal Reserve Board. (1995-A).

[1] Securitized home mortgage debt is a subset of total mortgage debt. The calculation of securitized home mortgage debt (1-4 family) is obtained by adding Flow of Funds outstanding levels for federally related home mortgage pools (Ginnie Mae, Fannie Mae and Freddie Mac) to the private label issuance of MBS recorded in the Flow of Funds.
[2] Debt outstanding for 1995 is through the end of the second quarter.

The mortgage market derives stability not only from its large size but from the many national and regional mortgage originators, servicers, and insurers operating over broad geographical regions and devoting significant capital to market development. In 1994, eight companies exceeded $10 billion in origination volume, ten companies exceeded $50 billion in servicing volume, and six companies exceeded $10 billion in mortgage insurance volume.[11]

[11] The top eight mortgage originators in 1994 were Countrywide, Norwest, Prudential, Chase Manhattan, Chemical, Fleet, GE Capital, and GMAC. The top ten mortgage servicers in 1994 were Countrywide, GE Capital, Fleet, Prudential, Norwest, Chase Manhattan, GMAC, Chemical, Bank of America, and Home Savings of America. The top six private mortgage insurers in 1994 were GE Capital, Mortgage Guaranty Insurance Corporation, PMI Mortgage Insurance Company, United Guaranty Corporation, Republic Mortgage Insurance Company, and Commonwealth Mortgage

Having made the enormous commitments -- of capital, workforce development, and technological resources -- needed to compete in the residential mortgage market, firms with a primary business in that market are unlikely to abandon it when faced with cyclical downturns. While such cyclical fluctuations may deter marginal firms, those invested in the market for the long-term will seek to preserve or even build their market share.

3. Weathering Regional Economic Downturns

Another concern for policymakers is the mortgage market's ability to weather regional fluctuations. Fannie Mae and Freddie Mac often use the phrase "being in all markets at all times" to refer to their capability to provide liquidity to regional housing finance markets during regional economic downturns. Although the GSEs' charters do not establish any specific requirement to operate in all markets at all times, the charters do suggest a responsibility to maintain a nationwide presence.

In the past, technological and information constraints, limits on interstate banking and branching by insured depository institutions, and other aspects of our financial system constrained mortgage credit flows across regions. Today, however, these problems have faded as regulatory and market changes have greatly enhanced credit flows. Investors, originators, and private mortgage insurance companies can now diversify regional risk in the secondary market.

By statute, OFHEO must prescribe a stress test that increases the amount of capital required for a given book of business as economic conditions worsen.[12] If the GSEs continue to operate at or near their regulatory minimum capital requirements, their ability to maintain or expand purchasing activity during a general or regional economic downturn could be limited.[13]

Similarly, while the GSEs may continually offer to purchase mortgages, even from distressed regions, their pricing may reflect risk differentials. Each GSE offers a "posted price" at which it will purchase any qualifying mortgage. However, the GSEs make the bulk

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Assurance Company. *The Mortgage Market Statistical Annual for 1995* contains complete details on market share rankings.

[12] The OFHEO stress test, by law, initially assumes that the GSEs take on no new business once the "stress period" begins [P.L. 102-550, Sec. 1361(a)(3)(A)]. Thus, it does not assume that the GSEs will continue to provide liquidity during a period of severe market stress. On the contrary, it assumes they will do no new business.

[13] "[OFHEO's] risk-based capital standard, which will be based on a stress test approach, will automatically respond to changes in either of the Enterprises' future risk profile. For example, if house prices fall, causing homeowners to have less equity in their properties and increasing the probability of their defaulting in the future, this will be immediately reflected in higher capital requirements." (OFHEO, 1996-B, p.4.)

of their mortgage purchases using negotiated prices, which are generally less than the posted price. Negotiated prices would presumably be adjusted to reflect changing risk characteristics of the underlying loans. Furthermore, any mortgage purchases made by a GSE in a distressed region or during an economic downturn must still satisfy the GSEs' underwriting standards. For example, mortgages with loan-to-value ratios exceeding 80 percent must have private mortgage insurance.

C. Affordable Housing Needs

How does the ability of Fannie Mae and Freddie Mac to finance affordable housing compare to that of other private market participants and existing government agencies? In the 1992 Act, Congress expanded the two GSEs' public purpose to include explicit requirements that the secondary mortgage market adequately serve underserved segments of the mortgage market, making affordable housing an additional topic for consideration when evaluating GSE status. The government has encouraged numerous initiatives to promote the flow of credit to underserved borrowers and communities and, as set forth in HUD's recent report, *The National Homeownership Strategy: Partners in the American Dream* (1995-A), an important government role in this mission still exists. Comparing the GSEs' achievements against certain affordable housing goals and the activities of other mortgage market participants provides insight into the value of GSE status to the public purpose of affordable housing.

1. The GSEs' Achievement of HUD's Affordable Housing Goals

One measure of the GSEs' contributions to affordable housing is their performance under affordable housing goals established by HUD.[14] Charged by Congress with ensuring that Fannie Mae and Freddie Mac meet their affordable housing requirements and the unmet needs of credit markets and underserved borrowers, HUD imposes housing goals based on the percentage of loans purchased from various types of targeted borrowers and communities.[15]

This housing goal framework can help expand the GSEs' participation in financing affordable housing and meeting other unmet credit needs. HUD has implemented the goals consistently and fairly. The goals have the following advantageous characteristics:

- The goals have a solid analytical and policy foundation.

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[14] In the following discussion, affordable housing goals refer to all three housing goals even though the old central city goal and the new underserved area goal are not based on borrower income.

[15] HUD was the primary regulator of Fannie Mae from 1968, and of Freddie Mac from 1989, until 1992, when Congress established OFHEO. HUD first issued affordable housing regulations for Fannie Mae in 1978.

- These broad-based performance goals are easily understood, provide appropriate flexibility, and do not seek to fine-tune the GSEs' activities or otherwise interfere with their daily operations.

- The goals can be used to target, to an important public purpose, the activities of the two dominant players in the conventional mortgage market.

- HUD set the goals to cover a four-year period, at levels attainable under varying economic conditions, including higher interest rates and less favorable market conditions than those prevailing in 1993-95.

- The goals represent reasonable benchmarks that the GSEs may exceed. They do not ratchet up or down based on annual changes in the GSEs' performance.

Table III.5 provides an overview of the goals and the GSEs' recent performance under the goals. In 1995, Fannie Mae satisfied all three interim housing goals, and Freddie Mac satisfied all but the central city goal. Fannie Mae's 1995 performance also exceeded all three of the goals that became effective in 1996, even at the fully phased-in levels that will apply in 1997 and 1998. Freddie Mac's 1995 performance would have satisfied two of the final 1996 goals, falling short (by less than a percentage point) only on the low- and moderate-income goal. The proportion of overall GSE activity meeting affordable housing goals has increased over the past few years, possibly due to the HUD goals and to CRA-driven increases in affordable housing lending generally and as a share of all mortgages originated.

Table III.5: Overview of the GSEs' Affordable Housing Goals and Performance[1]
(in percentage points)

Goal[2]	1993	1994	1995	1996 Goals	1997-1999 Goals	HUD's Market Size Estimate
Low- and Moderate Income						
Fannie Mae	34.1	45.1	42.8	40.0	42.0	48-52
Freddie Mac	30.0	38.0	39.6			
Geographic						
Fannie Mae	22.9	29.0	31.2	21.0	24.0	25-28
Freddie Mac	21.3	24.2	25.2			
Special Affordable						
Fannie Mae	10.0	16.7	15.8	12.0	14.0	20-23
Freddie Mac	7.2	11.4	13.2			

Source: HUD (1996-A, Table 3-2)

[1] Percentages of dwelling units in properties whose mortgages were purchased by the GSEs that qualified for each goal in 1992-1995, and goals for 1996-1999. Performance has been measured based on the structure of the goals for 1996-1999.
[2] Abbreviated definitions of the goals:

Low-Mod:	Households with incomes less than or equal to area median income (AMI).
Geographic:	Metro census tracts with median income less than or equal to 120 percent of AMI. County definitions are used in non-metropolitan areas.
Special Affordable:	Households with incomes less than or equal to 60 percent of AMI or less than or equal to 80 percent of AMI and located in low-income areas.

In evaluating this progress, it is important to consider the characteristics of the loans that count toward the goals.[16] For the most part, Fannie Mae and Freddie Mac met the central city housing goal by purchasing loans made to borrowers whose incomes exceeded the median MSA income. In 1994 (1995), for Fannie Mae, 55 percent (51 percent) of the loans purchased that counted toward satisfying the interim central city goal had borrower

[16] The following information on the characteristics of Fannie Mae's and Freddie Mac's loan purchases that satisfied the interim housing goals may be found in Fannie Mae (1996-A, 1995) and Freddie Mac (1996-A, 1995).

income greater than 100 percent of the median MSA income, and 42 percent (38 percent) had borrower income greater than 120 percent of the median MSA income. For Freddie Mac, 63 percent (59 percent) of the loans purchased that counted toward satisfying the interim central city goal in 1994 (1995) had borrower income greater than 100 percent, and 49 percent (46 percent) had borrower income greater than 120 percent of the median MSA income.

The majority of loans that counted toward meeting the interim affordable housing goals had loan-to-value (LTV) ratios less than or equal to 80 percent -- that is, mortgages made to borrowers who had made downpayments of at least 20 percent. In 1994, for Fannie Mae (Freddie Mac), loans with LTV ratios less than or equal to 80 percent made up 78 percent (79 percent) of loan purchases that counted toward meeting the low-moderate income goal, 71 percent (75 percent) that counted toward meeting the central city goal, and 73 percent (73 percent) that counted toward meeting the special affordable goal. In 1995, the corresponding percentages for Fannie Mae decreased to approximately 64 percent, while Freddie Mac's percentages remained about the same. The predominance of low LTV loans -- which have less credit risk than high LTV loans -- suggests that the private sector could finance the majority of Fannie Mae's and Freddie Mac's affordable housing business.

Beyond just meeting the HUD goals, the two GSEs have participated actively in expanding opportunities for affordable housing and in developing products and services to help meet the needs of low-income borrowers and communities. Fannie Mae, in particular, has made a clear commitment to provide educational materials and technical assistance to support lenders in affordable housing. The GSEs have also increased their underwriting flexibility, improved homebuyer education programs, and entered into partnerships with local governments and non-profit organizations to provide additional affordable housing assistance. These secondary market developments may also reflect innovations by private mortgage insurance companies and other mortgage market participants.

The GSE housing goals, combined with recent changes in underwriting standards and new mortgage products for affordable housing, may lead the two GSEs to further increase their affordable housing activities and serve a broader proportion of the affordable housing market than they have in the past. The GSEs could also become more active in financing multifamily mortgages, and in directly assisting homebuyers through affordable housing programs. We cannot project how the GSEs' contributions to affordable housing may change in the future since the GSEs already meet almost all of the housing goals. The GSEs' contribution to affordable housing should receive close examination as Congress considers the costs and benefits of their government sponsorship.

Finally, another aspect of the 1992 legislation that also deserves examination in any evaluation of such sponsorship is the requirement that HUD oversee the GSEs' fair lending practices. While the GSEs would remain subject to the Fair Housing Act even without such sponsorship, the 1992 legislation authorized HUD to prescribe additional safeguards against discriminatory lending practices. For example, HUD may review and comment on the

GSEs' underwriting and appraisal guidelines, analyze the GSEs' business practices to ascertain whether those practices discriminate, and work with and through the GSEs to identify and remediate discriminatory practices by lenders.

2. Affordable Housing Achievements: The GSEs Relative to the Market

HUD's housing goals provide one measure of the GSEs' affordable housing performance. The relative share of the GSEs' mortgages that fund affordable housing compared to other mortgage market participants would be another way to assess the GSEs' role in mortgage lending for affordable housing. We evaluated the share of each secondary market participant's loan purchases that can be classified as affordable housing loans, and the distribution of affordable housing loans among all mortgage market participants.

As described in the last section, regulators generally promote affordable housing finance by targeting borrower groups considered underserved by the market based on household income, race, location, or some combination of these characteristics. Income targets generally involve some comparison of borrower income to median MSA income.[17] Geographic targets focus on the racial and income characteristics of various census tracts or on their classification as central city, urban, suburban, or rural. The remaining tables in this section use various categories of targeted borrowers that fit the typical definitions of underserved.

a. Share of Business from Targeted Borrower Groups

Table III.6 summarizes each secondary mortgage market participant's loan purchases from selected targeted borrower groups. The percentages in Table III.6 are averages of yearly shares.

[17] Fannie Mae and Freddie Mac can satisfy the low- to moderate-income housing goal by purchasing loans with borrower income less than 100 percent of median MSA income. By contrast, for purposes of the Community Reinvestment Act (CRA) regulations recently established for FDIC-insured depository institutions, low- or moderate-income borrowers must have income that is less than 80 percent of median MSA income.

Table III.6: Percent of Secondary Market Participants' Loan Purchases From Targeted Borrower Groups
(1991-94 averages of yearly shares, in percentage points)

	<100% of Median MSA Income	<80% of Median MSA Income	Black	Hispanic	Census Tracts >80% Minority	Low/Mod Income Census Tracts[1]
Ginnie Mae[2]	54.1	33.5	8.8	7.7	3.6	14.1
Farmers Home Admin.	48.7	31.9	4.2	4.9	3.2	14.1
Commercial Banks	38.6	23.9	6.4	4.6	3.4	10.8
Other Purchasers[3]	36.3	22.6	6.0	5.3	3.5	11.0
Life Insurance Companies	35.4	23.1	8.1	5.0	2.3	9.1
Savings and Loans	33.8	19.1	4.0	3.3	2.0	9.3
Fannie Mae	29.7	13.4	2.7	3.8	2.3	7.9
Affiliates[4]	29.4	16.4	4.1	2.9	1.9	8.3
Freddie Mac	29.2	13.1	2.1	3.9	2.2	8.0

Source: HMDA Data summarized in Federal Reserve Board (1995-B, Table 4.41, p. A74), Canner and Passmore (1995-A), Canner, Passmore and Smith (1994), and Canner and Smith (1992).

[1] Low- or moderate-income census tracts are those in which median family income is less than 80 percent of the median family income of the MSA as a whole.
[2] Ginnie Mae does not actually securitize or purchase mortgages; it guarantees the timely payment of principal and interest on mortgage-backed securities consisting of FHA and VA mortgages.
[3] Other purchasers include investment banks, private companies that securitize mortgages, and pension funds.
[4] Affiliates include companies affiliated with the institution reporting the loan.

Table III.6 illustrates Ginnie Mae's clear lead in relative purchases of mortgages made to targeted borrower categories. This lead is not surprising given that FHA/VA loans -- targeted at lower-income borrowers -- represent the sole collateral for Ginnie Mae-guaranteed mortgage-backed securities.[18] Other secondary market participants generally make higher proportions of their loan purchases from targeted borrower groups than do Fannie Mae and Freddie Mac. For example, loans from borrowers earning less than 80 percent of median MSA income account for 33.5 percent of Ginnie Mae volume, but only 13.4 percent for Fannie Mae and 13.1 percent for Freddie Mac -- smaller percentages than those of each of the other secondary market participants. While analysis based on raw HMDA data has various limitations, it still provides a broad overview of relative market shares.[19]

An examination of lending activity broken down by credit risk also suggests that Fannie Mae and Freddie Mac do not provide a disproportionate share of credit to targeted borrower groups. Institutions that take on credit risk (i.e., the risk that a borrower will fail to make agreed-on payments) play a critical role in the mortgage lending process. When a mortgage bank originates an FHA-guaranteed loan, the FHA holds the credit risk; when a depository institution originates a conventional loan and holds the loan in portfolio, it holds the credit risk; when Fannie Mae purchases a conventional loan, it holds the credit risk.

A study of 1994 lending activity by Canner and Passmore (1995-A) identifies the entities bearing the credit risk in the overall mortgage market and in various subsections of the market.[20] The analysis in that study makes adjustments to incorporate private mortgage insurance companies. In keeping with their charters, Fannie Mae and Freddie Mac typically require such insurance on any mortgage with a loan-to-value ratio above 80 percent. Depository institutions also hold and purchase loans with private mortgage insurance. Thus, for loans with private mortgage insurance, the insurance company holds some of the risk, and other entities hold the rest.

Canner and Passmore (1995-A) split the mortgage market by loan size and borrower characteristic to estimate who holds the credit risk on mortgages made to targeted borrower groups. Table III.7 summarizes some of the results involving the relative share of targeted borrower loans in the mortgage-credit-risk portfolios of mortgage-market participants. The mortgage-credit-risk portfolio consists of all the mortgages for which a risk holder bears the

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[18] As noted previously, Ginnie Mae does not actually securitize or purchase mortgages but guarantees the timely payment of principal and interest on mortgage-backed securities made up of FHA and VA mortgages. In what follows in this study, the term securitize or purchase in relation to Ginnie Mae will refer to this guarantee function.

[19] Raw HMDA data as presented in Table III.6 includes home purchase, refinancing, home improvement, and mobile home loans. The prevalence of these types of loans in a secondary market participant's purchases may affect targeted borrower purchase percentages. HMDA data also include only the initial sale of a mortgage in the secondary market.

[20] Specifically, Canner and Passmore (1995-A) analyze owner-occupied home purchase mortgages originated between January and October of 1994. Canner and Passmore perform various adjustments to address limitations associated with analyzing raw HMDA data.

credit risk. The summary in Table III.7 of loans falling within the FHA single-family loan limit -- mortgages less than $77,197 (ranging up to a maximum of $152,362 in designated high-cost areas) -- includes the vast majority of targeted borrower loans. Table III.7 indicates that 39.8 percent of all FHA-eligible loans originated in 1994 were made to lower-income borrowers, 15.9 percent were made to African-American or Hispanic borrowers, 14.5 percent to lower-income census tract borrowers, and 9.8 percent to minority census tract borrowers. The table also shows that 40.9 percent of the FHA-eligible loans (without private mortgage insurance) held in depository institutions' portfolios were to lower-income borrowers, while 35.5 percent of the FHA-eligible loans (without private mortgage insurance) purchased by Fannie Mae and Freddie Mac were to lower-income borrowers.

Table III.7: Relative Share of Targeted Borrower Loans in the Credit Risk Portfolios of Mortgage Market Participants - 1994 (FHA-eligible loan size category)
(in percentage points)

	Lower Income Borrowers[1]	African Amer. or Hispanic Borrowers	Lower Income Census Tracts[1]	Predominately Minority Census Tracts[1]
All	**39.8**	**15.9**	**14.5**	**9.8**
FHA Insured	45.1	25.7	17.8	13.3
VA Insured	40.3	19.6	14.0	9.1
Depository Inst. Portfolio Holdings[2]	40.9	11.6	15.5	8.8
Loan Purchaser[2]				
Fannie Mae or Freddie Mac	35.5	9.7	10.5	7.7
Depository Inst. not Affiliated with Mortgage Originator	34.9	8.8	10.7	7.1
Other Purchaser[3]	40.7	11.1	13.6	8.4
Affiliate from an Ind. Mortgage Company	42.5	13.5	13.2	9.3
Affiliate from a Depository Inst.	44.0	13.8	16.9	8.1

Source: Canner and Passmore (1995-A, Table 3, p.1000) calculated from 1994 HMDA data.

[1] Canner and Passmore define lower-income borrowers as having less than 80 percent of the median MSA income, lower-income census tracts as having a median family income of less than 80 percent of the MSA median family income, and predominately minority census tracts as having a minority population that is larger than 50 percent of the tract's total population.
[2] The relative shares for depository institution portfolio holdings and loan purchaser categories are for loans without private mortgage insurance. Relative shares for loans with private mortgage insurance are lower for these borrower categories.
[3] The other purchaser category in this table includes investment banks, life insurance companies, pension funds, and other private companies that securitize mortgages.

According to these figures, Fannie Mae and Freddie Mac have a lower relative share of loans to targeted borrower groups than do most of the other mortgage market participants. The relative lower-income market share of Fannie Mae and Freddie Mac (35.5 percent) is also below the overall lower-income market share (39.8 percent) for FHA-eligible loans, a pattern repeated in the other targeted borrower groups shown in Table III.6. Canner and

Passmore (1995-B, p. 1006) suggest that the difference between Fannie Mae and Freddie Mac and depository institutions in performance in targeted areas "may arise because Fannie Mae and Freddie Mac, unlike depositories, generally have no interactions with borrowers and are not located in the neighborhoods where the mortgages are originated; thus they lack the opportunity to look beyond traditional measures of risk." This conclusion is also suggested by the Federal Reserve Board (1993, p.4): "The additional information about the borrowers and neighborhoods gained by being directly involved with borrowers and located in a neighborhood may enable depository institutions to break the statistical links between neighborhood characteristics and loan performance."[21]

b. Share of Overall Market Serving Targeted Borrower Groups

The statistics just described indicate that Fannie Mae and Freddie Mac make a relatively smaller portion of their mortgage purchases from targeted borrowers or locations than do most other secondary market participants. The data also show that the two GSEs incur a relatively smaller amount of credit risk from lending to targeted borrower groups than do other mortgage market participants. Still these data only show that the two GSEs are not market leaders in the share of their business devoted to such targeted borrower groups. The data do not indicate how the GSEs' volume of loans to targeted borrower groups compares to that of other mortgage market participants; it is quite possible to have a high percentage of business in certain communities but an overall low volume of loans.[22] Also, considering only secondary market participants (as in Table III.6) ignores depository institutions that originate and hold mortgages in their own portfolio, which make up a significant portion of the market.

To analyze this issue, Canner and Passmore (1995-A) compare the overall market allocation of the credit risk associated with lending to targeted borrower groups. Since our analysis does not focus on the precise allocation of credit risk to private mortgage insurers, we allocate the portion of the credit risk held by the insurer to the partner entity. This calculation gives a sense of various institutions' direct participation in lending to targeted borrower groups. Table III.8 summarizes the Canner and Passmore results for FHA-eligible loans.

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[21] After doing a similar analysis, HUD (1995-C) concluded that non-GSE portfolio lenders (i.e., banks and thrifts) serve more credit-constrained borrowers than do the GSEs. "The apparent borrower differences ... may be due to the portfolio lenders' greater knowledge of local markets, to the portfolio lenders' flexibility in underwriting borrowers that they know to be good risks based on long-term customer relationships, and to the funding by non-GSE portfolio lenders of certain types of properties -- such as mobile homes -- which the GSE lenders will only fund under more restrictive conditions." (p. 4-3) This conclusion is also consistent with that of the Federal Reserve.

[22] For example in Table III.5 the Farmers Home Administration has a high share of targeted borrowers in its loan purchases but those purchases make up only a small percentage of total purchases from these groups.

Table III.8: Summary of the Overall Allocation of the Credit Risk Associated with Lending to Targeted Borrower Groups - 1994 (FHA-eligible loan size category)
(Percentage of the total number of loans in borrower categories)

	Lower Income Borrowers	Black or Hispanic Borrowers	Lower Income Census Tracts	Predominately Minority Census Tracts
FHA/VA Insured	34.3	47.8	36.3	38.9
Depository Institutions[1]	33.0	25.0	33.9	28.8
Fannie Mae and Freddie Mac[2]	21.1	17.0	18.5	20.4
Other Secondary Market Purchasers[3]	8.1	6.0	7.4	7.0
Independent Mortgage Companies[4]	3.6	4.1	3.8	4.9

Source: Canner and Passmore (1995-A, Table 4, p. 1004)
Note: Columns may not add exactly to 100 percent because of rounding.

[1] The market share for depository institutions is obtained by adding depository institutions' holdings (with and without private mortgage insurance, or PMI), purchases by a bank or savings association not affiliated with a mortgage originator (with and without PMI), and purchases by an affiliate from a depository institution or its subsidiary (with and without PMI).
[2] The market share for Fannie Mae and Freddie Mac is obtained by adding their purchases with and without PMI.
[3] The market share for other secondary market purchasers is obtained by adding their purchases with and without PMI. This category includes investment banks, life insurance companies, pension funds and other private companies that securitize mortgages.
[4] The market share for independent mortgage companies is obtained by adding independent mortgage company holdings (with and without PMI), and purchases by an affiliate from an independent mortgage company (with and without PMI).

In the FHA-eligible loan size category, FHA and VA hold the largest share of credit risk and depository institutions have the second largest share. In fact, FHA, and VA, and depository institutions bear well over 60 percent of the credit risk for FHA-eligible loans to all categories of targeted borrowers. Combined, Fannie Mae and Freddie Mac hold about 20 percent of the credit risk for each targeted group.

Depository institutions' portfolio holdings appear to contribute significantly to affordable housing lending, a conclusion further supported by a 1995 Consumer Bankers Association survey, which was described in Elmendorf and Brough (1995). The survey reports that although 50 percent of the responding institutions sold some of their affordable housing loans into the secondary market, the institutions retained an average of 77 percent in their own portfolios.[23]

In sum, a number of measures indicate that Fannie Mae and Freddie Mac finance a smaller portion of loans to targeted borrowers than do FHA and VA, and insured depository institutions. This result is consistent with HUD (1995-C) data comparing the GSEs' affordable housing activities with FHA and other lenders. Table III.9 shows these comparisons across income, race/ethnicity, and location for home purchase mortgages guaranteed by FHA or acquired by the GSEs in 1993. Because Congress designed FHA specifically to support the affordable housing segment of the market, it is not surprising to find that FHA serves relatively more low-income and other targeted borrowers than do the GSEs, which provide general liquidity to a broad spectrum of the market.

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[23] Affordable housing loans for the purpose of the Consumer Bankers Association survey were defined as loans made through a program designed to increase purchase-money home mortgage lending to minority or low- to moderate-income applicants. The Consumer Bankers Association has conducted its survey, known as the *Affordable Mortgage Program Survey*, annually since 1992.

Table III.9: Distribution of Borrower and Census Tract Characteristics of FHA and GSE Home Purchase Mortgages in Metropolitan Areas, 1993
(in percentage points)

Borrower and Census Tract Characteristics	FHA	GSE	
		All	Eligible-Only
Income of Borrower			
80 % of Median or Below	42.0	18.3	28.0
81-100 % of Median	23.0	15.3	20.9
101-120 % of Median	16.0	15.7	17.6
121-150 % of Median	11.8	19.3	16.6
+150 % of Median	7.2	31.4	16.8
Under Median	65.0	33.6	48.9
Over Median	35.2	66.4	51.0
First-time Homebuyer	66.8	30.7	35.0
Repeat Homebuyer	33.2	69.3	65.0
Race/Ethnicity of Borrower			
White	78.1	87.6	86.9
Black	10.0	2.7	3.0
Hispanic	9.5	4.2	4.8
Asian	2.0	4.3	4.1
Other	0.4	1.2	1.2
*Income of Tract			
80 % of Median or Below	16.1	6.7	8.8
81-100 % of Median	29.7	18.3	22.9
101-120 % of Median	29.9	27.7	30.6
121-150 % of Median	19.0	29.0	26.0
+150 % of Median	5.3	18.3	11.7
*Minority Composition of Tract			
10 % Minority or Less	43.1	57.3	56.4
11-30 % Minority	34.8	30.5	30.1
31-50 % Minority	10.3	6.5	6.8
+50 % Minority	11.8	5.7	6.7
Underserved Areas	27.1	12.7	15.5
Served Areas	72.9	87.3	84.5

Source: *An Analysis of FHA's Single-Family Insurance Program*. (HUD, 1995-C, pp. 4-26).

D. Summary

Over the last 30 years, the secondary mortgage market has developed rapidly, assisted by the federal government's support for Fannie Mae, Freddie Mac, and Ginnie Mae. Both Fannie Mae and Freddie Mac have been instrumental in developing new products that increased the availability of mortgage credit under various economic circumstances.

Since the late 1980s the non-conforming mortgage market and other financial markets have successfully replicated the GSEs' function of linking capital markets to individual credit markets. These non-GSE secondary markets demonstrate private firms' ability to keep secondary markets liquid without government support. In addition, the sheer size of the mortgage market, together with the participation of large national and regional firms, provides considerable stability to the market. These developments suggest that the secondary market for conforming, conventional mortgages could operate efficiently and effectively were Congress to end government sponsorship of Fannie Mae and Freddie Mac. Nevertheless, as explained in the next chapter, a number of important uncertainties remain.

That chapter also considers the uncertainties concerning the GSEs' contributions to affordable housing. While both Fannie Mae and Freddie Mac participate actively in expanding opportunities for affordable housing, other market participants appear to be the leaders in providing credit to targeted borrowers. Despite the best efforts of Fannie Mae and Freddie Mac, the fact that those companies operate in the secondary market for mortgage loans issued under relatively conservative underwriting guidelines may put them at a disadvantage in actively promoting affordable housing loans. They may also lack the advantages that have helped depository institutions succeed in this area: direct participation in primary markets, local knowledge, and greater outreach in low-income communities because of CRA.

Without government sponsorship, the GSEs would have fewer incentives to continue serving various affordable housing markets. In addition, revitalized CRA regulations for FDIC-insured depository institutions that have stimulated affordable housing finance may, over the long run, stimulate more affordable housing activity by the GSEs and other market participants. On the other hand, rescinding the affordable housing goals (or similar obligations) attendant on GSE status would reduce the incentives for Fannie Mae and Freddie Mac to purchase at least some affordable housing loans, particularly those with higher LTV ratios or higher information and transaction costs. It could also limit certain other forms of assistance currently provided. Even if the GSEs lost their government sponsorship and reduced their affordable housing activity, the characteristics of their affordable housing loans suggest that the private sector could readily finance most of these loans. Chapter IV considers this from a broader perspective.

CHAPTER IV

POTENTIAL EFFECTS OF ENDING GOVERNMENT SPONSORSHIP AND OF MAINTAINING THE *STATUS QUO*

Without government sponsorship, Fannie Mae and Freddie Mac would probably continue to compete and prosper in the secondary mortgage market, and that market would probably retain the liquidity and regional stability it now displays. Yet the broader potential effects of ending such sponsorship remain uncertain. Nor can one know exactly how the mortgage market would evolve if such sponsorship continues. What is certain is that U.S. financial markets, and the housing finance market in particular, are undergoing dramatic changes, many of them driven by advances in technology. While such changes can create troubling uncertainties, they should ultimately benefit consumers and the economy. Mindful of such changes, we attempt to evaluate some of the broad economic and social effects of ending or retaining government sponsorship of Fannie Mae and Freddie Mac.

A. Risks of Ending Government Sponsorship

We will consider here how ending government sponsorship could introduce uncertainty into the mortgage market, increase mortgage costs, and reduce affordable housing efforts. Fannie Mae and Freddie Mac have played a central role in developing the efficient, liquid mortgage market we enjoy today. They have developed it so successfully that some have asked whether the market could operate effectively without government sponsorship. The two GSEs, in meetings with Treasury officials, have stated that they could restructure themselves to operate without government sponsorship, but that losing such sponsorship would raise mortgage costs.

1. Effect on the Liquidity and Stability of the Mortgage Market

Despite the strength of the secondary mortgage market, precipitous change in the GSEs' government sponsorship could pose potential risks for that market. Government sponsorship enables the GSEs' debt and mortgage-backed securities to receive better than AAA rates. A secondary market without GSE support would need to find other sources of credit enhancement to raise similar sums. The private sector has successfully provided such credit enhancements in other segments of the home mortgage market and in other markets but, given the large volume of securities issued by Fannie Mae and Freddie Mac, ending government sponsorship may at least cause some initial uncertainty.

In response to changing market conditions and the search for more efficient structures, private asset-backed securities markets have greatly increased their capacity to provide credit enhancement. They have developed structures ranging from pool insurance to the currently more common division of debt into senior and subordinated instruments. Some private companies specialize in providing credit enhancement to municipal bond issuers. In the long run, one would expect financial markets to develop the capacity to provide the level of credit enhancement necessary to accommodate the GSEs' volume of securities. Interest rates on such securities might still rise without government sponsorship, but the market could remain liquid and stable.

In the short run, the private market may have greater difficulty in providing the level of credit enhancement necessary to absorb the GSEs' current volume of securities without an increase in interest rates. This would certainly be the case if government sponsorship of Fannie Mae and Freddie Mac ended abruptly. Given the GSEs' current importance to the mortgage market, an abrupt end to government sponsorship would not be a prudent policy choice.

Furthermore, any changes in government sponsorship need not be made in isolation. Policymakers could consider changing other statutes and regulations to improve the liquidity and stability of a fully private secondary mortgage market. Congress already took one such step with the Secondary Mortgage Market Enhancement Act of 1984. The Act preempted certain state investment laws, thereby allowing depository institutions and institutional investors such as pension funds to purchase privately issued mortgage-backed securities as if they were issued by a federal agency or a GSE. Federal banking regulators might consider re-examining the risk-based capital treatment of privately issued mortgage-backed securities, which have a 50 percent risk-weight versus the 20 percent risk-weight assigned to GSE-issued mortgage-backed securities.[1]

2. Effect on Mortgage Interest Rates

Another concern is a potential increase in home mortgage rates for conforming, conventional fixed-rate loans. It is difficult to estimate with certainty how modifying or ending government sponsorship would affect mortgage interest rates. It appears that if federal sponsorship were ended, mortgage rates in this segment of the market would rise, though the effect is both hard to estimate and likely to be small relative to the normal fluctuations in mortgage rates attributable to macroeconomic and credit market factors.

There is no theoretical or legal reason why the GSEs must pass through all, or even part, of their subsidies to consumers. Hermalin and Jaffee (1996) explain how duopolists can increase their profits through tacit cooperation.[2] They point out that reducing subsidies may not increase mortgage rates if the GSEs priced just low enough such that other competitors stay out of the market. In general, the GSEs' pricing strategy, and the threat of competitor

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[1] The OTS uses a 20 percent risk-weight for both GSE and privately issued mortgage-backed securities.

[2] As Hermalin and Jaffee point out, "tacit" cooperation requires no actual collusion. Rather, it is possible for duopolists, acting independently and solely in their own individual interests, to act *as if* they were colluding.

entry into the conforming loan secondary market, will determine whether and how much of the subsidy is passed through in lower mortgage rates and, in turn, how any reduction in subsidies would affect conforming mortgage rates.

Empirical evidence of the GSEs' effect on conforming loan rates is also inconclusive. The GSEs point to comparisons of mortgage offer rates in weekly newspapers as evidence of a pass-through. A review of such rates in the weekly *Washington Post* real estate section shows that lenders' quotes on conforming rates generally running 25 to 50 basis points below their quotes on jumbo rates, although the difference recently diminished.

One concern about this comparison is that offer rates can and do differ from the rates at which loans are actually closed. Table IV.1 presents national averages on closed fixed-rate mortgages for both conforming and non-conforming loans.[3]

Table IV.1: National Averages on Fixed-Rate Mortgages

Year	Conforming Effective Rate (percent)	Jumbo Effective Rate (percent)	Jumbo Differential (basis points)
1983	12.86	12.4	-46
1990	10.38	10.56	18
1991	9.66	9.75	9
1992	8.49	8.6	11
1993	7.48	7.46	-2
1994	8.19	7.78	-41
1995	8.18	8.16	-2

Sources: Mortgage Interest Rate Survey (MIRS) conducted by the Federal Housing Finance Board (Federal Home Loan Bank Board prior to 1989). 1983 estimates, from GAO (1984), include both fixed- and adjustable-rate mortgages.

The GAO (1984) first reported that the 1983 national average rate of jumbo loans was less than that of conforming loans. During the 1990s, the differential on national averages

[3] The effective rate adjusts the contract rate for initial fees. MIRS data amortize the initial fees over a ten year time period to obtain the effective rate.

between conforming and jumbo loans has varied in size and sign. For the three-year period 1993-95, however, jumbo loans bore lower average effective rates than conforming loans.

Relying on national averages of closed rates to analyze the GSEs' effect on the interest rates of mortgages below the conforming loan limit also has shortcomings. Simple averages of mortgage rates across time cannot fully capture factors that could cause mortgage rates to vary according to loan characteristics such as loan size or credit quality. In addition, annual national averages do not account for such factors as any regional differences in mortgage rates or the timing of mortgage closures.

Several research papers, including one prepared for the interagency group (Cotterman and Pearce, 1996),[4] use econometric models to control for various factors that may affect the mortgage-rate differential between conforming and jumbo loans, such as geographic location, time of loan closing, loan size, and default risk. By controlling for such factors, an econometric model attempts to isolate the GSEs' effect on conforming mortgage rates. The Cotterman and Pearce paper, which builds on earlier work, estimates that closed conforming fixed-rate mortgages have had interest rates roughly 25 basis points (in 1993) to 60 basis points (in 1989) below the rates on jumbo mortgages. Of this range, Cotterman and Pearce view the core range of the differential as 25 to 40 basis points. A sample of their estimates is presented in Table IV.2. The Cotterman and Pearce estimates are similar to those found by other researchers. For example, ICF (1990) found that conforming loans had interest rates 23 basis points less than jumbo loans. Hendershott and Shilling (1989) found a 30 basis point differential.[5] Fannie Mae (1996-C, p. 218), in written comments on a preliminary draft of Cotterman and Pearce, identified a 20 to 35 basis point differential as reasonable and consistent with earlier findings using similar data.[6] Therefore, in Chapter II we assumed 20 to 40 basis points as a reasonable range for the possible pass-through of the GSEs' governmental benefits.

Table IV.2 also shows that the differential declined in recent years. This decline corresponds with the rapid growth of securitization in the jumbo market. These researchers also found that "stacking" -- *i.e.*, the concentration of a large number of mortgages -- at the conforming loan limit declined during the same period. Although the Cotterman and Pearce results are the best econometric evidence currently available, they involve a relatively simple

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[4] See also Hendershott and Shilling (1989) and ICF (1990). Shilling (1996) and Cook (1996) comment on Cotterman and Pearce. Hermalin and Jaffee (1996) also offer insights into this issue, as do comments on their paper from White (1996) and Kaufman (1996).

[5] Both Hendershott and Shilling (1989), and ICF (1990), reported smaller differentials for jumbo loans that were close to the conforming loan limit. For the time period covered by these studies, this effect was particularly important since the conforming loan limit was increasing regularly.

[6] Cotterman and Pearce (1996), in a preliminary draft of their paper, concluded that the conforming loan differential had a core range of 20 to 35 basis points.

model,[7,8] and include no data after 1993. Given the rapid fall in the conforming loan differential that they estimate between 1989 and 1993, an update of their analysis would be particularly useful.

Table IV.2: Estimated Differences in Rates Between Jumbo Loans and Conforming Loans, By Lender 1989-1993
(in percentage points)

	California			Total for 11 States		
Year	S&Ls	Mortgage Companies	S&Ls and Mortgage Companies	S&Ls	Mortgage Companies	S&Ls and Mortgage Companies
1989	-0.45	-0.51	-0.50	-0.31	-0.59	-0.59
1990	-0.34	-0.35	-0.36	-0.35	-0.36	-0.38
1991	-0.48	-0.46	-0.47	-0.33	-0.49	-0.43
1992	-0.17	-0.38	-0.32	-0.21	-0.30	-0.30
1993	-0.19	-0.28	-0.25	-0.28	-0.23	-0.24

Source: Cotterman and Pearce (1996, p. 125, Table 6)

In the face of conflicting data on offer rates and closed rates, theoretical uncertainty over how much the GSEs pass through their benefits by lowering mortgage rates, and the problems associated with estimating the effects of government sponsorship, we cannot make definitive statements about the degree to which reducing or eliminating government sponsorship would affect conforming mortgage rates. Further study is needed to estimate more precisely the GSEs' effects on mortgage rates below the conforming loan limit.

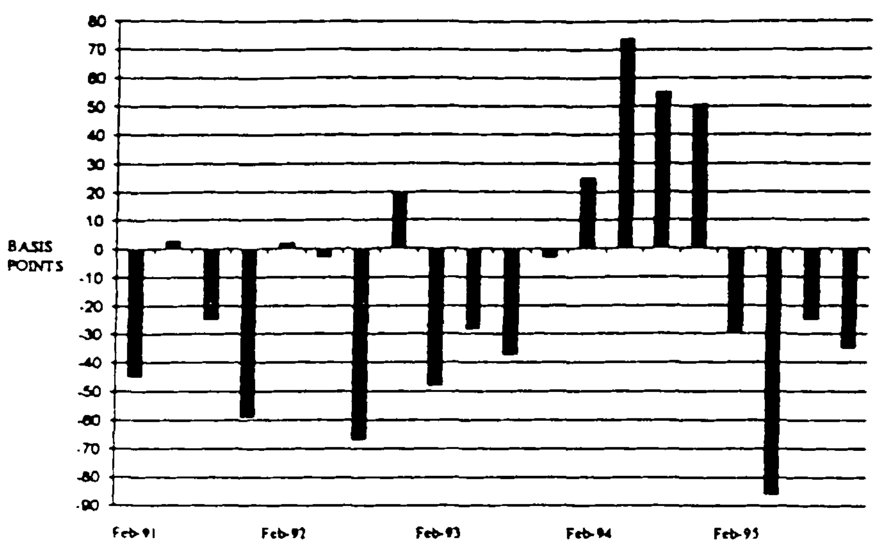
The information currently available indicates that the potential increase in mortgage rates would be small relative to the normal fluctuations in mortgage rates attributable to

[7] No doubt due to data limitations, the Cotterman and Pearce model includes information on relatively few of the variables that should affect loan rates. A more complete analysis would also model the joint determination of loan approval or disapproval, amount, and interest rate.

[8] The relationship between loan rate and loan size appears particularly complex, both theoretically and empirically. Consequently, a simple measure or estimate of the difference between conforming and jumbo mortgage rates masks a more complicated relationship between mortgage rates and mortgage size.

changes in macroeconomic and credit market conditions. Figure IV.1 shows quarter-to-quarter changes in average mortgage rates between 1991 and 1995. As the figure indicates, mortgage rates regularly change by considerably more than any change that could reasonably be expected from ending government sponsorship. To provide a benchmark for assessing the effect of a rise in mortgage interest rates, consider the following example. The median-priced home in the U.S. in 1995 was $112,900 and the average mortgage rate on a 30-year, fixed-rate mortgage was 7.95 percent.[9] Assuming the homebuyer made a 20 percent downpayment, a 20 basis-point increase in mortgage rates would increase the monthly payment by $12 per month. Assuming the homebuyer is in the 28 percent marginal tax bracket and pays state taxes at a marginal rate of 5 percent (net of the federal deduction), the after-tax cost of a 20 basis point increase would be $8 per month.

Figure IV.1: Quarterly Changes in Average Mortgage Rates



Source: HUD (1996-D)

In summary, it is not clear to what extent interest rates for fixed-rate conforming, conventional mortgages would increase if Congress ended the government's sponsorship of Fannie Mae and Freddie Mac, although such rates probably would rise. To the extent that observed differences in rates between conforming and jumbo mortgages reflect economic factors such as credit risk, or technical efficiencies achieved by the GSEs, ending such sponsorship may have almost no effect on mortgage rates. But to the extent that lower

[9] See HUD (1996-D).

conforming mortgage rates reflect a current pass through of at least some of the GSEs' governmental subsidies, as we assumed in Chapter II, then ending such sponsorship could lead to a slight increase in mortgage rates. If ending the GSEs' government sponsorship increased secondary mortgage market competition, however, that could in the long-run mitigate or even offset any such rate increase.

3. Effect on Affordable Housing Efforts

Congress has created a role for the GSEs in affordable housing, to which they have responded by substantially increasing their purchases of loans to lower-income homebuyers and on properties in under-served communities. Of course, the GSEs' affordable housing goals are only one of a set of government initiatives to promote affordable housing. The Community Reinvestment Act (CRA), for example, increases the incentives for primary lenders to make affordable housing loans.

While predicting future contributions by the GSEs and others to affordable housing is difficult, it may help to consider the challenges that the GSEs face relative to other participants in the affordable housing market. First, the GSEs do not make loans directly to homebuyers. Although they can offer products designed for affordable housing, they must rely on primary lenders to bring them such loans. Also, the GSEs have a number of active competitors in the affordable housing market, including the FHA, which focuses directly and primarily on affordable housing, and portfolio lenders, which have the advantage of better local knowledge.

The challenges faced by the GSEs are heightened by the fact that today's critical housing priorities center not on the general operation of the nation's credit markets but on the needs of certain borrowers that continue to find homeownership beyond their grasp. Last year, the Administration established the goal of increasing the U.S. homeownership rate to a historic high -- 67 percent of all households. HUD released a blueprint for achieving this goal, the *National Homeownership Strategy: Partners in the American Dream.*[10] The strategy includes 100 action items for increasing homeownership rates nationwide. It also identifies a lack of funds for downpayments and insufficient income -- not credit availability -- as the two main financial barriers to homeownership among the targeted borrower groups. As the *National Strategy* report points out, "obtaining sufficient funds to purchase a home for many low- and moderate-income households will require government and nonprofit financial support" (HUD, 1995, p. 4-11). For the country to meet today's critical housing needs, public policy attention should focus on the action items outlined in the HUD strategy. Again, the GSEs face challenges in helping to solve this problem. For the GSEs to buy a mortgage, they must first obtain mortgage originations that meet their underwriting standards (recognizing that the GSEs have recently modified some of their underwriting standards to boost their purchase of affordable housing loans). Also, for most affordable housing loans, a

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[10] HUD (1995). At the end of 1992, the national homeownership rate was 64.1 percent. By the end of 1995, the rate had increased to 65.1 percent.

private mortgage insurance company must take the first-loss risk before the GSEs may purchase the loans.[11]

Despite these challenges, Fannie Mae and Freddie Mac have contributed to promoting affordable housing finance. It is unclear whether the two companies need government sponsorship to continue their current efforts; knowing that would require more information on whether the GSEs' affordable housing efforts generate returns significantly below those of comparable lines of business. As described in the previous chapter, the majority of affordable housing loans purchased by the GSEs meet standard underwriting criteria. Freddie Mac states that "the corporation purchases most single-family and multifamily mortgages in support of affordable housing through its standard mortgage purchase programs and under the same credit standards as its other mortgage purchases" (Freddie Mac, 1996-A, p. 4), but this statement does not preclude some extraordinary efforts aimed at small groups of homebuyers.

Therefore, ending government sponsorship would leave at risk some smaller subset of the GSEs' purchases of affordable housing loans. This subset, typically referred to as community lending loans, consists of loans that target various groups of borrowers through flexible underwriting (lower debt or income ratios, and reduced down payments). HUD (1996-A) has reported that the GSEs purchased some 97,000 such loans, worth a total of $7.5 billion, in 1995. Community lending comprised 7 percent of Fannie Mae's total owner-occupied single-family purchases and 1 percent of Freddie Mac's.[12]

Another area of concern is how ending the GSEs' government sponsorship would affect homeownership opportunities. A study by Wachter et. al. (1996) predicts that it would reduce the overall homeownership rate, especially among first-time homebuyers and targeted borrower groups. These results must, however, be kept in perspective. In particular, the Wachter analysis could overstate the effects of ending government sponsorship for several reasons, some of which are presented below.[13] The Wachter analysis did not consider the ability of households to use adjustable-rate mortgages and assumed that ending government sponsorship would cause:

- Downpayment requirements to increase. This may not be a likely occurrence, however, since the fully private sector offers low downpayment mortgages enhanced through private mortgage insurance companies.

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[11] One promising development that may lower the cost of buying a home for all potential homebuyers is new technology that reduces the cost of originating and underwriting mortgages. Fannie Mae and Freddie Mac are actively involved in developing such technology, as are fully private firms.

[12] HUD (1996-A) reports that in 1995 the community lending purchases of Fannie Mae were 86,374 ($6.550 billion) and Freddie Mac's were 10,869 ($935 million).

[13] Yezer (1996) also discusses issues related to the Wachter et. al. (1996) analysis.

- A 50 basis point increase in mortgage rates. Such an increase exceeds those suggested by other research cited earlier in the chapter. Even if rates rose that much, it is unclear it could have such a broad effect on homeownership.

Although Wachter et. al. (1996) raise many important questions about ending government sponsorship and about overall housing policy, more research is necessary to determine the effect on homeownership rates.

The federal government has in place a specialized system for insuring and securitizing affordable housing loans -- FHA and Ginnie Mae. It also recently established the Community Development Financial Institutions (CDFI) fund to leverage public and private capital for community development activities including affordable housing projects. These government entities may be best equipped to target subsidies to specific borrower groups. Their current and future activities need to be considered when evaluating the effect that ending government sponsorship of Fannie Mae and Freddie Mac might have on the government's ability to achieve the goals laid out in the *National Homeownership Strategy*.

B. RISKS OF MAINTAINING THE *STATUS QUO*

Just as government sponsorship has real value and involves real costs, maintaining such sponsorship would involve risks that may benefit from further analysis. As described here, these risks include the effect of government sponsorship on Treasury borrowing costs, on other credit markets, on competition in the mortgage market and increased reliance on GSEs, and on the potential risk to the taxpayers. They also include the tension between the GSEs' public purpose and their responsibility to their shareholders.

1. Effect on Treasury Borrowing Costs

In addition to the implicit subsidies covered earlier in this report, government sponsorship may involve an explicit cost through increased Treasury borrowing costs. The large number of variables that affect financial markets make it difficult to ascertain to what extent GSE securities affect Treasury borrowing costs. However, the ways in which such securities could affect those costs are clear. First, if the GSEs increase the total demand for credit above what it would have been without government sponsorship, then the law of demand suggests that the GSEs must be raising all interest rates, including those for Treasury securities. While the GSEs issue a large volume of securities, any net additional demand for credit created by their government sponsorship is probably fairly small.

Second, since GSE securities serve as substitutes for Treasury securities for many purposes, and since they benefit from investors' perception that the federal government implicitly stands behind them, those securities compete directly with Treasury securities in the government securities market. To some extent, therefore, the considerable and growing supply of GSE securities (relative to the supply of Treasury securities) tends to lower prices in the government securities market and thereby increase the Treasury's borrowing costs.

Unfortunately, it is extremely difficult to estimate the amount of the increase. Financial markets are both dynamic and complex; many factors affect their demand, supply, and segmentation. When the Treasury previously attempted (Treasury 1990, 1991) to estimate the effect of GSE borrowing on Treasury costs, it could not quantify those effects. These estimation difficulties remain; nonetheless, further analysis seems appropriate. Together, Fannie Mae and Freddie Mac had over $1.4 trillion in debt and mortgage-backed securities outstanding at the end of 1995. Since the public holds $3.7 trillion of U.S. government debt, each basis point of increase in such costs would raise annual budgetary outlays by $370 million.

2. Effect on Other Credit Markets

While the benefits of GSE status provide an important subsidy that promotes homeownership, such a subsidy has economic costs. To the extent that the GSEs pass through the benefits of government sponsorship, they reduce the price of, and increase the demand for, mortgage credit relative to other types of credit. The economic effect of the subsidy to mortgage credit -- absent increases in the savings pool or attracting capital from abroad -- is to raise the price or reduce the amount of credit for other uses, such as small business, exporters, rural communities, and other business and consumer borrowers. Measuring such effects, however, is even more difficult than measuring the potential effects on Treasury borrowing costs.

3. Potential for Increased Reliance on the GSEs

Maintaining the current GSE status of Fannie Mae and Freddie Mac could, over time, find the housing finance market increasingly reliant on the GSEs as sources of credit for conforming, conventional mortgages. This increased reliance, coupled with the advantages the GSEs receive from government sponsorship, could undermine the viability of portfolio lenders operating in local markets, such as community banks and thrift institutions. If that were to occur, borrowers who do not easily meet the GSEs' underwriting standards may lose competitive local mortgage sources that may serve their needs better than national lenders.

Fannie Mae and Freddie Mac face *potential* competition from private-sector conduits now active in the secondary mortgage markets not dominated by Fannie Mae and Freddie Mac. One reason these firms do not now compete with the GSEs is that the benefits of government sponsorship deter entry into the market for fixed-rate conforming, conventional mortgages. Ending government sponsorship would encourage more private sector participation in the market for such mortgages. Increased competition would probably not eliminate the benefits Fannie Mae and Freddie Mac have already brought to this market, such as standardization of loan terms. On the other hand, continuing government sponsorship prevents Fannie Mae and Freddie Mac from competing in other lines of business; free to bring their considerable skills to bear in other markets, they would likely benefit consumers in these other markets.

The potential for competition in GSE-dominated markets is evident in the evolution of REMIC[14] securities. The private sector rapidly began issuing REMIC securities soon after the Tax Reform Act of 1986 authorized them. In 1987, fully private issuers accounted for almost all issuance of REMICs. Once the two GSEs were permitted to fully participate in this market, they became the leading REMIC issuers. In 1993, the GSEs issued approximately 98 percent of all REMICs.[15] If this concentration resulted from the GSEs' economies of scale, better technology, or some other form of superior economic efficiency, then privatization would probably not alter it. However, if it resulted from the benefits of government sponsorship, including a perceived implicit guarantee, privatization probably would increase competition.

The limited competition faced by Fannie Mae and Freddie Mac — and the lack of direct secondary market competition — may distort resource allocation and decrease financial innovation. By removing the subsidies derived from their government sponsorship, privatization would enable Fannie Mae, Freddie Mac, private conduits, and depository institutions to compete more equitably in financing home mortgages.

4. Effect on Potential Risk to the Taxpayer

Although Fannie Mae and Freddie Mac have developed a range of mechanisms to hedge the risks of their portfolios and protect their financial integrity against movements in the financial markets, there is no guarantee they will always be safe and sound entities. We have no evidence of any current safety and soundness problems at Fannie Mae and Freddie Mac.

The Shadow Financial Regulatory Committee recently highlighted questions regarding potential taxpayer risk:

> Whether or not a GSE actually becomes insolvent, taxpayers need to recognize that Treasury back-up implicitly supplies risk capital that enhances the value of private stakes in the firm. The availability of the implicit finance allows enterprise managers to escape the market discipline of making other arrangements to support their creditworthiness and promises to keep alive for GSE shareholders a claim on the enterprise's future profits in difficult times. This distorted arrangement for sharing risk makes private stakeholders willing to trade upside earning potential for downside risks at terms that disadvantage taxpayers.[16]

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[14] See footnote 8 in Chapter I for a definition of REMIC.

[15] *Mortgage Market Statistical Annual for 1995.*

[16] Shadow Financial Regulatory Committee (1996, p. 2).

Because one cannot know in advance whether, or to what extent, the government would assist a financially troubled or failing GSE, managing any potential risk exposure is necessarily more difficult than managing the risks of an explicit guarantee. When making an explicit guarantee, the government can clearly define and limit its obligations, and other parties can adjust their conduct accordingly. The government can also take specific steps to minimize the risk of any claim against that guarantee -- for example, by regulating an entity whose obligations are being guaranteed.

When there is no explicit guarantee, but merely a possibility that the government might decide to provide assistance in the future, the nature and scope of any such assistance is unknown. Efforts to manage an undefined potential risk are problematic.

In 1992, Congress sought to assure the safety and soundness of Fannie Mae and Freddie Mac, and thus reduce any potential taxpayer risk, by establishing the Office of Federal Housing Enterprise Oversight (OFHEO), an independent office within HUD. Congress charged OFHEO with assessing and maintaining the safety and soundness of the GSEs. OFHEO's regulatory duties include conducting examinations and establishing capital standards. It has the enforcement powers needed to respond quickly if problems arise. While still a new office, OFHEO's ongoing work in examining the two GSEs and developing risk-based capital requirements for them do help bolster the GSEs' safety and soundness, thereby making taxpayers better off. Creation of OFHEO is a positive development that we expect to have a salutary effect on the two GSEs' safety and soundness.

OFHEO's responsibilities are unusual because it regulates only two entities -- entities that comprise almost the entire secondary mortgage market for conforming, conventional mortgages. This concentration of regulatory scope has both advantages and disadvantages. OFHEO's structure provides a clear, focused safety and soundness mission, and strong accountability. Having only two institutions to regulate, OFHEO should be expert in the GSEs' operations and risks. On the other hand, that structure may also present challenges in the future. Since OFHEO oversees only Fannie Mae and Freddie Mac, it must continue to work diligently to retain an appropriate arm's-length independence from its regulated entities over time. In light of its relatively narrow mission, OFHEO will also need to maintain a vision of the housing finance system and the operations of financial markets that does not become narrowed by its exclusive focus on two GSEs.

If Congress were to end the GSEs' government sponsorship, we assume it would do so in a way that would remove any question of implicit taxpayer support and would thus make clear that investors bear the risks associated with the two companies' operations, just as they bear the risks of other fully private firms. Congress could then end safety and soundness regulation and subject Fannie Mae and Freddie Mac to full market discipline.

5. The Tension Between Profit and Public Purpose

When creating a GSE, Congress defines the problem (i.e., the market imperfection) it seeks to overcome, provides benefits (subsidies), and imposes limitations on the GSE. But if Congress wishes to revise those decisions in response to changing public needs, it no longer has the same freedom of action: in addition to the usual constraints of the legislative process, it must contend with the private interests of the GSE and its shareholders. Congress must consider, and legislate, any such changes through a process in which the GSEs are significant participants. As a private company, the GSE will act to fulfill its fiduciary responsibilities by promoting and protecting the interests of its shareholders.

Clearly Fannie Mae and Freddie Mac must serve their shareholders, but they must also comply with their federal charters. This ambiguity of responsibility, characteristic of GSEs, continually raises issues of accountability: To what extent is a particular GSE responding to its federal mandate and to what extent to the need to generate returns for its stockholders? What tradeoffs does it make between these objectives?

C. Balancing the GSEs' Public Purpose and the Benefits of Government Sponsorship

If Congress decided to maintain the GSE status of Fannie Mae and Freddie Mac, but sought to increase the public benefits they provide or reduce the government benefits they receive, it could pursue a wide range of options.

Illustrative of the many options that have been suggested are the following:

- Holding constant, or decreasing, the conforming loan limit to focus the GSEs more squarely on the market where affordability issues are most important;

- Strengthening the affordable housing goals;

- Requiring Fannie Mae and Freddie Mac to direct a portion of their earnings to affordable housing, perhaps along the lines of the Federal Home Loan Bank System's Affordable Housing Program (the System, another housing GSE, must annually make grants for affordable housing that amount to the greater of $100 million or 10 percent of the System's earnings).

- Requiring more directed assistance (both educational and financial) to lower-income borrowers, state and local governments, and non-profit organizations, as described in HUD's National Homeownership Strategy;

- Charging user fees to recoup some of the benefits of government sponsorship;

- Limiting the size of the GSEs' retained mortgage portfolio or requiring its divestiture (as Congress directed in 1954); and

- Ending certain benefits of government sponsorship, such as the exemption from SEC registration.

Analysis of any of these options would be a necessary part of the ongoing evaluation of the government's relationship with the GSEs in light of market developments. Also, policymakers would need to consider how such options would affect the GSEs and other government housing programs, especially FHA. Gradually decreasing the conforming loan limit (currently $207,000) could encourage the GSEs to increase their activity in the segment of the housing market most in need of assistance. Strengthening the affordable housing goals could also focus more of the GSEs' efforts on targeted borrowers. The goals recently published by HUD are actually below the relevant market shares for targeted borrower groups. The percentages could be increased or the definitions further tightened to try to better serve the public purpose. In addition, the goals could also place greater emphasis on increasing the GSEs' involvement in financing multifamily mortgages.

Alternatively, one could require the GSEs to provide direct financial and technical assistance to institutions and government agencies involved in affordable housing. Both GSEs provide such assistance to various community organizations, but to better target public benefits the government could have input on the level and scope of these activities.[17]

Imposing user fees on the GSEs' debt and mortgage-backed securities could recoup some of the GSEs' implicit government subsidy and level the playing field for other competitors.[18] Such fees could, however, create pay-as-you-go budget problems for any future legislation to end government sponsorship.[19]

Limiting the GSEs' retained mortgage portfolios (and thus requiring the GSEs to securitize more of the mortgages they purchase) would substantially reduce the benefits of government sponsorship retained by the GSEs' shareholders and would greatly reduce their interest-rate risk exposure.

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[17] For example, the Fannie Mae Foundation provides charitable support for various housing initiatives and other projects. Fannie Mae officials expect the foundation to spend between $50 and $70 million annually in the next five to seven years. By contrast, the Federal Home Loan Bank System must devote the greater of $100 million or 10 percent of net income to its statutorily defined Affordable Housing Program. If a similar 10 percent requirement had been applied to Fannie Mae and Freddie Mac in 1995, it would have raised $300 million (based on $3 billion in after-tax net income) to $450 million (based on approximately $4.5 billion in pre-tax net income).

[18] For a detailed discussion of user fees, see Congressional Research Service (1996).

[19] The pay-as-you-go problem could be mitigated if there were a sunset date for the user fee.

Repealing some of the other benefits of government sponsorship, such as the exemption from SEC registration, could also encourage competition from private firms and provide a slightly better balance between the benefits received by the GSEs and the benefits passed on to the housing finance market.

It should be stressed that none of these suggestions has received the detailed analysis that would be required before a decision can be made on whether or how to adjust government sponsorship.

D. Summary

The GSEs have made extraordinary contributions in pursuing their public goals. Congress has asked whether it is now feasible and desirable to alter or eliminate government sponsorship of Fannie Mae and Freddie Mac.

There seems little doubt that securitization and the secondary mortgage activities pioneered by Ginnie Mae, Fannie Mae, and Freddie Mac are now well-established and that the secondary market for conforming, conventional mortgages could operate efficiently and effectively even if Fannie Mae's and Freddie Mac's government sponsorship were altered. However, the broader potential effects of ending that sponsorship remain uncertain.

For example, the effect of any change upon the GSEs' affordable housing activities is unclear. The experience under the housing goals is only a few years old, and it is premature to judge how much of the GSEs' activity is driven by Congressional directive and HUD oversight and how much by the basic requirement of Fannie Mae and Freddie Mac as businesses to generate returns for their stockholders.

Altering government sponsorship could create the risk of a small increase in mortgage rates for the portion of the market in which Fannie Mae and Freddie Mac participate. The entry of new competitors into the market could mitigate this effect. Although we have analyzed these effects and provided rough estimates, further research would be helpful.

As Congress considers these matters, we also believe there should be detailed analysis of the operation and market implications of the various alternative approaches. A wide range of suggestions has been made to reduce the benefits of government sponsorship or to increase the public benefits provided by Fannie Mae and Freddie Mac.

Ending or modifying government sponsorship would entail risk, but would also have benefits. The potential effect of privatization on mortgage interest rates or the availability of credit for affordable housing represent important risks. Potential benefits could include more active competition, more efficient credit allocation, reduced potential risk to taxpayers, and reduced government borrowing costs. While preserving the *status quo* would eliminate any uncertainty associated with ending government sponsorship, it has risks as well.

Fannie Mae and Freddie Mac are important institutions, and no change will occur without careful analysis and public discussion. We believe the analysis presented here and the additional work suggested can further such discussion.

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DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
July 11, 1996

STATEMENT BY TREASURY SECRETARY ROBERT E. RUBIN

The report reminds us of the central facts of Waco -- that federal agents were killed in Waco by people who violated gun and explosives laws, sexually abused children, and started a terrible fire that killed scores of people. It does not mention, however, that ATF was reformed, agents were disciplined, managers were replaced, and new procedures were adopted to prevent a Waco-like tragedy from occurring again. By failing to recognize these important facts and by blaming law enforcement, the report fails to properly clarify the difference between the villains and the victims of Waco.

The report unfairly attacks former Treasury officials Bentsen, Altman and Noble, the people who made sure that Waco was thoroughly and objectively investigated. These men acted in the best tradition of public service on Waco.

It is time to put Waco behind us and focus on what really matters to the American people -- fighting crime. ATF does critical work -- enforcing the law against gangs and violent criminals, fighting the upsurge in church fires, and preventing extremists from carrying out acts of terror. I continue to have the feeling that some of those who criticize ATF are simply seeking to undermine public support for policies like the Brady Act and the assault weapons ban.

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RR-1168

DEPARTMENT OF THE TREASURY

TREASURY NEWS

1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGOED UNTIL 2:30 P.M.
July 12, 1996

CONTACT: Office of Financing
202/219-3350

TREASURY'S 52-WEEK BILL OFFERING

The Treasury will auction approximately $19,250 million of 52-week Treasury bills to be issued July 25, 1996. This offering will provide about $900 million of new cash for the Treasury, as the maturing 52-week bill is currently outstanding in the amount of $18,359 million. In addition to the maturing 52-week bills, there are $23,172 million of maturing 13-week and 26-week bills.

Federal Reserve Banks hold $11,483 million of bills for their own accounts in the maturing issues. These may be refunded at the weighted average discount rate of accepted competitive tenders.

Federal Reserve Banks hold $4,569 million of the maturing issues as agents for foreign and international monetary authorities. These may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders. Additional amounts may be issued for such accounts if the aggregate amount of new bids exceeds the aggregate amount of maturing bills. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $376 million of the maturing 52-week issue.

Tenders for the bills will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D.C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

Details about the new security are given in the attached offering highlights.

oOo

Attachment

RR-1169

DEPARTMENT OF THE TREASURY

NEWS CLIPS

Compiled in the Office of Public Affairs

HIGHLIGHTS OF TREASURY OFFERING OF 52-WEEK BILLS
TO BE ISSUED JULY 25, 1996

July 12, 1996

Offering Amount	$19,250 million
Description of Offering:	
Term and type of security .	364-day bill
CUSIP number	912794 2S 2
Auction date	July 18, 1996
Issue date	July 25, 1996
Maturity date	July 24, 1997
Original issue date	July 25, 1996
Maturing amount.	$18,359 million
Minimum bid amount	$10,000
Multiples	$1,000
Submission of Bids:	
Noncompetitive bids	Accepted in full up to $1,000,000 at the average discount rate of accepted competitive bids
Competitive bids . . .	(1) Must be expressed as a discount rate with two decimals, e.g., 7.10%
	(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position are $2 billion or greater.
	(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.
Maximum Recognized Bid at a Single Yield . . .	35% of public offering
Maximum Award	35% of public offering
Receipt of Tenders:	
Noncompetitive tenders . .	Prior to 12:00 noon Eastern Daylight Saving time on auction day
Competitive tenders	Prior to 1:00 p.m. Eastern Daylight Saving time on auction day
Payment Terms	Full payment with tender or by charge to a funds account at a Federal Reserve bank on issue date

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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FOR IMMEDIATE RELEASE
July 12, 1996

STATEMENT OF TREASURY SPOKESMAN HOWARD SCHLOSS

The Bureau of Alcohol, Tobacco and Firearms and the District of Columbia Fire Marshal have informed Secretary Rubin the fire last month at the Main Treasury building was accidental. ATF and the Fire Marshal said the fire started as a result of renovation work that was taking place on the roof. Specifically, a propane torch being used on the roof ignited the blaze.

We appreciate the efforts of the ATF and the D.C. Fire Marshal in making this determination.

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RR-1170

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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FOR IMMEDIATE RELEASE
July 15, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $14,169 million of 13-week bills to be issued July 18, 1996 and to mature October 17, 1996 were accepted today (CUSIP: 912794Z98).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.17%	5.31%	98.693
High	5.20%	5.34%	98.686
Average	5.19%	5.33%	98.688

Tenders at the high discount rate were allotted 6%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$54,876,271	$14,169,071
Type		
Competitive	$49,281,615	$8,574,415
Noncompetitive	1,468,064	1,468,064
Subtotal, Public	$50,749,679	$10,042,479
Federal Reserve	3,421,860	3,421,860
Foreign Official Institutions	704,732	704,732
TOTALS	$54,876,271	$14,169,071

An additional $110,268 thousand of bills will be issued to foreign official institutions for new cash.

5.18 - 98.691

RR-1171

DEPARTMENT OF THE TREASURY

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FOR IMMEDIATE RELEASE
July 15, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $14,030 million of 26-week bills to be issued July 18, 1996 and to mature January 16, 1997 were accepted today (CUSIP: 9127943V4).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.35%	5.58%	97.295
High	5.37%	5.60%	97.285
Average	5.36%	5.59%	97.290

Tenders at the high discount rate were allotted 5%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$51,711,078	$14,030,028
Type		
Competitive	$43,348,746	$5,667,696
Noncompetitive	1,540,364	1,540,364
Subtotal, Public	$44,889,110	$7,208,060
Federal Reserve	3,750,000	3,750,000
Foreign Official Institutions	3,071,968	3,071,968
TOTALS	$51,711,078	$14,030,028

An additional $479,732 thousand of bills will be issued to foreign official institutions for new cash.

RR-1172

DEPARTMENT OF THE TREASURY

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FOR IMMEDIATE RELEASE
July 16, 1996

STATEMENT BY TREASURY SECRETARY ROBERT RUBIN
ON THE PRESIDENT'S BROWNFIELDS TAX INCENTIVE
AND EMPOWERMENT ZONE PROPOSALS

Today, the Ways and Means Oversight Subcommittee will be considering tax incentives to encourage cleanup and redevelopment of contaminated and economically distressed sites. Earlier this year, President Clinton called for such an incentive in his State of the Union address and included this initiative, fully paid for, in his FY 1997 budget.

The President's brownfields tax incentive will spur the cleanup and redevelopment of thousands of contaminated sites, and together with the new Empowerment Zone and Enterprise Community proposal, will help to rebuild neighborhoods, create jobs, and restore hope to our nation's cities and distressed rural areas.

I thank Congressman Rangel for introducing H.R. 3747, containing the President's brownfields tax incentive and Empowerment Zone proposals, and Senators Moseley-Braun, Jeffords and D'Amato for introducing a companion measure, S. 1911, in the Senate. The Administration strongly urges the Oversight Subcommittee to favorably consider these proposals.

RR-1173

Background

Under the President's brownfields tax incentive, environmental cleanup costs would be fully deductible in the year in which they are incurred -- a significant incentive that would reduce the cost of capital for these types of investment by more than half. The $2 billion incentive is expected to leverage $10 billion in private investment, returning an estimated 30,000 brownfields to productive use. The incentive would be available in 40 of the existing EPA Brownfields pilot areas, in areas with a poverty rate of 20 percent or more, in adjacent industrial or commercial areas, and in Empowerment Zones and Enterprise Communities, both existing ones and those that would be designated in the second round.

The Clinton Administration's Empowerment Zone and Enterprise Community program was authorized by Congress in the Omnibus Budget Reconciliation Bill of 1993. This program was designed as a competitive demonstration program for revitalizing distressed communities pursuant to a strategic plan developed at the community level and supported by local and state governments, the federal government, and the private sector. Over 500 communities that satisfied various poverty, population, and size criteria were nominated for designation, with many communities hailing the application process itself for producing tremendous benefits. On December 21, 1994, nine Empowerment Zones and 95 Enterprise Communities were designated. Qualifying businesses in all of the designated areas became eligible for a new category of tax-exempt financing, and businesses in Empowerment Zones also became eligible for a significant federal wage credit and a capital investment incentive.

The Empowerment Zone and Enterprise Community proposal, which is an important component of the President's Community Empowerment agenda, would authorize a second round of designations, adding another 100 distressed urban and rural communities to the 104 designated in December 1994. The second round would build upon the solid successes of the first round, and would also strengthen the tax incentives available to businesses in the designated communities (including the brownfields tax incentive, additional section 179 expensing for small businesses, and new tax exempt bonds).

The Treasury Department will be submitting written testimony to the Subcommittee on these matters.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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FOR IMMEDIATE RELEASE
July 16, 1996

Contact: Dean DeBuck
(202) 874-4970

TREASURY TO HOLD ELECTRONIC MONEY CONFERENCE SEPTEMBER 19-20

The Department of the Treasury is presenting an electric money and banking conference to examine the role of the government in the technological revolution that is sweeping the financial services industry. The conference will be held on September 19-20 at the Sheraton Washington Hotel in Washington, D.C.

Secretary Robert E. Rubin will present the keynote address on Thursday morning. Featured speakers on September 19 include Federal Reserve Board Chairman Alan Greenspan, Federal Trade Commission Chairman Robert Pitofsky and Citicorp Chairman John S. Reed.

On Friday, September 20, Congressman Michael N. Castle of Delaware will open the second day of the conference and Comptroller of the Currency Eugene A. Ludwig will deliver the closing address. Secretary Rubin has designated the Comptroller to coordinate electronic money issues and activities among Treasury bureaus.

The conference is titled "Toward Electronic Money and Banking: The Role of Government." Topics for panel discussions will include:

- Need for International Cooperation;
- Consumer Issues;
- Security and Authentication;
- Payment System Issues;
- E-Money Systems: Case Studies;
- Privacy Issues;
- Law Enforcement Perspectives; and
- Electronic Money: Perspectives on Issuers.

-MORE-

RR-1174

The program is designed for a variety of interests from the private sector, including bankers, non-bank financial service providers, technology providers, consumer groups and scholars. Staff and policy-level officials from federal and state government agencies and Congressional staff will also find the conference useful.

The registration fee is $495 (after August 12: $595). For more information, please contact Phyllis Savoy at the Office of the Comptroller of the Currency by fax at (202) 874-5436. Registration materials are also available by e-mail at [e-money.conference@occ.treas.gov]. Conference program updates will be posted periodically on the Treasury Department web site: http://www.ustreas.gov.

The Treasury Department will provide complimentary registration to accredited press.

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DEPARTMENT OF THE TREASURY

TREASURY NEWS

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EMBARGOED UNTIL 2:30 P.M.
July 16, 1996

CONTACT: Office of Financing
202/219-3350

TREASURY'S WEEKLY BILL OFFERING

The Treasury will auction two series of Treasury bills totaling approximately $27,000 million, to be issued July 25, 1996. This offering will provide about $3,825 million of new cash for the Treasury, as the maturing 13-week and 26-week bills are outstanding in the amount of $23,172 million. In addition to the maturing 13-week and 26-week bills, there are $18,359 million of maturing 52-week bills. The disposition of this latter amount was announced last week.

Federal Reserve Banks hold $11,483 million of bills for their own accounts in the three maturing issues. These may be refunded at the weighted average discount rate of accepted competitive tenders.

Federal Reserve Banks hold $4,332 million of the three maturing issues as agents for foreign and international monetary authorities. These may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders. Additional amounts may be issued for such accounts if the aggregate amount of new bids exceeds the aggregate amount of maturing bills. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $3,956 million of the original 13-week and 26-week issues.

Tenders for the bills will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

Details about each of the new securities are given in the attached offering highlights.

oOo

Attachment

RR-1175

HIGHLIGHTS OF TREASURY OFFERINGS OF WEEKLY BILLS
TO BE ISSUED JULY 25, 1996

July 16, 1996

<u>Offering Amount</u>	$13,500 million	$13,500 million
<u>Description of Offering:</u>		
Term and type of security	91-day bill	182-day bill
CUSIP number	912794 3L 6	912794 3W 2
Auction date	July 22, 1996	July 22, 1996
Issue date	July 25, 1996	July 25, 1996
Maturity date	October 24, 1996	January 23, 1997
Original issue date	April 25, 1996	July 25, 1996
Currently outstanding	$11,774 million	- - -
Minimum bid amount	$10,000	$10,000
Multiples	$ 1,000	$ 1,000

<u>The following rules apply to all securities mentioned above:</u>

<u>Submission of Bids</u>:

Noncompetitive bids . . . . Accepted in full up to $1,000,000 at the average discount rate of accepted competitive bids

Competitive bids . . . .
(1) Must be expressed as a discount rate with two decimals, e.g., 7.10%.
(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position is $2 billion or greater.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

<u>Maximum Recognized Bid at a Single Yield</u> . . . . 35% of public offering

<u>Maximum Award</u> . . . . 35% of public offering

<u>Receipt of Tenders</u>:

Noncompetitive tenders . . . . . . Prior to 12:00 noon Eastern Daylight Saving time on auction day

Competitive tenders . . . . Prior to 1:00 p.m. Eastern Daylight Saving time on auction day

<u>Payment Terms</u> . . . . Full payment with tender or by charge to a funds account at a Federal Reserve Bank on issue date

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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July 17, 1996

Monthly Release of U.S. Reserve Assets

The Treasury Department today released U.S. reserve assets data for the month of June 1996.

As indicated in this table, U.S. reserve assets amounted to $83,455 million at the end of June 1996, down from $83,468 million in May 1996.

U.S. Reserve Assets (in millions of dollars)

End of Month	Total Reserve Assets	Gold Stock 1/	Special Drawing Rights 2/3/	Foreign Currencies 4/	Reserve Position in IMF 2/
1996					
May	83,468r	11,051r	11,037	46,153	15,227
June	83,455	11,050	11,046	46,077	15,282

1/ Valued at $42.2222 per fine troy ounce.

2/ Beginning July 1974, the IMF adopted a technique for valuing the SDR based on a weighted average of exchange rates for the currencies of selected member countries. The U.S. SDR holdings and reserve position in the IMF also are valued on this basis beginning July 1974.

3/ Includes allocations of SDRs by the IMF plus transactions in SDRs.

4/ Includes holdings of Treasury and Federal Reserve System; beginning November 1978, these are valued at current market exchange rates or, where appropriate, at such other rates as may be agreed upon by the parties to the transactions.

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RR-1176

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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EMBARGOED UNTIL 2:30 P.M.
July 17, 1996

CONTACT: Office of Financing
202/219-3350

TREASURY TO AUCTION 2-YEAR AND 5-YEAR NOTES TOTALING $31,250 MILLION

The Treasury will auction $18,750 million of 2-year notes and $12,500 million of 5-year notes to refund $27,768 million of publicly-held securities maturing July 31, 1996, and to raise about $3,475 million new cash.

In addition to the public holdings, Federal Reserve Banks hold $1,517 million of the maturing securities for their own accounts, which may be refunded by issuing additional amounts of the new securities.

The maturing securities held by the public include $2,749 million held by Federal Reserve Banks as agents for foreign and international monetary authorities. Amounts bid for these accounts by Federal Reserve Banks will be added to the offering.

Both the 2-year and 5-year note auctions will be conducted in the single-price auction format. All competitive and non-competitive awards will be at the highest yield of accepted competitive tenders.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

Details about each of the new securities are given in the attached offering highlights.

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Attachment

RR-1177

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC OF
2-YEAR AND 5-YEAR NOTES TO BE ISSUED JULY 31, 1996

July 17, 1996

Offering Amount	$18,750 million	$12,500 million
Description of Offering:		
Term and type of security	2-year notes	5-year notes
Series	AH-1998	L-2001
CUSIP number	912827 Y6 3	912827 Y7 1
Auction date	July 23, 1996	July 24, 1996
Issue date	July 31, 1996	July 31, 1996
Dated date	July 31, 1996	July 31, 1996
Maturity date	July 31, 1998	July 31, 2001
Interest rate	Determined based on the highest accepted bid	Determined based on the highest accepted bid
Yield	Determined at auction	Determined at auction
Interest payment dates	January 31 and July 31	January 31 and July 31
Minimum bid amount	$5,000	$1,000
Multiples	$1,000	$1,000
Accrued interest payable by investor	None	None
Premium or discount	Determined at auction	Determined at auction

The following rules apply to all securities mentioned above:

Submission of Bids:

Noncompetitive bids . . . Accepted in full up to $5,000,000 at the highest accepted yield

Competitive bids . . . .
(1) Must be expressed as a yield with three decimals, e.g., 7.123%
(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all yields, and the net long position is $2 billion or greater.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Maximum Recognized Bid at a Single Yield . . . 35% of public offering

Maximum Award . . . . 35% of public offering

Receipt of Tenders:

Noncompetitive tenders . Prior to 12:00 noon Eastern Daylight Saving time on auction day

Competitive tenders . . . Prior to 1:00 p.m. Eastern Daylight Saving time on auction day

Payment Terms . . . . Full payment with tender or by charge to a funds account at a Federal Reserve Bank on issue date

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

Testimony of Lawrence H. Summers
Deputy Secretary

before the
Senate Committee on Commerce, Science, and
Transportation

July 18, 1996

Introduction

Chairman Pressler, Senator Hollings, Senator Stevens, Senator Inouye, members of the Committee. I appreciate the opportunity to appear before you to discuss the proposed Natural Disaster Protection and Insurance Act of 1996.

I would like particularly to thank Senator Stevens and Senator Inouye for their leadership on this issue. The concerns that prompted this legislation and hearing are bipartisan. Disasters make no distinctions on the basis of party affiliation or state boundaries, and all of us recognize that the costs of natural disasters are too high, not only to federal, state and local governments, but to businesses, homeowners, and residents throughout the nation.

The Clinton Administration is committed to ensuring that we respond quickly and appropriately whenever and wherever disaster strikes. As a result, American communities impacted by natural disasters receive our help faster than at any time in our history. Responding to disasters is only one part of the equation -- the more difficult part is finding what steps can be taken to reduce the overall costs natural disasters impart. We commend the Committee for attempting to address this problem. Unfortunately, we believe that the proposed legislation does not yet accomplish this goal.

We have four principal concerns with S.1043: (1) the bill does not significantly reduce the costs of natural disasters, as the mitigation provisions are inadequate; (2) the bill introduces a federal role in regulating the insurance industry, a significant change that warrants careful study; (3) the bill provides a broad antitrust exemption for the reinsurance industry, without yielding clearly defined benefits; and (4) the bill subjects the taxpayers to a major potential liability through the auction of excess-of-loss contracts, an effort that requires a good deal more work before enactment.

S.1043 does provide benefits to the insurance industry. However, legislation in this area should be comprehensive and include effective mechanisms that will reduce the growth of

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federal disaster expenses as well as the overall impact and economic cost of catastrophic occurrences.

Reducing the Costs of Catastrophic Events

Over the last decade, federal expenditures due to natural disasters have grown substantially. Since Hurricane Hugo in September 1989, the federal government has expended almost $34 billion for emergency assistance and rebuilding after major disasters, including $9.5 billion for Hurricanes Andrew and Iniki, and Typhoon Omar in 1992; $7 billion for Midwest floods in 1993; and $12 billion for the Northridge earthquake in 1994.

We need, as a nation, to do better. We have to address the total problem in the area of natural disasters, and this requires addressing how we reduce the costs of disasters. As is true in medicine, "an ounce of protection is worth a pound of cure." The principal strategy for reducing the costs of natural disasters is pre-disaster mitigation. While insurance can, and should, have an important role in encouraging mitigation, it is primarily a means of spreading, not reducing, costs.

There are two reasons why the mitigation provisions of S.1043 are unlikely to significantly improve what is already being done by states and localities. First, the bill provides insufficient funds for pre-disaster mitigation. Meaningful mitigation efforts require states and communities to invest resources in their critical infrastructure to better withstand natural disasters. The funds provided in S.1043 through the hazard mitigation fund are much too small to have any real effect. As you may know, the proposed hazard mitigation fund will receive the unobligated FEMA Section 404 funds and a surcharge of no more than 5% of the proceeds of the excess-of-loss contracts. Our preliminary estimates indicate that under $20 million per year would be available to this fund, assuming that Treasury auctioned most of the excess-of-loss contracts. On a pro rata basis, this small pool is unlikely to offer sufficient incentives to states or localities to undertake the implementation of genuine mitigation measures. As a point of reference, communities in the State of California currently spend over $3 billion annually on fire protection alone.

Second, S.1043 will not encourage any new mitigation planning. States and localities already undertake flood mitigation planning under the National Flood Insurance Reform Act of 1994, Section 409 planning under the Robert T. Stafford Disaster Relief Act of 1968, mitigation planning funded through National Earthquake Hazard Reduction Act of 1977, and mitigation planning through the Performance Partnership Agreements. The federal government should continue to work with states to simplify, consolidate and focus the mitigation planning already supported at the state and local level. FEMA is currently working with states to clarify state mitigation roles and unify planning requirements.

Successful natural disaster strategies must begin first with concrete methods of reducing the costs to society and governments. This bill, at best, touches on these issues and calls for a study.

Federal Involvement in Setting Insurance Rates

S.1043 creates a loss costs commission within the Treasury Department, responsible for providing loss costs estimates for natural disaster insurance. This commission would in essence be charged with setting rates for the insurance industry, without any regulatory oversight. It would effectively set a floor for hazard insurance rates within every state for each of the natural disaster perils.

There are a number of problems with this proposal. The most significant is the expansion of the federal role into the setting of insurance industry rates. I believe we must proceed very carefully in considering any type of expansion. It may be that a convincing argument can be made for increased federal involvement in the insurance industry. However, I do not believe that the government should take ad hoc steps to regulate any industry -- particularly one that is explicitly the subject of state regulation -- without full consideration of the potential implications.

I am also concerned about the difficulty that a commission would face with setting loss costs on a national basis. It is questionable whether the commission would be able to resolve the contentious issues that would be likely to arise regarding the risk estimation models, particularly questions that relate to the estimates of the frequency and costs of major disasters. It is likely that communities at risk from earthquakes will dispute the estimated loss costs ranges due to the "catastrophic" nature of the estimates, and the inherent difficulty and uncertainty in predicting the occurrence of earthquakes. Similarly, communities at risk from hurricanes face similar uncertainties with respect to long term weather forecasts. We know that risk modeling is an area undergoing tremendous and dynamic development. With the industry continuously creating new, more sophisticated models, the creation of a commission might in fact have the unintended consequence of impeding the further development by the private sector of effective models.

The commission's rate setting mechanism could prove to be unfair to states and to consumers. While private insurance firms will have the option of adopting the loss costs estimates in their rate filings with state regulators, state regulators will be required to treat the loss costs as authoritative unless the regulator makes a finding that the costs are excessive, inadequate or unfairly discriminatory. We believe that this structure may not allow state regulators to properly challenge an inflated loss costs component of a rate application. If a commission is needed at all, it should be structured in a manner that provides both regulators and insurance companies with optional loss costs ranges based on publicly disclosed models. This bill would not have that effect.

Finally, S.1043 would place a new administrative burden on the federal government. Our estimates suggest that the staffing needs for the new commission will be about 75 full time staff employees, a number which does not include the 11 part-time commissioners, and require annual funding of at least $15 million. The bill would authorize only $5 million for the initial expenses of the proposed commission.

Antitrust Exemptions for the Reinsurance Industry

S.1043 proposes a new antitrust exemption for natural disaster reinsurers. Such an exemption is not needed to enable the private insurance industry to provide reinsurance in an appropriate pro-competitive fashion. If natural market forces are insufficient to induce the private insurance industry to provide this reinsurance, we do not see any additional incentive that would be afforded through a broadened antitrust exemption, other than the prospect of the extra profit to be gained by engaging in anticompetitive activity. This incentive would clearly work to the detriment of the insurance-buying public.

The business of insurance already enjoys substantial antitrust immunity under the McCarran-Ferguson Act, an exemption that has been highly controversial over the years. However, there is an important exception to McCarran-Ferguson: the insurance industry is prohibited from engaging in group boycotts. We see no reason to abandon this protection in the context of reinsurance for natural disasters.

Excess-of-Loss Contracts

We support the concept for federal excess-of-loss contracts to increase industry capacity to insure against major disaster risks. These contracts would provide a financial instrument that, if effectively used by the insurance industry, could increase the capacity of the primary insurance and reinsurance markets to provide natural disaster coverage. Nevertheless, we recognize that there are no assurances that the industry will transfer this capacity to consumers in the form of increased coverage.

We believe that an excess-of-loss proposal without further exploration would be premature. I have two concerns: First, experience suggests that for the federal government to take on large responsibilities of the kind envisioned by S.1043, extraordinary caution is needed. The amounts in question may be as high as $25 billion per year. It is conceivable that they would be as large as $250 billion over a decade, an amount that approaches the costs of the Savings and Loan bailout. While the contracts would be sold through an auction mechanism, and the federal government should receive fair consideration, experience suggests that without great care in the development and management of this program, there is a real risk that the federal government will not be adequately compensated. Second, it is important that benefits pass through to ensure more widely available hazard coverage for consumers. In this area, we need to better understand the relationship between pricing and availability.

Conclusion

In conclusion, natural disaster losses affect us all. It is essential that we work together to reduce their impact. But it is an extremely complex and multi-faceted problem. We look forward to working with this Committee and others to push ahead toward actions -- whether administrative or legislative, federal, state, local or private -- that will make natural hazards less synonymous with natural disasters.

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
July 18, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 52-WEEK BILLS

Tenders for $19,372 million of 52-week bills to be issued July 25, 1996 and to mature July 24, 1997 were accepted today (CUSIP: 9127942S2).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.47%	5.79%	94.469
High	5.49%	5.81%	94.449
Average	5.49%	5.81%	94.449

Tenders at the high discount rate were allotted 41%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$48,581,604	$19,372,364
Type		
Competitive	$42,425,495	$13,216,255
Noncompetitive	929,809	929,809
Subtotal, Public	$43,355,304	$14,146,064
Federal Reserve	4,850,000	4,850,000
Foreign Official Institutions	376,300	376,300
TOTALS	$48,581,604	$19,372,364

An additional $795,200 thousand of bills will be issued to foreign official institutions for new cash.

5.48 - 94.459

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DEPARTMENT OF THE TREASURY

TREASURY NEWS

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FOR IMMEDIATE RELEASE
July 22, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $13,555 million of 13-week bills to be issued July 25, 1996 and to mature October 24, 1996 were accepted today (CUSIP: 9127943L6).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.12%	5.26%	98.706
High	5.15%	5.29%	98.698
Average	5.14%	5.28%	98.701

Tenders at the high discount rate were allotted 12%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$48,336,868	$13,554,560
Type		
Competitive	$43,110,903	$8,328,595
Noncompetitive	1,323,287	1,323,287
Subtotal, Public	$44,434,190	$9,651,882
Federal Reserve	3,232,500	3,232,500
Foreign Official Institutions	670,178	670,178
TOTALS	$48,336,868	$13,554,560

An additional $89,822 thousand of bills will be issued to foreign official institutions for new cash.

5.13 - 98.703

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FOR IMMEDIATE RELEASE
July 22, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $13,591 million of 26-week bills to be issued July 25, 1996 and to mature January 23, 1997 were accepted today (CUSIP: 9127943W2).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.28%	5.50%	97.331
High	5.30%	5.52%	97.321
Average	5.30%	5.52%	97.321

Tenders at the high discount rate were allotted 18%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$54,423,774	$13,590,890
Type		
Competitive	$46,501,196	$5,668,312
Noncompetitive	1,259,786	1,259,786
Subtotal, Public	$47,760,982	$6,928,098
Federal Reserve	3,400,000	3,400,000
Foreign Official Institutions	3,262,792	3,262,792
TOTALS	$54,423,774	$13,590,890

An additional $436,108 thousand of bills will be issued to foreign official institutions for new cash.

5.29 - 97.326

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TREASURY NEWS

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STATEMENT OF ROBERT E. RUBIN
SECRETARY
DEPARTMENT OF THE TREASURY
BEFORE THE SENATE CAUCUS ON INTERNATIONAL NARCOTICS CONTROL AND THE SENATE SUBCOMMITTEE ON INTERNATIONAL TRADE
July 23, 1996

Mr. Chairman, thank you for the invitation to meet with you and your colleagues this morning. I welcome the opportunity to address the critical issue of how drug trafficking and money laundering may pose threats to our trade and our financial systems. Mr. Biden, I would also like to thank you for your commitment and leadership on the issue of combatting drug trafficking and abuse.

Mr. Chairman, in lieu of my own testimony, I wish I could simply read the letter you sent to me about this hearing. It captured in precise terms the great challenge we face every day at Treasury. We believe American jobs, wages, and profits depend upon our nation embracing the competitive pressures and possibilities of the international marketplace. At the same time, we understand that changes in markets, technology, financial institutions, and in the ways criminal enterprises do business make our country vulnerable to the trade in illegal drugs and the laundering of criminal profits. You have identified the gravity of this problem, and we share your concerns about it.

Rapidly expanding commerce helps the American people, but more activity can also provide greater opportunities to criminals to misuse the trade and financial systems that facilitate the flow of goods and services between countries. As the volume of goods and funds crossing our borders grows, governments must increasingly combat threats to trade and national security. With the increased sophistication of financial systems, governments must address the vulnerabilities of these systems in a world where it is easier than ever to transfer money from one financial institution to the next, and from one country to the next.

Our government has no greater priority for public safety and public health than stopping the smuggling, trafficking, and use of illicit narcotics, and the movement of illicit financial gains from the illicit narcotic trade. Drugs poison our youth, lead to violence throughout our society, and adversely affect our economy. Money laundering allows criminals to hide and enjoy their illicit gains, while threatening legitimate financial institutions. At the same time, however, money laundering can also be a vulnerability for the traffickers. Criminals try to separate themselves from their illegal operations, but they cannot separate themselves from their illegal profits. That means that money laundering gives us a powerful vantage point from which we can address both the threats posed to our financial system from illegal profits <u>and</u> the criminal activities that produce those profits.

The men and women who protect our borders face daily challenges from the smuggling of weapons, technology, drugs, counterfeit commercial products, and unfit agricultural products. The Departments of Defense, Treasury, Justice, State, ONDCP, and other agencies as well, are joined in a partnership to address every facet of this problem, and we are proud to work with the field general who coordinates these efforts, Barry McCaffrey.

Treasury has special expertise in the matters you are addressing today. Interdiction is a principal mission of the Treasury Department, and remains the number one priority of our bureau, the U.S. Customs Service. Treasury has also developed a powerful program to combat money laundering, because hitting traffickers in the pocketbook and preventing them from laundering drug profits is an effective way to undermine the trafficking organizations themselves.

That program includes the Criminal Investigative Division of the IRS and Customs which target money laundering operations in their own investigations and in Task Forces such as the Organized Crime Drug Enforcement Task Forces and High Intensity Drug Trafficking Areas. These operations are aided greatly by the Financial Crimes Enforcement Network which serves as a central collection and dissemination point for financial information crucial to money laundering investigations.

Treasury also operates through international organizations such as the G-7, the Summit of the Americas, and the Financial Action Task Force to develop common law enforcement strategies, legislation and regulation against drug traffickers and money launderers.

Now, let me give you a few examples of what Treasury has been doing in these areas to combat drugs and money laundering:

First, Customs is focused on the interdiction problem in the Southwest and has instituted Operation Hard Line. Because of Hard Line, Customs now has more agents, more inspectional resources, more physical barriers against port running, and more secondary inspections to stanch the flow of illegal drugs across the border. In a single year, this operation has led to a 24% increase in narcotics seized at the border. Moreover, it has resulted in an over 50% decrease in port running incidents.

Second, because traffickers are migrating from the Southwest to the Caribbean as a major entry point for narcotics, Customs is implementing Operation Gateway in Puerto Rico and the Virgin Islands. Cocaine seizures in Puerto Rico for the first half of FY96 have increased by 46%, from 10,458 pounds in FY1995 to 15,284 pounds in FY96. During that same period, heroin seizures in Puerto Rico have increased substantially as well.

Third, Treasury's bureaus are active participants in the Organized Crime Drug Enforcement Task Forces and High Intensity Drug Trafficking Areas program. We are making important progress through initiatives such as the Customs-IRS anti-money laundering Task Force, "Operation El Dorado," and the Customs-DEA led "Operation Cornerstone," which helped lead to the indictment of four of the Cali cartel leaders.

Recently, Ray Kelly, the Treasury Department's distinguished Undersecretary for Enforcement, and I visited with the men and women who run El Dorado in New York. This operation is doing very impressive work. The Task Force focuses on money transmitters and supplements the enforcement efforts of New York State financial authorities who can devote only a handful of experts to track the illegal activities of hundreds of suspect firms and individuals. In the last three years, they have seized literally tens of millions of dollars and tons of illegal drugs.

Fourth, the Assistant Secretary of Treasury for Enforcement, Jim Johnson, is a principal in the High Level Contact Group with Mexico. This group, coordinated by General McCaffrey, meets directly with high level officials to urge even greater efforts by Mexico on narcotics control and anti-money laundering matters. Treasury has the lead role with respect to money laundering issues, and we use the group to stress the importance of Mexico expanding the work it began with the criminalizing of money laundering. Just last week, a Treasury delegation went to Mexico to discuss mandatory reporting requirements for banks and other financial institutions which will make the Government of Mexico better able to track illicit proceeds.

Fifth, the Summit of the Americas nations have targeted money laundering. Last December, I chaired a ministerial conference in Argentina where the nations of the hemisphere stated their support for legal, regulatory, and law enforcement measures, including the need to criminalize money laundering, to implement regulatory measures such as currency transaction reports, and the creation of financial intelligence units to better disseminate important financial information to investigatory authorities.

Sixth, two weeks ago, General McCaffrey, Attorney General Reno and I co-hosted a southwest border conference in El Paso. At the conference, there were strong presentations on the drug smuggling corridors along the borders each of the states, the importance of good intelligence information, the critical role coordination plays among law enforcement agencies at all levels of government, and the importance of even greater coordination with, and support from, the Mexican authorities. In addition, there was great emphasis on money laundering strategies and their great potential for attacking the operations of narco-traffickers.

Seventh, we are working with the Departments of State and Justice to respond to President Clinton's call for international dialogue on money laundering problems through a money laundering initiative. As directed by President Clinton last October, we have declared a national emergency against the Cali Cartel, and have taken steps under the International Economic Emergency Powers Act to block assets of companies owned by this group, and to prohibit all economic transactions by U.S. persons with these parties. We have taken those steps against 282 companies and persons either owned or controlled by or acting for or on behalf of the Cali Cartel, and are continuing to review information to add more names to this list.

Eighth, a group headed by the Comptroller of the Currency reviews issues arising with the development of new forms of currency, including how the enhanced use of electronic money relates to money laundering. FinCEN and the other law enforcement bureaus are members of this group, and they are reviewing new means for tracking and reporting such transfers so we can continue following all kinds of illicit proceeds.

As you can see, Mr. Chairman, Treasury is deeply engaged in the fight against illegal drugs. We are standing against organized crime and international drug traffickers who are intent on using every technological or market development to sell illegal narcotics and launder illicit funds.

These are clearly crimes that involve the cutting edge of technology and which search for weak links across national borders. They place at risk not only the soundness of the financial system but the kind of society in which our children will grow up. Because Treasury presides at the junction where trade, finance and enforcement meet, we are focusing on this issue with great intensity -- using the unique assets Treasury has in the finance and enforcement areas, and collaborating effectively with our Cabinet and White House colleagues, wherever and whenever we can.

The problem of drugs is not a partisan issue. We believe that hearings like this advance our own understanding of the issue and our effectiveness in addressing it. We hope to hear from you, formally and informally, about how we can wage this fight more effectively. With the leadership of the President and the Congress, we will continue to work aggressively against illegal narcotics, the profits they generate, and the organizations which ply this very dangerous trade.

I thank you for providing the opportunity to discuss these problems today and I look forward to working with you in the future.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

STATEMENT OF LAWRENCE SUMMERS
DEPUTY SECRETARY
DEPARTMENT OF THE TREASURY
BEFORE THE SENATE SUBCOMMITTEE ON INTERNATIONAL TRADE,
CAUCUS ON INTERNATIONAL NARCOTICS CONTROL
U.S. SENATE
July 23, 1996

Mr. Chairman and members of the Subcommittee, thank you for inviting me to meet with you this morning. I welcome this opportunity to address the vitally important issue of Treasury's efforts to combat the scourge of drug trafficking and the laundering of the profits derived from drug trafficking as they relate to trade and finance.

Treasury's Efforts to Combat International Drug Trafficking and Money Laundering

Increasing international trade is a fact of the global economy. As the Secretary has said, while the expansion of trade provides many benefits to the American people, it also provides an expansion of opportunities for those who will misuse the trade and financial systems that regulate and facilitate the flow of goods and services between countries. The Treasury Department and its bureaus have been entrusted with ensuring the soundness of our financial system and protecting our borders. We are vigilant in our efforts to combat crime which threatens our nation's financial security.

At Treasury, fighting international drug trafficking and money laundering is a top priority and we utilize all of our resources and the expertise of all of the Treasury bureaus, to combat these problems. For example:

- The Customs Service actively pursues border interdiction, and anti-smuggling and money laundering investigations.

- Agents of the Criminal Investigation Division of the Internal Rev·nue Service conduct intense financial investigations to follow the trail of dirty money to its source.
- The Secret Service utilizes its financial expertise in countering white collar crimes pursued by the traffickers as ends in themselves and as means to hide other illicit assets.
- ATF attacks drug distribution networks by disrupting their trafficking in illegal firearms and uncovers money laundering activities during the course of its investigations into illegal alcohol, tobacco, firearms and explosives schemes.
- The Financial Crimes Enforcement Network (FinCEN) provides a wealth of financial information and analytical skills to the investigating bureaus and local law enforcement.

We are applying a multifaceted approach to combat drug trafficking and money laundering. We are working smarter and focusing our energies where they are most needed. Our efforts include:

- strengthening the physical barriers at our borders,
- increasing our interdiction efforts at the borders,
- applying more sophisticated techniques to reviewing the individuals and vehicles crossing our borders,
- upgrading our technology,
- assigning an increased number of agents to problem areas along our borders,
- increasing our efforts at interdiction efforts at sea,
- pursing intensive investigations in coordination with other law enforcement agencies,
- actively participating in anti-drug trafficking and anti-money laundering task forces,
- promoting international cooperation and uniformity of anti-money laundering laws,

- posting of Treasury agents to strategic posts outside the US, and
- conducting training for law enforcement agents in other countries.

Drug Trafficking

In our anti-drug smuggling activities, much of our effort is directed at interdicting narcotics at our border. As you know, the Southwest border is a principal entry point for narcotics. The Customs Service has intensified its efforts to combat drug trafficking at the Southwest border. A primary example of these efforts is "Operation Hard Line", a Customs Service program to harden our border defense against drug smuggling by focusing on smuggling in vehicles and commercial cargo, investigations, and intelligence support at ports of entry. Operation Hard Line recently concluded its first year of operation on the Southwest border.

As a part of Operation Hard Line, Customs officials at ports of entry are increasing the frequency of inspections of the lines of trucks and cars waiting to cross the border, increasing the use of drug-sniffing canines, questioning more drivers, and increasing the use of instruments to detect structural irregularities, such as empty spaces and false floors, which can provide a hiding place for narcotics or cash, without having to climb into or dismantle the vehicle. Customs has also strengthened Southwest border enforcement efforts by transferring 117 Special Agents to the Southwest border. These additional agents will allow Customs and other anti-narcotics agencies to enhance tracking of intelligence and leads that should reduce drug smuggling and trafficking even further. Moreover, Customs has built physical enhancements, such as movable and stationary barriers and tire-deflating devices, to deter "port runners" - those drug couriers who would run over our law enforcement personnel and innocent civilians to evade inspections which would reveal their contraband.

Thus far, $55 million have been allocated to Operation Hard Line, allowing for more inspections, as well as greater collection and use of intelligence to build complex anti-smuggling cases. This allocation has financed enhanced technology, such as truck x-ray systems, as well as the construction of the stronger physical barriers.

The results of Operation Hard Line thus far are encouraging, and seizures along the Southwest border in Fiscal Year 1995 increased dramatically from the previous fiscal year. Overall, Customs reports that the total amount of drugs seized on the Southwest border in Fiscal Year 1995, in pounds, is up 24 %. Operation Hard Line has also reduced the incidents of violent port running by over 54 percent.

<u>Seizures</u>

Customs seizes more drugs than all other federal agencies combined. In fiscal year 1995 Customs seized over 85% of the heroin, 61% of the cocaine, and 51% of the marijuana seized by all Federal agencies.

Every day, all along the border, shipments of drugs are cut off, thanks to the dedicated men and women of the Customs service, the increased cooperation with other federal agencies, and the additional support in terms of personnel, equipment and technology through Operation Hard Line. For example:

- Hidalgo, Texas, November 1995 - a tractor with a refrigerated trailer filled with broccoli yielded 749 pounds of cocaine.
- Nogales, Arizona, February 1996 - inspectors found 1,257 pounds of cocaine hidden in a transformer.
- Tecate, California, March 1996 - agents seized 4,200 pounds of marijuana in a phony UPS

truck.

- Brownsville, Texas, April 1996 - follow up investigations on a previous big cocaine seizure led to another 3,080 pounds in a tractor trailer.
- Laredo, Texas, April 1996 - another 2,301 pounds of cocaine was found in a refrigerated trailer by a drug sniffing canine and his handler.
- Grande City, Texas, May 1996 - a refrigerated trailer yielded 2,039 pounds of cocaine.
- San Ysidro, California, June 1996 - a Volvo was stopped with 44 pounds of heroin.
- In Operation Cornerstone, one of the most comprehensive investigations into the operations of the Cali Cartel, Customs and DEA uncovered six major smuggling routes used by the Cartel to move hundreds of thousands of pounds of cocaine inside shipments of lumber, concrete fence posts, frozen vegetables, and coffee into the US since the early 1980s. Operation Cornerstone has provided a unique understanding of how the Cali Cartel conceals its drugs, smuggles them into the US, distributes them within the US, collects and launders drug monies and provides a sophisticated system of facilitation and support to the members of their organization in the US.

We are building on these successes. The President's Fiscal year 1997 budget includes an additional $65 million for Operation Hard Line. These funds will pay for more and improved x-ray equipment for examination of cargo, more and better targeted examination of passenger vehicles, automated license plate readers, and more agents for the collection of intelligence and the building of cases against trafficking organizations. By the end of 1997, 657 additional Customs agents and inspectors will be on the job to better stop the smuggling of narcotics across the Southwest border. Customs will also receive 170 more support personnel from the National

Guard to assist in narcotics detection and anti-smuggling.

Line Release Program and Land Border Carrier Initiative

Commissioner Weise took another important step last October to strengthen the border against smuggling by restricting participation in the Line Release Program. Line Release is a program begun in 1987 to pre-screen shipments of companies with a clean record, but still subject them to random full-scale inspections. Since last October, approval of new applicants for participation in the Line Release Program has been restricted to importers who ship their cargo using carriers who have agreed to become part of the Land Border Carrier Initiative. The Land Border Carrier Initiative strengthened the Line Release Program by requiring participants to provide information about the trucking companies and drivers they use, and to use only trucking companies and drivers approved by Customs. The program is designed to encourage the carriers to police their own facilities and conveyances thereby making them less vulnerable to narcotics smuggling. The approval process essentially requires trucking firms to give background information on themselves and their employers, to create, under the guidance of Customs, anti-smuggling safeguards at their warehouses and lots, and to open these facilities to unannounced inspections by Customs officials. As of May, 1996, 525 carriers had signed up to participate in the Land Border Carrier Initiative Program and to date 280 carriers have been certified by Customs. As of July 1, 1996, all Line Release shipments entering at the Southwest border can only be carried on Customs approved trucks.

The Line Release Program and Land Border Carrier Initiative are important examples of how we are working more effectively in dealing with the increased trade volume to counter smugglers and money launderers. By reviewing and evaluating shipments before the trucks even reach the border, Customs is able to strategically target vehicles for inspection. This focus developed by Commissioner Weise is an important example of how more resources can be targeted at higher risk shipments as a result of strategic enforcement.

Operation Gateway

Treasury is also responding to the shift of certain smuggling efforts to other parts of the country. In part because of enhanced enforcement at other locations, Puerto Rico and the Virgin Islands have become major entry points for narcotics being smuggled into the US and for money laundering into major Latin American banking networks. In response, a long term initiative - called "Operation Gateway" - was initiated in March 1996. Operation Gateway encompasses all areas of interdiction, including expanded marine and air enforcement, heightened cargo examination and expanded small vessel searches. The program also calls for enhanced use of technology, additional inspection and investigative support, and a joint collaborative effort by Customs, the Coast Guard, the Defense Department, and the Department of Justice. Operation Gateway involves the deployment of high speed vessels, the use of 2 additional helicopters, the use of a portable x-ray system to examine cargo and baggage, and the assignment of additional personnel to the island. Since March 1996, Customs has already seized 68.3 pounds of heroin and 2,727 pounds of cocaine in Puerto Rico. This represents and increase of 68.3% and 307% percent, respectively, over the same period in 1995.

Cooperation by Carriers

Customs is also promoting efforts by air, sea and land carriers to deter smugglers of illegal drugs. Currently 3,500 carriers have signed agreements with Customs to share the burden of stopping the flow of illegal drugs into this country by inspecting their own vehicles and notifying

Customs of any illegal cargo. During 1995 alone there were 93 documented instances in which carriers alerted Customs to narcotics aboard their conveyances upon arrival in the US, or in which carriers intercepted the narcotics prior to the carrier leaving for the US. Combined, these carrier actions accounted for the seizure of 25 pounds of heroin, 8,096 pounds of cocaine and 46,624 pounds of marijuana. These cooperating carriers saved themselves millions of dollars in possible penalty actions by passing along information that they received or observations that they made.

Improved Targeting

The interdiction of drugs concealed in commercial shipments can be very labor intensive and requires skill in sorting out the appropriate targets from the millions of shipments. Customs has implemented and is preparing to implement a variety of programs which enhance targeting and interdiction at cargo facilities while maintaining/enhancing processing times of legitimate cargo. In support of our automated systems, Customs employees are formed into multi-disciplinary contraband targeting and intelligence units that constantly review commercial documentation and research information in various databases. At the largest ports these cross-functional teams are made up of agents, intelligence analysts and inspectors to identify targets and provide employees with up to the minute information on smuggling threats. Later this year, Customs will place a prototype advanced Automated Targeting System (ATS) at select high risk ports of entry. This system will separate high risk shipments from legitimate ones.

Money Laundering

In addition to our efforts to stop smuggling at the border, Treasury's law enforcement bureaus also attack traffickers and their organizations by following their illicit profits. Treasury has enacted an aggressive and comprehensive anti-money laundering program which hits criminals in the pocketbook. This prevents them from laundering drug profits and is an effective way to undermine the activities of the trafficking organizations themselves.

In addition to taking away traffickers' profits, money laundering investigations are also important because following the money trail can lead to prosecution of the upper levels of the trafficking organizations. Drug lords can keep themselves far removed from street-level deals, but they cannot divorce themselves from their profits. Denying traffickers access to their profits robs them of the benefit of their trafficking.

To evaluate the success of anti-money laundering programs, one must first realize that money laundering is a relatively new concept. It has only been criminalized in the United States since 1986 when Congress enacted the money laundering law, 18 U.S.C. sections 1956 and 1957.

As a result of U.S. attention to the problem as well as global focus from the Financial Action Task Force and other multilateral initiatives, more than 60 countries have criminalized money laundering in the last 10 years.

The efforts of the Financial Action Task Force has resulted in the establishment of Financial Intelligence Units (FIUs) in various nations around the world to protect the banking community, to detect criminal abuse of its financial system and to ensure adherence to its laws against financial crime. The Financial Crimes Enforcement Network is one model of an FIU and others exist in such countries as Great Britain, France, Belgium, the Netherlands, Argentina and Australia. Where five years ago, there were fewer than five FIUs in the world, today there are more than 20 countries with financial intelligence units focused on money laundering issues. As world policy efforts intensify in addressing international crime, Treasury, State and Justice are assisting with the establishment of FIUs in countries such as Poland, Panama and Ecuador.

Many criminal organizations are desperate to move their cash out of the United States because its just too risky to launder it here. Presently, the safest way for criminals to repatriate criminal proceeds to Colombia is to sell their U.S. dollars to Colombian businesses. This procedure of hiding their money is complicated, involves many steps and is therefore expensive. According to reports, the cost of laundering has risen from six percent in the mid 80's to more than 20 percent today. We are having an effect on the day-to-day laundering operations.

Treasury is attacking money laundering on all fronts - through enforcement, intelligence, and investigations.

Enforcement

Treasury's commitment to anti-money laundering enforcement is evidenced by the number of agents assigned to investigate these cases and the number of cases successfully prosecuted. Our efforts have met with great success. Treasury has committed the full time equivalent of 2,821 personnel, including 1,100 agents, to investigating money laundering and, in the last six years, IRS and Customs have successfully prosecuted more than 12,000 money laundering and currency crimes. Since 1993, we have seized over $500,000,000 and have obtained the largest penalty ever assessed against a bank for money laundering - $30 million. On average, every Customs agent working money laundering investigations seized $600,000 per agent per year. In Fiscal year 1995 alone, the Treasury bureaus seized and forfeited over $200,000,000.

Thus, Treasury is using its resources in an efficient and coordinated way and our systematic approach to financial crime enforcement is paying off. Let me give you a few examples of our cases:

Operation El Dorado is a task force of approximately 150 law enforcement officers in the

New York/New Jersey metropolitan area from Customs, IRS, Secret Service, HHS, New York and New Jersey police, and federal and state prosecutors. The task force investigates illicit proceeds that have entered the banking system disguised as normal business earnings and the illicit proceeds that cannot be traced to their origin because numerous financial transactions were conducted to disguise the paper trail. Investigations include the narcotics smuggling cartels of South America, traditional organized crime, African and European organized criminal organizations and terrorist groups. To date, over $70 million in cash and assets have been seized, approximately 1000 kilograms of cocaine have been seized and over 100 arrests have been made for money laundering.

- Operation No Mas is an on-going Customs investigation which has resulted in the dismantling of a criminal organization responsible for the importation of approximately 30,000 kilograms of cocaine and 6 million pounds of marijuana into the US. Thus far, this investigation has resulted in the seizure of real estate in Florida, $3.5 million dollars, and the freezing of $210 million dollars in Swiss bank accounts. Through this investigation, Customs exposed the infrastructure of unique drug smuggling organizations and their ability to hide huge quantities of money in bank accounts throughout the world.
- As a part of Operation Dinero, an undercover international money laundering investigation, IRS and DEA established and operated an undercover bank to gain knowledge of the illegal activities of the Cali Cartel. The operation resulted in 74 arrests in the US, 43 arrests in Nova Scotia, Spain and Italy, seizures of 25 kilos of cocaine, 41 tons of hashish, 2,777 pounds of marijuana, over $38,000,000 in currency and over $65,000,000 in property.

Intelligence

As part of our effort to obtain better intelligence leading to additional criminal prosecutions we have recognized the need to improve the international tracking of the flow of laundered money. To enhance this goal, Treasury has authorized FinCEN to use nearly $700,000 in asset forfeiture funds to upgrade and expand significantly our communications with, technical assistance to, and training of the other financial intelligence units (FIUs) - the counterparts of FinCEN - around the world. This network of anti-money laundering intelligence organizations has been growing rapidly in the last year. There are now 20 FIUs around the world, with almost an equal number of countries poised to create these units in the near future. The success of this initiative will continue to increase the vulnerability of money launderers and decrease the havens where they can hide and enjoy their ill-gotten gains.

Continuing Challenges

Despite these successes, we still face many challenges in the years ahead. For example, the Bank Secrecy Act, which was enacted to make it more difficult for criminals to launder their illegal profits, created reporting requirements for financial institutions and individuals. Financial Institutions are required to report cash transactions over $10,000 and individuals are required to report international transportation of currency and monetary instruments over $10,000. Nevertheless, electronic money - such as "smart cards', electronic banking, and computer transactions - does not expressly fall within the definition of "monetary instrument". This creates a loophole to avoid reporting requirements. Cash can be converted to a stored value card and does not have to be reported. This allows for wholesale avoidance of reporting requirements and the movement of digital currency across borders by money launderers. Likewise, money transferred internationally through the Internet is not subject to reporting requirements. Although wire transfers are not reportable, banks are required to maintain records of transfers. Audit trails exist. Transfers through the Internet on the other hand can be completed without the use or intervention of banks. As a result, there is no audit trail.

An added challenge lies in the fact that many countries lack the capacity to investigate criminal cases with global implications, especially those requiring substantial technical proficiency. The rise in use of computers and alternative payment technologies present new opportunities for those intent on perpetrating electronic fraud. As commerce, banking and all other facets of business and exchange are digitized, our ability to deal successfully in shutting down these schemes will become crucial.

International Cooperation is Vital to our Success

The ease with which money can be moved internationally makes the laundering of money easier for traffickers and smugglers. As a result, it is more necessary than ever to have all nations actively involved in anti-money laundering efforts. The cash available, for example, to the cartels or the "mob" organizations gives them an extraordinary opportunity to dominate fledgling sectors of the legitimate economy as few legitimate firms or business people can. Financial fraud and money laundering schemes have a major impact upon global financial systems. It is estimated that transnational organized crime groups are responsible for billions in financial losses. Therefore, the efforts of the international community must be focused on these potential abuses.

Treasury is actively engaged in the international arena. Our activities have included:

- The Summit of the Americas communique (Buenos Aires) involved 34 governments of the Western Hemisphere endorsing a coordinated multilateral plan committing hemisphere governments to combat money laundering. The nations agreed on the need to criminalize the laundering of the proceeds of drug trafficking and other serious crimes, authorize the seizure and forfeiture of the proceeds of these crimes, promote regulatory efforts such as requiring reporting of suspicious financial transactions; and create financial information units, similar to Treasury's FinCEN.

- As a follow-up to the Summit, in May 1996, the Secretary hosted a meeting of the finance ministers of the western hemisphere at which, for the first time, money laundering was included on the agenda. The Secretary further stressed the initiatives of the Summit.
- Just weeks ago, the Financial Action Task Force completed an update of its 40 recommendations which had been issued in 1990 to ensure that the countermeasures address today's money laundering threat. These new recommendations will serve as a benchmark for the next century.
- In March 1996, the Asia Pacific Economic Counsel (APEC) met and, for the first time, discussed the importance anti-money laundering measures.
- Interpol recently adopted resolutions aimed at thwarting international financial crimes, including the first major anti-money laundering declaration in its history. This was done with considerable US backing and leadership by Treasury's Office of Enforcement.
- As previously mentioned, a global network of anti-money laundering Financial Intelligence Units - the counterparts of Treasury's FinCEN - is being organized to facilitate the exchanges of money laundering information and other financial data.
- A coordinated effort employing modern technology and program management; the use of multi-agency task forces to investigate these formidable groups; sharing investigative

information and working on specific cases; and planning and organizing international training seminars that lead to notable international law enforcement partnerships, is needed and is being encouraged through a number of venues, including the G-7 nations.

- A US government team of experts from federal regulatory, law enforcement, and foreign affairs agencies is working with their counterparts in Russia to develop new laws, regulations and investigative capabilities that will strengthen the framework for international cooperation to prevent money laundering and financial fraud.
- Treasury bureaus are actively involved in international training activities. Customs has provided overseas anti-narcotics training, emphasizing containerized cargo, to Mexican customs agents in Mexico City and four other large cities along the border. Customs also provided anti-money laundering training in 16 countries in Europe, Asia, and Central and South America. IRS has provided anti-money laundering and financial crimes training in Russia, Belarus, the Ukraine, Argentina and at the International Law Enforcement Academy (ILEA) in Budapest, Hungary. In the next two months they will be teaching classes in Eastern Europe, Brazil and Budapest.

We recognize that we have to make concerted efforts to obtain cooperation with some countries that are engaging in money laundering practices. Last October, President Clinton directed that we work directly with countries to ensure cooperation against money laundering. The Treasury Department is working with the State and Justice Departments to strengthen the international dialogue on this topic.

As directed by President Clinton last October, we have declared a national emergency against the Cali cartel, and have taken steps under the International Economic Emergency powers

Act to block assets of companies owned by this group, and to prohibit all economic transactions by US persons with these parties. We have taken those steps against 282 companies and persons either owned, controlled by, or acting for or on behalf of the Cali Cartel, and are continuing to review information to add more names to this list.

The Southwest border has been an area of concern, and so our dealings with Mexico deserve particular note. I strongly believe that we are seeing real change in Mexico due greatly to the leadership of President Zedillo in coming to grips with the law enforcement issues, but also due to the strengthening of US-Mexico relations that occurred in the wake of NAFTA and the US financial assistance package last year. Let me deal with each of those issues in turn.

As to the enforcement issues, we are heartened by President Zedillo's, Attorney General Lozano's, and Finance Minister Ortiz' commitment to anti-narcotics matters. Over the last year, this commitment has manifested itself in a new law criminalizing money laundering, the expulsion of a leading narco-trafficker to the United States, and the record number of eradicated acres of certain narcotics crops.

Our dialogue with Mexico reflects our mutual understanding that, notwithstanding improved efforts, some of the problems associated with narcotics crossing from Mexico into the United States persist. While we are pleased by some of the recent measures, we view them as a starting point for even more vigorous actions -- within Mexico and in coordination with the U.S. -- to stop the flow of drugs across our Southwest border.

However, just as our own anti-narcotics fight depends in great part on a healthy underlying economy and society, Mexico's counter-drug efforts in the future also depend on its remaining financially stable and economically strong. Instability and poverty would render

Mexico less able to enforce its laws and more susceptible to the corrupting influence of drug traffickers. Had we not provided assistance and had Mexico defaulted on its obligations in late 1994 and early 1995, we would be facing an even more serious drug problem today.

Conclusion

We at Treasury will continue to direct our efforts both nationally, through our regulatory and investigative efforts, and internationally, through our cooperative relationships with our trading partners and through forced bilateral discussions, to work toward eliminating drug trafficking and money laundering.

Thank you.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
July 23, 1996

Contact: Jon Murchinson
(202) 622-2960

TREASURY HOSTS INFLATION-PROTECTION SECURITY SYMPOSIUM

Deputy Treasury Secretary Lawrence H. Summers will chair a public symposium on possible structures for Treasury's upcoming inflation-protection security.

The symposium will be at 3 p.m. Wednesday, July 24, at the Treasury Department. The room number for the symposium will be announced. Invited participants will include members of the financial and academic communities that replied to Treasury's May 20 request for comment.

Secretary Robert E. Rubin announced on May 16 that Treasury intends to issue securities that provide protection against inflation as a multi-year experiment. Inflation-protection securities are designed to strengthen national savings by offering Americans an investment that guarantees a return in excess of inflation. It is anticipated that all taxpayers will benefit as these securities are expected to reduce Treasury's financing costs.

Due to space constraints this meeting is not open to cameras. Media without Treasury or White House credentials wishing to attend should contact the Office of Public Affairs at (202) 622-2960, with the following information: name, Social Security number and date of birth, by 5 p.m. today. This information can be faxed to (202) 622-1999.

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RR-1184

Department of the Treasury; Notice of Meeting

AGENCY: Office of the Assistant Secretary for Financial Markets, Treasury.

ACTION: Notice of Meeting.

TIME AND DATE: 3:00 p.m., July 24, 1996.

PLACE: Room To Be Announced, Main Treasury Building, 1500 Pennsylvania Avenue, N.W., Washington, D.C. 20220.

STATUS: The meeting will be open to the public. For security reasons, in order to be admitted to the Treasury Building, you must call the contact person below.

MATTERS TO BE CONSIDERED: The Department of the Treasury is hosting a symposium to discuss the advantages and disadvantages of certain structures under consideration for the inflation-protection security Treasury intends to issue.

CONTACT PERSON FOR MORE INFORMATION: Questions about this notice should be addressed to Alison Shelton, Financial Economist, Office of Federal Finance Policy Analysis, Office of the Assistant Secretary for Financial Markets, at 202-622-2680. Persons wishing to attend the meeting are requested to contact Tinese Hamilton at 202-622-2624, prior to 12:00 noon Eastern time on July 24, 1996, to make arrangements for attendance.

SUPPLEMENTARY INFORMATION: On May 16, 1996, the Department of the Treasury (Department or Treasury) announced its intention to issue a new type of marketable book-entry security with a nominal return linked to the inflation rate in prices or wages, as officially published by the United

States Government. An Advance Notice of Proposed Rulemaking (ANPR) seeking comments on various structures was published on May 20, 1996 (61 FR 25164) and a series of meetings was subsequently held by the Treasury to obtain public input on the new inflation-protection security.

As a result of the comments received in response to the ANPR and at the public meetings, the Department is holding a symposium to discuss and obtain comments and information on the comparison between two different structures for an inflation-protection security -- a Canadian-style and a current pay structure.

The Treasury has invited certain commenters to take part in the symposium. These participants will comment on certain questions posed by the Treasury and take part in a discussion. Members of the public are invited to observe. Written comments from the public are also welcome (see below). The Treasury intends to seek further comment on the structure for Treasury inflation-protection securities and other issues prior to issuing final rules.

Possible Structures

The Canadian-style structure was described in the ANPR. Briefly, the principal of a Canadian-style inflation-protection security is adjusted for inflation (with a lag) such that its real value remains constant. The semiannual coupon payments are a fixed percentage of the current, inflation-adjusted value of the principal on the interest payment date. At maturity, the inflation-adjusted principal is paid, along with the last interest payment. (Please refer to the ANPR for the formulas for the Canadian-style structure.)

Some commenters have suggested that the Treasury consider an alternative structure that was not described in the ANPR. Under this current pay structure, all the inflation compensation and real interest is paid out semiannually. The formula for the semiannual coupon on the current pay security is the sum of the semiannual coupon and the principal appreciation (depreciation) of the Canadian-style security. Looking at this another way, the current pay semiannual coupon rate is the sum of the real semiannual rate, the six-month percentage change in the price or wage index, and the product of these two rates. The principal of the current pay security would not be indexed. In order to simplify the security, it is assumed here that the rate will not be less than zero. Possible formulas for the current pay structure are provided in the Appendix at the end of this notice.

Questions

The Treasury Department is interested in responses to the following questions:

1. Which structure, Canadian or current pay, is likely to have the largest potential market?

2) Which investor groups would find investments in the different structures appealing?

3) How would the yield on the current pay structure compare with the yields on other Treasury securities (bills, notes, or bonds)?

4) If the current pay structure were strippable, would there be substantial market interest in the stripped components?

5) Would the preferred maturity sectors for the current pay structure be different from those for the Canadian-style structure?

6) What would be the best way to auction current pay securities? For example, should the Treasury use a single-price auction and set the coupon rate at the highest accepted yield? Should reopening auctions be based on price rather than yield?

7) Which structure would provide the Treasury with the largest savings in financing costs?

Written Comments

The Treasury also welcomes written comments on these questions. Written comments should be sent to: the Government Securities Regulations Staff, Bureau of the Public Debt, 999 E Street N.W., Room 515, Washington, D.C. 20239. Comments received, together with any written materials presented at the symposium, will be available for public inspection and copying at the Internal Revenue

Service, FOIA Reading Room, located at the Internal Revenue Service building at Pennsylvania Avenue and 11th Streets, N.W., Room 1621, until the Treasury Department Library reopens.

Date: ____________

Darcy Bradbury

Darcy Bradbury

Assistant Secretary, Financial Markets

[Billing Code: 4810-39]

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGOED UNTIL 2:30 P.M.
July 23, 1996

CONTACT: Office of Financing
202/219-3350

TREASURY'S WEEKLY BILL OFFERING

The Treasury will auction two series of Treasury bills totaling approximately $26,000 million, to be issued August 1, 1996. This offering will result in a paydown for the Treasury of about $1,575 million, as the maturing weekly bills are outstanding in the amount of $27,580 million.

Federal Reserve Banks hold $6,933 million of the maturing bills for their own accounts, which may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders.

Federal Reserve Banks hold $5,397 million as agents for foreign and international monetary authorities, which may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders. Additional amounts may be issued for such accounts if the aggregate amount of new bids exceeds the aggregate amount of maturing bills.

Tenders for the bills will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

Details about each of the new securities are given in the attached offering highlights.

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Attachment

RR-1185

HIGHLIGHTS OF TREASURY OFFERINGS OF WEEKLY BILLS
TO BE ISSUED AUGUST 1, 1996

July 23, 1996

Offering Amount	$13,000 million	$13,000 million
Description of Offering:		
Term and type of security	91-day bill	182-day bill
CUSIP number	912794 3M 4	912794 3X 0
Auction date	July 29, 1996	July 29, 1996
Issue date	August 1, 1996	August 1, 1996
Maturity date	October 31, 1996	January 30, 1997
Original issue date	May 2, 1996	August 1, 1996
Currently outstanding	$13,638 million	- - -
Minimum bid amount	$10,000	$10,000
Multiples	$ 1,000	$ 1,000

The following rules apply to all securities mentioned above:

Submission of Bids:

Noncompetitive bids . . . . Accepted in full up to $1,000,000 at the average discount rate of accepted competitive bids

Competitive bids . . . .
(1) Must be expressed as a discount rate with two decimals, e.g., 7.10%.
(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position is $2 billion or greater.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Maximum Recognized Bid at a Single Yield . . . . 35% of public offering

Maximum Award . . . . 35% of public offering

Receipt of Tenders:

Noncompetitive tenders . . . . Prior to 12:00 noon Eastern Daylight Saving time on auction day

Competitive tenders . . . . Prior to 1:00 p.m. Eastern Daylight Saving time on auction day

Payment Terms . . . . Full payment with tender or by charge to a funds account at a Federal Reserve Bank on issue date

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
July 23, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 2-YEAR NOTES

Tenders for $18,786 million of 2-year notes, Series AH-1998, to be issued July 31, 1996 and to mature July 31, 1998 were accepted today (CUSIP: 912827Y63).

The interest rate on the notes will be 6 1/4%. All competitive tenders at yields lower than 6.288% were accepted in full. Tenders at 6.288% were allotted 68%. All noncompetitive and successful competitive bidders were allotted securities at the yield of 6.288%, with an equivalent price of 99.930. The median yield was 6.270%; that is, 50% of the amount of accepted competitive bids were tendered at or below that yield. The low yield was 6.239%; that is, 5% of the amount of accepted competitive bids were tendered at or below that yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$40,760,811	$18,785,774

The $18,786 million of accepted tenders includes $1,537 million of noncompetitive tenders and $17,249 million of competitive tenders from the public.

In addition, $1,900 million of tenders was awarded at the high yield to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $817 million of tenders was also accepted at the high yield from Federal Reserve Banks for their own account in exchange for maturing securities.

RR-1186

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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Statement of the Honorable Lawrence H. Summers
Deputy Secretary of the Treasury
Before the Subcommittee on Capital Markets, Securities,
and Government Sponsored Enterprises
Committee on Banking and Financial Services
United States House of Representatives

July 24, 1996

RR-1187

GOVERNMENT SPONSORSHIP OF THE FEDERAL NATIONAL MORTGAGE ASSOCIATION AND THE FEDERAL HOME LOAN MORTGAGE CORPORATION

Statement of the Honorable Lawrence H. Summers
Deputy Secretary of the Treasury

Before the Subcommittee on Capital Markets, Securities, and Government Sponsored Enterprises
Committee on Banking and Financial Services
United States House of Representatives

July 24, 1996

SUMMARY

As a result of over three generations of U.S. government policy supporting omeownership, the United States now has the strongest housing finance market in the orld. Today, homeownership rates in the United States are at their highest levels in fteen years. Fannie Mae and Freddie Mac have played critical roles in building a liquid econdary market for home mortgages, thereby helping make homeownership possible for illions of Americans. Through their affordable housing activities, they have also ontributed to expanding homebuying opportunities for low- and moderate-income amilies.

Congress, while recognizing the important benefits provided by the GSEs' ctivities, has asked whether it is now both feasible and advisable to change their status.

The securitization techniques and other secondary mortgage activities originally oneered by Ginnie Mae, Fannie Mae, and Freddie Mac are now well-established. They e practiced by many fully private firms and are applied not only to non-conforming ortgages but to many other types of obligations. For these reasons, there seems little oubt that the secondary market for conforming, conventional mortgages could operate fficiently and effectively even if Fannie Mae's and Freddie Mac's government onsorship were altered.

The more critical issue is whether the benefits of a change would be sufficient to tweigh the disruption and risks to the home mortgage market that it might entail.

Government sponsorship provides benefits to Fannie Mae and Freddie Mac that e quite tangible, even though the federal budget does not report them. Any uantification is, of course, uncertain. Taking into account the reduced borrowing and perating costs associated with GSE status, we estimate these benefits to be on the order f $6 billion in 1995.

These government benefits should, in turn, be compared to the benefits that Fannie lae and Freddie Mac provide, in reduced mortgage costs and in access to mortgages, that ould not otherwise be available. These benefits are even more difficult to estimate with onfidence. One plausible estimate would be that Fannie Mae and Freddie Mac reduce verage mortgage costs by perhaps 30 basis points in their part of the market, for a total avings to consumers of some $4 billion in 1995; however, there are many ways in which uch an estimate could be refined.

ıss-through estimates do suggest the effect the GSEs have on mortgage rates, but dc ›tinguish between a pure pass-through of GSE benefits and the two firms' techn· managerial efficiency. Although ending government sponsorship would remo· ›rmer, it may have no effect on the latter.

:ning the estimates of a $4 billion pass-through with the $6 billion of the GSEs ts of federal sponsorship, implies that the GSEs' shareholders retained in 1995 income approximately $2 billion of GSE benefits. This estimate is generally consis :h comparable estimates reported by CBO and GAO.

ıss-through estimates do not include the extent to which the GSEs provide added hrough their affordable housing activities. It is uncertain to what extent endin SEs' government sponsorship would affect those activities. With HUD's afforo using goals still relatively new, it is premature to judge how much of those activit driven by those requirements, and how much by the basic business object Fannie Mae and Freddie Mac.

; or modifying government sponsorship would entail risk, but would have potent :fits. Its potential effect on mortgage interest rates would represent an impoı :, as would any potential negative consequence for the availability of credit for af : housing. Potential benefits could include increased market competition, more : t credit allocation, reduced U.S. government borrowing costs, and reduced poten to taxpayers.

gh the analysis undertaken in this report and others is substantial, we belie· :onclusions regarding the desirability of ending or modifying government spons ›f Fannie Mae and Freddie Mac are premature. The GSEs' experience under the 19 is relatively short, and many of the most important issues could benefit from furthe

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GOVERNMENT SPONSORSHIP OF THE FEDERAL NATIONAL MORTGAGE ASSOCIATION AND THE FEDERAL HOME LOAN MORTGAGE CORPORATION

Statement of the Honorable Lawrence H. Summers
Deputy Secretary of the Treasury
Before the
Subcommittee on Capital Markets, Securities, and Government Sponsored Enterprises
Committee on Banking and Financial Services
United States House of Representatives
July 24, 1996

Mr. Chairman, Representative Kanjorski, Members of the Subcommittee. I appreciate this opportunity to present the Treasury's report on the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

Created by Congress to provide stability and liquidity to the secondary mortgage market, Fannie Mae and Freddie Mac are privately owned companies known as government-sponsored enterprises (GSEs). Like other GSEs[1], Fannie Mae and Freddie Mac have corporate charters granted by the federal government. To promote a public purpose, those charters limit Fannie Mae and Freddie Mac to a particular line of business -- operating in the secondary mortgage market -- and provide various government benefits that lower their operating costs and enable them to borrow at rates much lower than other financial institutions.

As a result of over three generations of U.S. government policy supporting homeownership, the United States now has the strongest housing finance market in the world. To make housing available to more Americans, Congress made an explicit judgment to direct credit toward home mortgages. One way it sought to do so was by creating intermediaries such as Fannie Mae and Freddie Mac that would buy and resell mortgages. Fannie Mae and Freddie Mac have played critical roles in building a liquid

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The other GSEs include the Federal Home Loan Bank System, the Farm Credit System, the Student Loan Marketing Association, and the College Construction Loan Corporation.

secondary market for home mortgages. This system has helped make homeownership possible for millions.

Despite this enormous progress, many low- and moderate-income and minority families continue to face substantial barriers to homeownership. President Clinton has made increased homeownership a national priority, and with the help of his National Homeownership Strategy, the homeownership rate has reached 65.1 percent this year, the highest level in fifteen years. Both GSEs have made, and continue to make, important contributions toward meeting the national goal of increased homeownership.

Fannie Mae and Freddie Mac are privately owned. Their stock trades actively on the New York Stock Exchange and had a total market value of over $48 billion at the end of 1995. Last year they paid a total of $957 million in common stock dividends. As a result, in part, of their government sponsorship, Fannie Mae and Freddie Mac can participate in the mortgage market at lower costs and in ways other private financial institutions cannot. Clearly Fannie Mae and Freddie Mac must serve their shareholders, but they must also comply with their federal charters. This ambiguity of responsibility, characteristic of GSEs, continually raises issues of accountability: To what extent is a particular GSE responding to its federal mandate and to what extent to the need to generate returns for its stockholders? What tradeoffs does it make between these objectives?

In the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, Congress recognized these issues, and recognized that many of the circumstances that had led to the establishment of Fannie Mae and Freddie Mac in their current forms had changed. The Act directed the Treasury and three other agencies to report on the desirability and feasibility of ending the federal government's sponsorship of Fannie Mae and Freddie Mac, and thereby removing both the limitations and benefits of federal sponsorship. If privatized, Fannie Mae and Freddie Mac could operate as fully private entities under state corporate charters. Their shareholders and management would determine the nature and scope of their business activities.

In response to this mandate, the Treasury conducted a broad review of the government's relationship with Fannie Mae and Freddie Mac. We paid particular attention to how ending the federal government's sponsorship of Fannie Mae and Freddie Mac might affect the cost of home mortgage credit and the efficiency of the mortgage credit market. We also reviewed their affordable housing activities, to help assess whether and how these might be affected.

The Secondary Mortgage Activities of Fannie Mae and Freddie Mac

Fannie Mae and Freddie Mac operate by purchasing conforming residential mortgage loans -- mortgages that meet their specifications and are below a certain size limit. The GSEs purchase these mortgages from banks, thrifts, mortgage banks, and other mortgage loan originators. By doing so, they give these originators access to the broader national capital market.

Fannie Mae and Freddie Mac finance these purchases in two ways. First, they pool mortgages and issue securities backed by the pooled mortgages, in a process called securitization. Mortgage-backed securities represent interests in the underlying mortgages. The mortgage borrowers' monthly payments of interest and principal are used to pay investors. The GSEs guarantee these payments and, in return, collect a guarantee fee. Second, the GSEs purchase mortgages for their own portfolios, and fund them by issuing debt securities to investors.

The Benefits of Federal Sponsorship

Federal sponsorship helps Fannie Mae and Freddie Mac undertake their activities in several important ways. First, it reduces the GSEs' operating costs by: exempting them from paying state and local corporate income taxes; exempting their securities from registration with the Securities and Exchange Commission; and authorizing them to issue and transfer securities through the Federal Reserve's book-entry system.

Second, government sponsorship permits the GSEs to borrow at rates better than the highest-rated private firms -- and very close to the rates on Treasury securities, which carry the government's full faith and credit. In addition to the advantages mentioned above, federal law gives special status to GSE securities. It permits national banks to hold them in unlimited amounts. It makes them lawful investments for federal fiduciary and pu ınds and lawful collateral for public deposits. It authorizes the Secretary of the Tre to purchase up to $2.25 billion of each GSE's obligations (and thus extend credit t GSE). GSE securities are also eligible collateral for loans from Federal Reserv s and Federal Home Loan Banks, and the Federal Reserve buys and sells such se es in its open market operations. The federal government does not guarantee GSE s es -- in fact, federal law requires a disclaimer of any U.S. obligation. Invest netheless believe that federal sponsorship provides a *de facto* guarantee -- becaus believe Congress would not allow either GSE to fail. This perception, in turn, e Fannie Mae and Freddie Mac to borrow at rates lower than any private financ itution.

the two GSEs hold less capital than comparable fully private firms, without incurri ner borrowing costs. At the end of 1995, the two GSEs had a combined $1.4 trillion rtgage-backed securities outstanding, mortgages in portfolio, and other assets, ly $16.8 billion in capital. The two GSEs had an average capital-to- assets ratio o ercent. That ratio falls to 2.75 percent if one allocates capital, at the minim e currently required by the GSEs' safety and soundness regulator, to the $972 billion rtgage-backed securities that the GSEs guarantee but do not carry on their balanc s. By contrast, FDIC-insured savings institutions, which invest predon in mortgage-related assets, had an average capital-to-assets ratio of 7.8 percent

imate the benefits of federal sponsorship are worth almost $6 billion annual annie Mae and Freddie Mac. Of this amount, reduced operating costs (i.e., exemp om SEC filing fees and from state and local income taxes) represent approx y $500 million annually and the borrowing cost advantage over $5 billion annua ese estimates are broadly consistent with the magnitudes estimated by the Congr l Budget Office and General Accounting Office. As we discuss below, Fannie and Freddie Mac appear to pass through part of these benefits to consumers throug ed mortgage costs and retain part for their own stockholders.

three types of benefits aid Fannie Mae and Freddie Mac in both aspects of their b s -- securitizing mortgages and retaining mortgages in portfolio. The benefits curren olve no direct government payments to the two GSEs and under current rules are not reported in the federal budget. Nonetheless, they have real economic value to the GSEs and involve real costs for the government to provide, a conclusion readily accepted by economic and financial experts. While fully private firms frequently pay fees to third-party guarantors to provide credit enhancement for their securities, the GSEs receive at no cost to them a package of benefits that makes the credit standing of their securities superior to anything available in the marketplace.

The Contributions of Fannie Mae and Freddie Mac

Providing Liquidity for Mortgage Lenders

Congress created Fannie Mae as a government corporation in 1938 to purchase and resell mortgages, and thereby help provide liquidity to financial institutions that had limited access to national capital markets. Freddie Mac was created in 1970 with a similar purpose. Both organizations have, as intended, contributed strongly to the development of a more open, effective, and liquid mortgage market.

Over the past 25 years, these two companies and the financial markets have changed dramatically. Interest rate ceilings have been eliminated and limitations on geographic expansion reduced. Mortgage lenders now have geographic diversification and access to national (and international) capital markets.

One of the most important changes was the development of securitization itself. The first mortgage backed security was created in 1970 by the Government National Mortgage Association, Ginnie Mae. Since then, Ginnie Mae, Fannie Mae, and Freddie Mac have each contributed to the development of mortgage securitization. Today, approximately 48 percent of outstanding single-family mortgage debt -- over $1.7 trillion -- has been pooled and securitized. Mortgages securitized by Fannie Mae and Freddie Mac represent approximately 62 percent of the dollar total.

This activity is no longer limited to GSEs or to government organizations like Ginnie Mae; private companies securitized 46 percent of jumbo mortgages in 1994, a rate comparable to the 52 percent of conforming mortgages securitized by Fannie Mae and Freddie Mac. Private companies have also begun a secondary market in mortgages with substandard credit quality (commonly called B-C credit mortgages), as well as auto loans, credit card loans, and a variety of other obligations.

Despite the development of private liquid secondary markets, ending the GSEs' federal sponsorship would probably cause an increase in home mortgage rates for conforming, conventional loans (as discussed below). Although the amount of any such increase is difficult to determine, it should be smaller than the fluctuations in mortgage rates attributable to normal variations in macroeconomic and credit market factors.

Savings on Mortgage Costs

One question is the extent to which Fannie Mae and Freddie Mac pass on the fruits of government sponsorship to consumers in the form of reduced mortgage costs. The GSEs can pass through those benefits by purchasing mortgages at higher prices (lower mortgage rates) than they would without government sponsorship. Such a pass-through is inherently difficult to measure. In preparing this report, we sponsored one study of this issue and reviewed others.

Most discussions of pass-through focus on the differences between the market rates for fixed-rate conforming mortgages that Fannie Mae and Freddie Mac can and do purchase, compared to non-conforming mortgages (generally larger jumbo mortgages) that can be purchased only by other private financial institutions. Some comparisons have been made based upon the advertised on-offer rates for the two types of mortgages. These comparisons typically show a rate advantage for conforming mortgages. Other studies have compared the Federal Housing Finance Board's data on mortgages that actually have closed and have found average rates on jumbo loans lower than on conforming loans.

However, raw comparisons may mislead because other factors could affect the price differential between conforming and jumbo loans; the size and terms of the mortgages, their geographic location and credit quality, or the depth and liquidity of the market for larger versus smaller homes may have independent effects. After attempting to control for some of these factors statistically, recent studies suggest the GSEs reduce rates on fixed-rate conforming, conventional mortgages by about 20 to 40 basis points. It is unclear how much of such a differential results from pass-through of GSE benefits rather than from such other factors as the GSEs' technical and managerial efficiency; furthermore, the differential may change over time. A plausible estimate of 30 basis points, the midpoint of this range, suggests that in 1995 the GSEs passed through approximately $4 billion of pre-tax benefits.

This calculation necessarily omits certain factors. It does not include the value of the stability the GSEs may give the conforming, conventional mortgage market. Nor does it place a value on the extent to which the GSEs make affordable housing finance more available than it otherwise would be (an issue discussed below).

It is even more difficult to estimate with certainty how modifying or ending government sponsorship would affect mortgage interest rates. Although some increase seems likely, certain factors suggest that the increase in rates might be less than the pass-through estimate given above. Fannie Mae and Freddie Mac currently have no effective competition in the conforming, conventional secondary mortgage market except each other. Nonetheless, many financial institutions compete vigorously in other secondary markets, for both mortgages and other types of obligations. Depending upon how changes were undertaken, competition from other financial institutions could moderate the effects of privatization. These issues have, however, received very little analysis; further research is necessary before definitive conclusions can be drawn.

Supporting Affordable Housing

In 1995, the Department of Housing and Urban Development (HUD) released the Administration's blueprint for increasing homeownership, the *National Homeownership Strategy: Partners in the American Dream*. Many of the nation's current critical unmet housing needs differ from those of the past. Mortgages are now widely available, and so the Administration and Congress have focused on the needs of borrowers who continue to find homeownership beyond their grasp. The *Homeownership Strategy* lists a series of steps the public and private sectors should take to increase homeownership opportunities for all Americans.

Both Fannie Mae and Freddie Mac have expanded their activities in these areas. They have developed specialized mortgage products, increased underwriting flexibility, improved homebuyer education programs, and entered into partnerships with local governments and nonprofit organizations to provide additional affordable housing assistance.

In 1992, Congress directed HUD to develop a set of housing goals to ensure that the GSEs' mortgage purchases included loans to such targeted potential borrowers as low-income households and residents of central cities and rural areas. HUD issued interim requirements in October 1993. The final regulations, issued in December 1995, established targets for the GSEs' purchases of mortgages from underserved areas, low- and moderate-income households, and very-low-income households. The final regulation also established fair lending requirements, including a requirement that the GSEs assess whether their underwriting standards, business practices, repurchase requirements, pricing, fees, and other procedures could result in impermissible discrimination, and how such standards and practices may affect purchases of mortgages for low- and moderate-income families.

Fannie Mae and Freddie Mac already meet or exceed HUD's affordable housing goals in most respects. In 1995, Fannie Mae satisfied all three interim housing goals, and Freddie Mac satisfied all but the central city goal. Still, under a variety of measures, the GSEs' relative participation in financing affordable housing is less than that of FHA and FDIC-insured depository institutions.

By the nature of their activities, Fannie Mae and Freddie Mac face challenges relative to other market participants in promoting affordable housing. They do not make any direct loans; they must rely on others to originate loans that they may then purchase or help securitize. Current law allows them to purchase mortgages with less than a 20 percent downpayment only if the borrower obtains private mortgage insurance or if the private sector or a government agency provides some other credit enhancement that limits the GSEs' credit risk.

There is continuing innovation in the primary market (i.e., the market for originating mortgages) and by private mortgage market participants, such as private mortgage insurance companies, finance companies, and FDIC-insured depository institutions. Fannie Mae and Freddie Mac can and do contribute to overcoming their challenges in this area by working cooperatively with mortgage originators and mortgage insurance companies to develop mortgage products for the underserved.

Since 1992, Fannie Mae and Freddie Mac have increased their holdings of mortgages from low-income borrowers and underserved areas. For example, Fannie Mae, which has most strongly emphasized lending in inner-city neighborhoods, increased its activity in underserved areas (as defined in HUD's 1995 final rule on GSE housing goals) from 22.9 percent in 1993 to 31.2 percent in 1995, while Freddie Mac's activity increased from 21.3 percent to 25.1 percent during the same period. Although this improved performance obviously results in part from HUD's oversight and encouragement, it is impossible to ascertain the extent to which it represents a response to that oversight, to the affordable housing activities of mortgage originators, or to diversification of the GSEs' business activities as their basic market becomes more saturated. For example, the majority of single-family mortgages that counted toward meeting the HUD goals in 1995 (64 percent or more for each goal and each GSE) went to borrowers who made downpayments of at least 20 percent. Since a lack of funds for downpayments constitutes one of the main impediments to homeownership in lower-income communities, it is unclear to what extent the goals have stimulated mortgage originators to make loans that they would not otherwise have made. However, affordable housing loans often entail higher marketing, servicing, and credit costs than other GSE-purchased loans, so these historical loan-to-value (LTV) ratios may understate the GSEs' effect on affordable housing. It is too early to evaluate fully whether a trend toward more flexible underwriting practices will increase the availability of higher LTV loans and spur additional mortgage originations to low- and moderate-income homebuyers.

HUD reports that it designed the affordable housing goals to be achievable under economic conditions more adverse than the recent period of high affordability, and notes that they may become binding constraints as market conditions change. The goals may themselves be revised periodically to encourage the GSEs to increase their affordable housing activities beyond what the fully private sector might otherwise do.

ng government sponsorship would in all probability have some effect on the GSE. ibutions to affordable housing. Without being able to estimate the extent to whic SEs undertake affordable housing activities because of federal requirements, rathe or other reasons, one cannot estimate how rescinding or revising HUD's goals affect their activities. As HUD and the GSEs gain more experience with the goal ould have better understanding of the effects of these programs.

nding opportunities for homeownership should remain one of our highest prior he actions of GSEs and other financial institutions in this crucial area will meri ued attention from HUD and Congress.

Impl s of the *Status Quo*

t on Treasury Borrowing Costs

her, Fannie Mae and Freddie Mac have over $1.4 trillion in debt and mort cked securities outstanding -- an amount equal to nearly two-fifths of the Trea urities held by the public. Since GSE securities may be substituted for Trea urities for many purposes (as discussed above), and since they benefit from inve rception that the federal government implicitly stands behind them, those secur mpete directly with Treasury securities in the government securities market. To s ent, therefore, the considerable and growing supply of GSE securities (relat he supply of Treasury securities) tends to lower prices in the government secur arket and thereby increase the Treasury's borrowing costs.

theless, it is extremely difficult to estimate by how much. Financial markets are b amic and complex; many factors affect their demand, supply, and segm n. When Treasury previously attempted (Treasury 1990, 1991) to estimate the e GSE borrowing on Treasury costs, it could not quantify those effects. These estim ifficulties remain; nonetheless, further analysis seems appropriate. Since the publi $3.7 trillion of Treasury debt, each basis point of increase in such costs woul annual budgetary outlays by $370 million.

Effect on Other Credit Markets

While the benefits of GSE status provide an important subsidy that promotes homeownership, such a subsidy has economic costs. To the extent that the GSEs pass through the benefits of government sponsorship, they reduce the price of, and increase the demand for, mortgage credit relative to other types of credit. The economic effect of the subsidy to mortgage credit -- absent increases in the savings pool or attracting capital from abroad -- is to raise the price or reduce the amount of credit for other uses, such as small businesses, exporters, rural communities, and other business and consumer borrowers. Measuring such effects is, however, even more difficult than measuring the potential effects on Treasury borrowing costs.

Potential for Increased Reliance on the GSEs

Maintaining the GSE status of Fannie Mae and Freddie Mac could, over time, find the housing finance market increasingly reliant on the GSEs as sources of credit for conforming, conventional mortgages. This increased reliance, coupled with the advantages the GSEs receive from government sponsorship, could undermine the viability of portfolio lenders operating in local markets, such as community banks and thrifts. If that were to occur, borrowers who do not easily meet the GSEs' underwriting standards may lose competitive local mortgage sources that may serve their needs better than national lenders.

In addition, greater reliance on the GSEs could increase risk to financial markets and taxpayers by further concentrating mortgage credit risk in just two companies -- companies with relatively low capital-to-asset ratios, whose GSE status alters investors' risk-reward calculus.

Potential Risk to Taxpayers

Although Fannie Mae and Freddie Mac have developed a range of mechanisms to hedge the risks of their portfolios and protect their financial integrity against movements in the financial markets, there is no perfect guarantee that they will always be safe, sound, and profitable entities. Recognizing this, Congress recently established HUD's Office of

Federal Housing Enterprise Oversight (OFHEO) as the two GSEs' federal safety and soundness regulator. OFHEO's establishment is a positive development that we expect to have a salutary effect on the two GSEs' safety and soundness. Such regulation is necessary, in part because the very nature of government sponsorship attenuates the normal market discipline that investors would otherwise exercise in purchasing securities issued by a fully private firm.

OFHEO's mission is unquestionably important. Overseeing the GSE's safety and soundness diminishes the likelihood of financial difficulties that could raise any question of government assistance. The stringency and effectiveness of OFHEO's regulatory policies will therefore be critical.

Further Analysis Required

As noted above, further analysis of many of these issues is necessary for any informed conclusions. Research on both the current conforming mortgage market and the affordable housing market would help clarify the risks and benefits of any action by Congress.

There should also be detailed analysis of the operational and market implications of any action that Congress considers. If Congress decided to maintain the GSE status of Fannie Mae and Freddie Mac, but sought to increase the public benefits they provide or reduce the government benefits they receive, it could pursue a wide range of options. Illustrative of the many options that have been suggested are: strengthening the affordable housing goals by requiring Fannie Mae and Freddie Mac to increase their market shares or to direct more activity to targeted areas or borrowers; requiring the GSEs to subsidize affordable housing directly, through programs analogous to the Federal Home Loan Banks' Affordable Housing Program; requiring increased involvement in financing multifamily mortgages; requiring more directed assistance (educational and financial) to lower-income borrowers, state and local governments, and non-profit organizations; limiting the size of the GSEs' retained mortgage portfolios; freezing or reducing the conforming loan limit; removing certain benefits of GSE status, such as the exemption from registering securities with the SEC; and requiring periodic estimation and public disclosure of the value of the government benefits that the GSEs receive. These options need further analysis before a decision can be made on whether or how to adjust government sponsorship.

Conclusions

Fannie Mae and Freddie Mac have succeeded in developing a liquid secondary mortgage market for conforming, conventional mortgages. Congress, while recognizing the important benefits provided by the GSEs' activities, has asked whether it is now both feasible and advisable to change their status.

The securitization techniques and other secondary mortgage activities originally pioneered by Ginnie Mae, Fannie Mae, and Freddie Mac are now well-established. They are practiced by many fully private firms and are applied not only to non-conforming mortgages but to many other types of obligations. For these reasons, there seems little doubt that the secondary market for conforming, conventional mortgages could operate efficiently and effectively even if Fannie Mae's and Freddie Mac's government sponsorship were altered.

The more critical issue is whether the benefits of a change would be sufficient to outweigh the disruption and risks to the home mortgage market that it might entail.

Government sponsorship provides benefits to Fannie Mae and Freddie Mac that are quite tangible, even though the federal budget does not report them. Any quantification is, of course, uncertain. Taking into account the reduced borrowing and operating costs associated with GSE status, we estimate these benefits to be on the order of $6 billion annually.

These government benefits should, in turn, be compared to the benefits that Fannie Mae and Freddie Mac provide, in reduced mortgage costs and in access to mortgages, that would not otherwise be available. These benefits are even more difficult to estimate with confidence. One plausible estimate would be that Fannie Mae and Freddie Mac reduce average mortgage costs by perhaps 30 basis points in their part of the market, for a total savings to consumers of some $4 billion annually; however, there are many ways in which such an estimate could be refined.

The pass-through estimates do suggest the effect the GSEs have on mortgage rates but do not distinguish between a pure pass-through of GSE benefits and the two firms' technical and managerial efficiency. Although ending government sponsorship would remove the former, it may have no effect on the latter.

Combining the estimates of a $4 billion pass-through with the $6 billion of the GSEs' benefits of federal sponsorship, implies the GSEs' shareholders retained in pre-tax income approximately $2 billion of GSE benefits. This estimate is generally consistent with comparable estimates reported by CBO (1996) and GAO (1996-A).

Not included in the pass-through estimates is the extent to which the GSEs provide added value through their affordable housing activities. The extent to which their affordable housing activities would be affected by ending government sponsorship is unclear. With HUD's affordable housing goals still relatively new, it is premature to judge how much of GSE activity is driven by HUD's administration of the requirements, and how much by the basic business objectives of Fannie Mae and Freddie Mac.

Ending or modifying government sponsorship would entail risk, but would have potential benefits. Its potential effect on mortgage interest rates would represent an important risk, as would any potential negative consequence for the availability of credit for affordable housing. Potential benefits could include increased market competition, more efficient credit allocation, reduced U.S. government borrowing costs, and reduced potential risk to taxpayers.

Although the analysis undertaken in this report and others is substantial, we believe firm conclusions regarding the desirability of ending or modifying government sponsorship of Fannie Mae and Freddie Mac are premature. The GSEs' experience under the 1992 Act is relatively short, and many of the most important issues could benefit from further study. Furthermore, should Congress decide to act, there are several possible approaches, each with different implications that should be analyzed and reviewed.

Fannie Mae and Freddie Mac are important institutions participating in markets that affect the homeownership of millions of Americans. Ultimately no change will be made without rigorous public discussion and a broad consensus. We hope this report is helpful to that process.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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FOR IMMEDIATE RELEASE
July 24, 1996

Contact: Jon Murchinson
(202) 622-2960

MEDIA ADVISORY

Treasury Secretary Robert E. Rubin will announce proposed changes to the State and Local Government Series Securities (SLGS) program at 11:30 a.m. today before the Public Finance Network at the National League of Cities, 1301 Pennsylvania Avenue, NW, 5th floor.

Treasury has issued nonmarketable SLGS since 1972 as investments for the proceeds of tax exempt bond issues that are subject to IRS regulations, such as yield restrictions and arbitrage rebate. Investing in SLGS enables state and local governments to more easily comply with tax regulations.

Media seeking site information should contact Randolph C. Arndt of the National League of Cities at (202) 626-3158.

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RR-1188

DEPARTMENT OF THE TREASURY

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ADV 11:30 A.M. EDT
Remarks as prepared for delivery
July 24, 1996

**REMARKS OF TREASURY SECRETARY ROBERT E. RUBIN
BEFORE THE PUBLIC FINANCE NETWORK
WASHINGTON, D.C.**

Thank you very much for inviting me to speak here this morning. The Treasury Department works with state and local governments in many ways, and we believe that partnership is critical to improving the way our governments work. Today, I have the pleasure to announce changes in Treasury's state and local government series securities -- which is commonly, and unfortunately, called the "SLGS" program.

This is a highly technical subject, but I want to make three non-technical and important points: First, these changes should make it easier, more convenient, and cheaper for states and local governments to refinance tax exempt bonds issued to pay for projects that matter to their citizens, from school construction and repair to strong bridges and pothole-free roads.

Second, the changes are a good example of reinventing the federal government, saving taxpayer dollars, eliminating unnecessary regulation and introducing new flexibility. We took a common sense approach. In fact, when we started to look at updating these regulations, we couldn't figure out why some of them were still there. Those regulations would be gone.

And third, the federal government needs to -- and is -- approaching its delivery of services and products like a private sector company in a competitive market. Many in our ranks have come from public and private finance, and we know how important it is to make Treasury's financial products and services as modern, innovative and competitive as America's most advanced financial markets. From the restructuring of our maturity mix to our proposal to issue inflation-indexed securities, to today's announcement, we have strived to be responsive and innovative.

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RR-1189

The changes I am announcing are designed to make SLGS more attractive, competitive, cost-effective securities. We propose to increase the maximum interest rate payable by the Treasury on SLGS. In effect, we would cut our fee from 12.5 basis points to 5 basis points. For example, if a town wants to refinance a school bond issue to take advantage of lower interest rates, the town would need to purchase Treasury securities to pay off the old bonds. If the town purchases $10 million in 5-year SLGS, the lower fees I am announcing today would mean that they could earn about $31,500 more over the life of the investment on a present value basis. Put another way, the town would be able to sell $31,500 less in bonds to refinance their old, higher-interest rate debt than under our old rules.
But pricing is not the only issue. The changes would also make investments in SLGS more flexible, useful and competitive.

--We would permit government bodies to purchase SLGS with funds subject to rebate requirements, such as construction funds, as well as funds subject to yield restrictions.

--We would eliminate the so-called "all-or-nothing rule" and permit government bodies to blend investments in SLGS with investments in securities purchased in the secondary markets.

--We would eliminate the extensive certifications that are currently required, and rely instead on enforcement of arbitrage laws under existing income tax regulations.

--We would shorten the time periods by more than half from subscription to purchase for new issues of time and demand deposit SLGS and we also shortened noticed periods for early redemptions of SLGS.

--We would permit investors in time deposit SLGS to rollover the proceeds of their maturing SLGS (including interest) into new SLGS.

--We would change the pricing formula for SLGS that are redeemed prior to maturity to better reflect market prices, and allow market-priced redemption of SLGS at a premium.

--And we would eliminate the cap on the amount of demand deposit securities that can be purchased.

Our announcement today includes changes that state and local governments -- and many of you -- have been seeking for years. I'm pleased to present these changes to you, and I want to thank you for the comments you made in helping us to develop them. I hope that they will help state and local governments better re-finance the strong infrastructure and solid services that their citizens have the right to expect. Thank you very much.

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FOR IMMEDIATE RELEASE
July 24, 1996

Contact: Jon Murchinson
(202) 622-2960

MEDIA UPDATE

The Treasury Department's public symposium on possible structures for inflation-protection securities will be at 1:30 pm today in room 3311, 1500 Pennsylvania Avenue, NW.

Due to space constraints this meeting is not open to cameras. Media without Treasury or White House credentials wishing to attend should contact the Office of Public Affairs at (202) 622-2960, with the following information: name, Social Security number and date of birth, by noon today. This information can be faxed to (202) 622-1999.

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RR-1190

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
July 24, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 5-YEAR NOTES

Tenders for $12,510 million of 5-year notes, Series L-2001, to be issued July 31, 1996 and to mature July 31, 2001 were accepted today (CUSIP: 912827Y71).

The interest rate on the notes will be 6 5/8%. All competitive tenders at yields lower than 6.625% were accepted in full. Tenders at 6.625% were allotted 9%. All noncompetitive and successful competitive bidders were allotted securities at the yield of 6.625%, with an equivalent price of 100.000. The median yield was 6.572%; that is, 50% of the amount of accepted competitive bids were tendered at or below that yield. The low yield was 6.537%; that is, 5% of the amount of accepted competitive bids were tendered at or below that yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$27,060,703	$12,510,193

The $12,510 million of accepted tenders includes $512 million of noncompetitive tenders and $11,998 million of competitive tenders from the public.

In addition, $900 million of tenders was awarded at the high yield to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $700 million of tenders was also accepted at the high yield from Federal Reserve Banks for their own account in exchange for maturing securities.

RR-1191

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TESTIMONY OF DAVID A. LIPTON
ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS
BEFORE THE SENATE COMMITTEE ON FOREIGN RELATIONS

July 25, 1996

Mr. Chairman and members of the Committee. I greatly appreciate the opportunity to be here today to discuss with you the concerns raised by Mr. Harry Wu and the Laogai Research Foundation regarding World Bank-funded projects in the Xinjiang Autonomous Region of China.

Mr. Wu has shown courage and dedication in his efforts to draw attention to human rights abuses in China. The State Department's most recent human rights report to this Committee documents China's human rights abuses. As that report details, Mr. Wu has personally been a target of such abuses. Thus, when Mr. Wu issued allegations last October regarding the role of the World Bank in China, the U.S. Government, including the Treasury Department, reacted with great concern and immediate action. We pressed the World Bank for a prompt and thorough investigation. The seriousness of the charges made by Mr. Wu regarding the role of the World Bank in China demanded nothing less.

Therefore, I welcome this opportunity to discuss three key issues with you today:

- United States policy on World Bank lending to China;
- the Bank's overall strategy for economic development in China; and
- the Tarim Basin project, and other Bank projects in Xinjiang.

United States Policy on World Bank Lending to China

U.S. policy on World Bank lending to China has been developed in the context of our overall foreign and economic policy there, which in turn has been shaped by both realities and moral imperatives. On the one hand, China has made dramatic progress in building a market economy and a more vibrant society and has become an increasingly important political player in regional and global affairs. On the other hand, on some critical issues, we and China have deep differences.

RR-1192

Accordingly, our policy toward China is guided by three tenets: First, we believe that China's development as a secure, open and successful nation is profoundly in the interest of the United States. Second, we support China's full integration and its active participation in the international community. And third, while we seek dialogue and engagement to manage our differences with China, we will not hesitate to take the action necessary to protect our interests.

Reflecting this approach, since the crackdown in Tiananmen Square in 1989, we have not supported any World Bank lending to China unless it is directed specifically to programs which serve basic human needs (BHN). In addition to meeting this key criterion, U.S. support for BHN projects is also conditioned on their economic, financial, and environmental soundness.

Other World Bank members, however, strongly support active and extensive World Bank development assistance to China. Without their concurrence, we cannot succeed in confining the Bank's role to BHN projects. But we can, and I believe we do, make a difference by helping shape the Bank's overall operations in China, holding individual projects to the highest standards, and increasing the focus of non-BHN projects on reforming and opening China's economy and society.

The United States has argued forcefully that continued Chinese access to the concessional resources of the International Development Association (IDA) is not justified. It is true that China still has large concentrations of extreme poverty -- indeed, an estimated 80-100 million people are still destitute. Nevertheless, it is also true that China's economic progress has greatly improved its international creditworthiness, i.e., its ability to attract and to service loans on commercial terms. In our view, the poorest and least creditworthy borrowers should have first claim on IDA resources.

Our efforts have produced significant progress on this issue, although the pace has been slower than we would have liked. In 1993, the IDA donors agreed that IDA assistance to more creditworthy borrowers, including China, be directed primarily to poverty-focused activities or those that promote environmental sustainability. IDA lending to China has been declining. Most recently, donors formally agreed to reduce IDA lending to China significantly, to about $300 million annually for the next three years -- about 4 percent of total IDA lending as opposed to 15 percent in the early 1990s -- and then to terminate IDA lending altogether.

<u>The World Bank's Country Assistance Strategy for China</u>

The vast majority of the World Bank's financial and analytical support for economic development and reform in China is now provided on market-based rather than concessional terms, and is focussed on four major areas:

- support for market-oriented economic reforms vital to greater opportunity and engagement for the millions of Chinese poor, with special emphasis on reform of the financial system, state-owned enterprises, and the legal framework and institutions needed in a market economy;

- removal of infrastructure bottlenecks, and adoption of a regulatory framework to attract foreign private investment in power, transport, and water supply;

- direct alleviation of poverty, concentrating on basic education, health services, and disease prevention, particularly in the poorest interior areas; and

- environmental protection which, again, provides greatest benefit to the poor.

We continue to urge the Bank to sharpen its focus on improving the living conditions of the absolute poor. We firmly believe that Bank operations and outreach to local communities will materially improve the economic and political status of groups such as the Uygurs. We have also strongly encouraged accelerated reform of state-owned enterprises, and eliminating policies which distort market forces and economic efficiency and impede the roles of the private sector and foreign investment.

Mr. Chairman, this Administration believes, as did others before it, that this kind of focussed adjustment strategy tracks well with China's development needs, with the Bank's fundamental mandate, and, most importantly, with long-term U.S. interests and objectives in China.

The Tarim Basin and Other Projects in Xinjiang

Let me turn now to the Tarim Basin project, about which Mr. Wu first raised his concerns. The project was funded by a $125 million IDA credit approved by the Bank's Executive Board in August 1991. It was explicitly designed to improve the income and well-being of 138,000 families, about 500,000 of China's poorest people, in Xinjiang, a remote and drought-prone area where annual per capita income is below $100. Key elements of the project support construction of irrigation, drainage and drinking water facilities, and promote agricultural and livestock development. Project beneficiaries are almost exclusively smallholder farmers of the Uygur ethnic minority, a particularly disadvantaged group.

When Mr. Wu made public his concerns about the project last October, the Bank moved quickly, and with our strong support, to investigate the facts. We supported the Bank's decision to conduct a detailed investigation of the project. The investigative team included a senior Bank official with experience in China, a U.S.-trained Chinese-speaking lawyer, the Deputy Chief Auditor of Hong Kong, and a retired former Dean of Hong Kong University. The investigation included extensive travel within Xinjiang -- a region roughly 2 1/2 times the size of Texas with a total population of about 13 million. Using materials prepared by Mr. Wu, the Bank team prepared its own itinerary, conducted on-site inspections, reviewed the project's procurement and contracting documentation, and interviewed approximately 1,000 Uygur people living and working in the project area. On the basis this investigation, the Bank concluded that project benefits are going to the intended minority beneficiaries and reported that it had uncovered no evidence of either forced labor or benefits to any prison farms or penal institutions.

Mr. Wu has also focussed attention on the Xinjiang Production and Construction Corps (XPCC) and its role in implementing World Bank projects. The XPCC, which is also called the Xinjiang State Farms Organization, is engaged in a broad range of activities throughout the region. It has commercial and civilian functions in areas such as agriculture and irrigation, in which capacity it served as implementing agency for two Bank projects. However, information provided by both Mr. Wu and the World Bank makes it clear that XPCC is also engaged in prison management. On the question of military activities, the Department of Defense has stated that while the XPCC maintains militia units and a military structure, it is "clearly a civilian organization."

A key focus of the World Bank's investigation was therefore to explore the precise role of the XPCC in the two Xinjiang projects in which, unlike the Tarim Basin Project, the organization was directly involved. In both cases the Bank's examination of project records and sites found that only civilian or commercial units of the XPCC had been involved in implementation, that there was no evidence that any project benefits had gone to prisons, and that there was no evidence that XPCC-provided prison labor had been used on these projects.

Conclusion

Mr. Chairman, let me again emphasize that both the U.S. Government and the World Bank have reacted to Mr. Wu's allegations with seriousness. We believe that the Bank mounted a good-faith effort to investigate these concerns, and we accept the conclusion that the Bank found no evidence to support any of the specific assertions. Mr. Wu is surely correct that there are numerous penal institutions in the Tarim Basin. But there is no evidence that prison labor was used in the project or that the XPCC was involved in any way. Moreover, the distance of the prisons from the project rules out the possibility that they benefitted directly from the project. Mr. Wu is also correct in identifying the multiple functions and activities of the XPCC; however, no evidence was found that the XPCC employed prison labor in Bank projects or that prisons it administered benefitted from Bank projects. The available evidence indicates that the Bank has not knowingly engaged with anything but the commercial and civilian functions of XPCC

That said, we fully recognize that the Bank's investigation has not been exhaustive. Because Xinjiang is so vast, neither the Bank team, nor any investigative team, could be expected to go everywhere and see everything.

Bank President Wolfensohn has reaffirmed the Bank's strong opposition to forced labor practices in Bank projects and restated that the Bank would not support military activities. To this end, the Bank has committed to ensuring that the commercial and civilian activities of Chinese implementing agencies for Bank projects are completely separated from other functions such as prison management. More broadly, the Administration is working actively with each of the multilateral development banks to develop a screening process to systematically incorporate worker rights issues into lending operations.

In conclusion Mr. Chairman, I want to restate the Administration's deep commitment to improving the human rights condition and material living standards of the Chinese people. We believe that the World Bank is a uniquely important instrument for constructive change in China. And we will continue to incorporate concerns such as those raised by Mr. Wu in our reviews of all World Bank projects.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
July 25, 1996

UNITED STATES AND INDONESIA SIGN PROTOCOL TO INCOME TAX TREATY

The Treasury Department announced today the signing, on July 24, 1996, of a Protocol amending the United States-Indonesia Income Tax Convention. The Protocol was signed in Jakarta by Secretary of State Warren Christopher and Indonesian Minister of Foreign Affairs Alatas Ali Abdullah. The Protocol will be submitted to the United States Senate for its advice and consent to ratification.

The principal shortcoming of the existing Convention (signed in 1988) is the high level of withholding taxes permitted on dividend, interest and royalty payments. In many cases the withholding rates significantly exceed those found in Indonesia's other recent treaties, as well as in most U.S. tax treaties. These high rates present a substantial barrier to the transfer of U.S. capital and technology into Indonesia and reduce the attractiveness of Indonesia as a location for U.S. corporations to establish operations to serve world markets. In addition, this competitive disadvantage to U.S. investors harms Indonesia by lessening desirable competition for Indonesian investment opportunities. Therefore, the proposed protocol reduces these withholding tax rates. Under the proposed Protocol, withholding rates on direct investment dividends, interest payments, and royalty payments are reduced from 15 percent to 10 percent.

The Protocol will enter into force upon the exchange of instruments of ratification. It will have effect for amounts paid or credited on or after the first day of the second month following entry into force.

Copies of the Protocol are available from the Office of Public Affairs, Treasury Department, Room 2315, Washington, D.C. 20220. Please refer all questions to (202) 622-2960.

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PROTOCOL AMENDING THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE REPUBLIC OF INDONESIA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME, WITH A RELATED PROTOCOL AND EXCHANGE OF NOTES SIGNED AT JAKARTA ON THE 11TH DAY OF JULY, 1988

The Government of the United States of America and the Government of the Republic of Indonesia, desiring to conclude a protocol to amend the Convention between the Government of the United States of America and the Government of the Republic of Indonesia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, with a related protocol and exchange of notes signed at Jakarta on the 11th day of July, 1988, have agreed as follows :

Article I

1. Paragraph 2 of Article 11 of the Convention shall be deleted and replaced by the following :

   "However, if the beneficial owner of the dividends is a resident of the other Contracting State, the tax charged by the first-mentioned State may not exceed :

   (a) 10% of the gross amount of the dividends if the beneficial owner is a company that owns directly at least 25% of the voting stock of the company paying the dividends;

   (b) 15% of the gross amount of the dividends in all other cases."

2. Paragraph 4 of Article 11 of the Convention shall be deleted and replaced by the following :

   "Where a company which is a resident of a Contracting State has a permanent establishment in the other Contracting State, that other State may impose an additional tax in accordance with its law on the profits attributable to the permanent establishment (after deducting therefrom the company tax and other taxes on income imposed thereon in that other State) and on interest payments allocable to the permanent establishment, but the additional tax so charged shall not exceed 10%."

Article 2

Paragraph 2 and 3 of Article 12 of the Convention shall be deleted and replaced by the following:

"(2) The rate of tax imposed by one of the Contracting States on interest derived from sources within that Contracting State and beneficially owned by a resident of the other Contracting State shall not exceed 10% of the gross amount of such interest.

(3) Notwithstanding paragraphs 1 and 2, interest arising in one of the two States shall be taxable only in the other State to the extent that such interest is derived by :

(i) The Government of the other State, including political subdivisions and local authorities thereof; or
(ii) the Central Bank of the other State; or
(iii) a financial institution owned or controlled by the Government of the other State, including political subdivisions and local authorities thereof."

Article 3

Paragraph 2 of Article 13 of the Convention shall be deleted and replaced by the following :

"(2) The rate of tax imposed by a Contracting State on royalties derived from sources within that Contracting State and beneficially owned by a resident of the other Contracting State shall not exceed 10% of the gross amount of royalties described in paragraph 3. "

Article 4

This Protocol shall be an integral and inseparable part of the Convention between the Government of the United States of America and the Government of the Republic of Indonesia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, with a related protocol and exchange of notes signed at Jakarta on the 11th day of July, 1988.

Article 5

This Protocol shall be subject to ratification and instruments of ratification shall be exchanged as soon as possible. It shall enter into force on the date of exchange of the instruments of ratification. The provisions shall for the first time have effect for amounts paid or credited on or after the first day of the second month next following the date on which the Protocol enters into force.

In witness whereof, the undersigned, duly authorized thereto by their respective Governments, have signed this Protocol.

Done at Jakarta, in duplicate, in the English language, this 24th day of July, 1996.

For the Government of the United States of America	For the Government of the Republic of Indonesia
Warren Christopher	Ali Alatas

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
July 25, 1996

Contact: Rebecca Lowenthal
(202) 622-2960

U.S. TREASURY DEPARTMENT HONORS FORMER SECRETARY LLOYD BENTSEN

The U.S. Treasury Department bestowed its highest honorary award, the Alexander Hamilton Award, on former Treasury Secretary Lloyd M. Bentsen in a ceremony today, July 25 in Washington, D.C.

In presenting the award to Mr. Bentsen, Treasury Secretary Robert E. Rubin lauded his long history of public service and contributions to Treasury. "In his two years at Treasury, Lloyd Bentsen played a pivotal role in deficit reduction and he led successful efforts to increase free and fair international trade and economic opportunity through the North American Free Trade Agreement and the GATT agreement," Secretary Rubin said. "During his tenure, interstate banking became a reality after years of unsuccessful legislation and Treasury's law enforcement mission was strengthened. The Lloyd Bentsen Treasury Department, like the man himself, was energetic, innovative, engaged and highly successful." Mr. Bentsen was accompanied by his wife, B.A., at the ceremony in the Andrew Mellon Auditorium.

Mr. Bentsen served as Treasury Secretary from January 1993 until December 1994, following an exemplary career in the U.S. Senate that lasted 22 years. He has a long history of public service, having served in the army during World War II, as Hidalgo County Judge then Congressman in his native Texas. He was a businessman in Houston for 16 years before running for Senate in 1970.

The award was named after the distinguished statesman Alexander Hamilton, who was named the first Secretary of the Treasury in 1789. In today's ceremony, 564 Treasury employees from across the country were honored for their accomplishments. The ceremony has been held annually since 1964.

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DEPARTMENT OF THE TREASURY

TREASURY NEWS

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FOR IMMEDIATE RELEASE
July 25, 1996

Contact: Rebecca Lowenthal
(202) 622-2960

U.S. TREASURY DEPARTMENT HONORS THE LATE LEE F. JACKSON

The U.S. Treasury Department bestowed its highest honorary award, the Alexander Hamilton Award, on the late Lee F. Jackson, who served as the U.S. Executive Director of the European Bank for Reconstruction and Development (EBRD), in a ceremony today, July 25 in Washington, D.C.

Mr. Jackson, who was appointed by President Clinton to the EBRD post in August 1995, died in a plane crash April 3 while accompanying U.S. Commerce Secretary Ron Brown on a trade mission to the former Yugoslavia.

In presenting the award to Mr. Jackson's parents, Luther and Nettie Jackson, Treasury Secretary Robert E. Rubin said of his service, "Mr. Jackson demonstrated the highest standards of dedication to public service throughout his career. As executive director of the EBRD, he advanced vital U.S. policy interests while helping to support economic and democratic transitions in Europe and the Former Soviet Union. Those of us who knew Lee remember his energy and tremendous enthusiasm and we will miss him."

Prior to joining the EBRD, Mr. Jackson served as Treasurer of the City of Boston, Massachusetts. During his tenure, Boston achieved and maintained the highest bond ratings in its history, despite a recession and cuts in state aid. Before coming to Boston, Mr. Jackson worked as an investment banker in San Francisco and New York, working for several firms where he financed infrastructure projects for cities, states and public authorities. He began his career as an economist for the U.S. Department of Energy's Office of Hearings and Appeals. Mr. Jackson received an MBA from Stanford University in 1983, and a BA, cum laude, in economics from Williams College in 1979. He was raised in White Plains, New York.

The award was named after the distinguished statesman Alexander Hamilton, who was named the first Secretary of the Treasury in 1789. In today's ceremony at the Andrew Mellon Auditorium, 564 Treasury employees from across the country were honored for their accomplishments. The ceremony has been held annually since 1964.

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DEPARTMENT OF THE TREASURY

TREASURY NEWS

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FOR RELEASE UPON EMBARGO
July 25, 1996

Contact: Michelle Smith
(202) 622-2960

RUBIN ANNOUNCES $7 BILLION EARLY PAYMENT FROM MEXICO

Treasury Secretary Robert E. Rubin on Thursday announced that Mexico will repay ahead of schedule $7 billion in early August under the United States emergency support package.

Combined with earlier payments, Mexico will have repaid almost three-quarters of the $12.5 billion it borrowed from the United States last year, leaving $3.5 billion in outstanding support. To date, the United States has received more than $1.2 billion in interest.

"The U.S. emergency support program, combined with Mexico's continued, disciplined adjustment efforts, is working and vital U.S. economic and security interests have been protected," Secretary Rubin said. "With this $7 billion repayment, the American people are being repaid well ahead of schedule for the loans we provided to Mexico.

"With nearly three-quarters of the debt about to be repaid, we can say that default has been averted, the Mexican economy is beginning to recover and our exports to Mexico are running at an all-time high. The strategy is working."

Under the original agreement with the United States, all disbursements of funds under the support program are backed by Mexican oil export proceeds which flow through an account at the Federal Reserve Bank of New York.

"This substantial prepayment is good news for both the United States and Mexico. The United States is being repaid a large part of our support earlier than scheduled, while still maintaining more than adequate backing from oil export revenues," Secretary Rubin said. "Mexico has been able to lower its borrowing costs and extend the maturity of its external obligations, while deepening its access to private international capital markets."

The majority of Mexico's prepayment -- $6 billion -- will come from a new private bank loan. This loan is backed by released oil export revenues which, in effect, is a partial privatization of the U.S. oil facility. Mexico will fund the remaining $1 billion of the August

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(More)

prepayment from other market financings, including proceeds of the recent Brady Bond exchange and a Japanese yen-denominated issuance.

Secretary Rubin also welcomed Mexico's announcement that it will repay an additional $1 billion of its International Monetary Fund obligations. "The IMF' continues to play a valuable role in ensuring the ongoing success of this program," Secretary Rubin said.

In evaluating these transactions, Treasury emphasized the critical importance of protecting vital U.S. interests, including those of U.S. taxpayers. Treasury has preserved more than adequate coverage of the $3.5 billion in remaining Mexican obligations. Moreover, the oil export proceeds will be released only when the prepayment has been made.

All of Mexico's peso-denominated dollar-indexed securities, or *tesobonos*, have been redeemed, and Mexico has returned to the international capital markets to raise some $18.5 billion, including this latest issue, in the last 12 months. U.S. exports to Mexico are at an all-time high -- 16 percent higher in the first half of this year than last year and 11 percent higher than the same period in 1994.

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MEXICO PREPAYMENT: FACT SHEET

In early August, Mexico will prepay $7.0 billion of the remaining $10.5 billion in medium-term swaps outstanding under the United States Emergency Support Package. The Administration's strategy of support for Mexico has worked: default was averted, the Mexican economy has begun to recover, U.S. exports to Mexico are at an all-time high, and Mexico will have repaid nearly three-quarters of its debt to the U.S. well ahead of schedule. The balance of the U.S. swaps remain fully protected.

- The majority of the prepayment - $6 billion - will come from a new private bank floating rate note issue. This issue is backed by Mexican oil export revenues released from the U.S. oil facility - in effect, a partial privatization of the U.S. oil facility.

- Mexico will fund an additional $1 billion prepayment to the United States from other market financings, including proceeds of the recent Brady Bond exchange and a Japanese yen-denominated issuance. In early August, Mexico is also expected to make an early payment of $1 billion to the IMF.

- Mexico has repaid $2 billion of short-term swaps, bringing their total borrowings down from a peak of $12.5 billion in July 1995. With this upcoming payment, nearly three-quarters of the $12.5 billion provided to Mexico as of July 1995 will be repaid after just one year.

In evaluating these transactions, the Department of the Treasury has underscored the critical importance of protecting vital U.S. interests, including those of U.S. taxpayers.

- Because of the benefits to the U.S., Treasury is prepared to release its claim to some of Mexico's oil export proceeds to facilitate the prepayment. These proceeds will be released only when the associated prepayment has been made.

- Treasury has preserved adequate coverage for Mexico's remaining obligations: the share of oil proceeds carved out will be less than the share of U.S. swaps prepaid, thereby preserving adequate coverage of Mexico's remaining obligations.

The U.S.-led emergency financial support program for Mexico - combined with Mexico's continued, disciplined adjustment efforts - has achieved its objective: preserving American interests.

- Vital United States economic and security interests have been protected.

- Default was averted. All *Tesobonos* have been redeemed. Including this latest issue, Mexico has returned to the international capital markets and raised over $18 billion in the past twelve months. Mexico's reserves have increased almost three-fold from the low levels of early 1995.

- Inflation has been brought under control. Domestic financial markets have stabilized. While the effects of recession are still being felt in Mexico, economic growth has resumed.

- U.S. exports to Mexico are running at all-time record levels this year, and the financial stability of other emerging U.S. export markets has been preserved.

- To date, in addition to capital repayments, the U.S. has received over $1.2 billion in interest payments on our loans to Mexico, yielding net earnings of $450 million after subtracting our borrowing costs.

The bottom line: this substantial prepayment is good news for both countries.

- Mexico is able to lower its borrowing costs and extend the maturity of its external obligations, while deepening its access to international capital markets.

- The U.S. gets repaid nearly two-thirds of our outstanding support package ahead of schedule, while maintaining adequate oil-backing for the remaining swaps.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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FOR IMMEDIATE RELEASE
Thursday, July 25, 1996

Contact: Calvin Mitchell
Jon Murchinson
202-622-2960

MEDIA ADVISORY

Treasury Secretary Robert E. Rubin will travel to Los Angeles Monday, July 29, 1996 to address the Town Hall on the Clinton Administration's economic policies as they relate to urban America. The Secretary will detail current efforts of the Treasury to ensure capital access to citizens of economically distressed areas in the United States, as well preview new areas of policy development.

The Secretary will also participate in a press conference at the "LANCER" site in South Central Los Angeles, a redevelopment project, along with officials from the James Irvine Foundation, the Trust for Public Land, the California Center for Land Recycling (CCLR) and the Concerned Citizens of South Central Los Angeles.

Town Hall is a non-profit, non-partisan forum in Los Angeles for the discussion of public issues with over 4,000 members from the business community, academia, government, the media and the arts.

Media seeking site information regarding the Town Hall speech should contact Rebecca Shehee at 213-628-8141, and Naomi Goldman at 310-826-8826 regarding the press conference in South Central Los Angeles.

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RR-1197

federal financing bank NEWS
WASHINGTON, D.C. 20220

Press 202-622-2960
FFB 202-622-2450

July 26, 1996

FEDERAL FINANCING BANK

Charles D. Haworth, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of June 1996.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $63.7 billion on June 30, 1996, posting a decrease of $1,277.1 million from the level on May 31, 1996. This net change was the result of a decrease in holdings of agency debt of $571.9 million, in agency assets of $690.0 million, and in agency guaranteed loans of $15.2 million. FFB made 18 disbursements during the month of June. FFB also received 15 prepayments in June.

Attached to this release are tables presenting FFB June loan activity and FFB holdings as of June 30, 1996.

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FEDERAL FINANCING BANK
JUNE 1996 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE
GOVERNMENT - GUARANTEED LOANS				
GENERAL SERVICES ADMINISTRATION				
Atlanta CDC Office Bldg.	6/4	$1,430.29	9/2/25	7.185% S/A
HCFA Headquarters	6/4	$164,900.00	7/1/25	7.186% S/A
Chamblee Office Building	6/6	$238,017.73	4/1/97	5.769% S/A
HCFA Headquarters	6/6	$753.31	7/1/25	7.136% S/A
Miami Law Enforcement	6/6	$735.21	1/3/22	7.146% S/A
Oakland Office Building	6/13	$51,228.91	9/5/23	7.354% S/A
Chamblee Office Building	6/14	$550,000.00	4/1/97	5.849% S/A
Foley Square Office Bldg.	6/21	$608,700.00	7/31/25	7.282% S/A
Foley Services Contract	6/24	$34,502.28	7/31/25	7.264% S/A
GSA/PADC				
ICTC Building	6/19	$8,023,167.35	11/2/26	7.252% S/A
RURAL UTILITIES SERVICE				
Amelia Telephone #394	6/4	$69,000.00	1/3/28	7.114% Qtr.
E. Nebraska Tele. #398	6/5	$276,000.00	1/3/17	7.072% Qtr.
Horry Tele. Coop. #419	6/17	$3,185,000.00	12/31/12	7.046% Qtr.
Molalla Tele. Co. #420	6/20	$1,143,000.00	12/31/14	7.123% Qtr.
E. Nebraska Tele. #398	6/21	$350,000.00	1/3/17	7.171% Qtr.
Farmers Telephone #399	6/25	$1,966,000.00	1/3/22	7.187% Qtr.
Beaver Creek Coop. #391	6/28	$300,000.00	12/31/13	6.903% Qtr.
WRECI Electric #353	6/28	$659,000.00	12/31/25	7.030% Qtr.

S/A is a Semi-annual rate: Qtr. is a Quarterly rate.

FEDERAL FINANCING BANK
(in millions)

Program	June 30, 1996	May 31, 1996	Net Change 6/1/96-6/30/96	FY '96 Net Change 10/1/95-6/30/96
Agency Debt:				
Export-Import Bank	$ 1,847.0	$ 2,008.3	$ -161.3	$ -659.3
Resolution Trust Corporation	6,536.2	6,946.8	-410.6	-6,672.4
Tennessee Valley Authority	0.0	0.0	0.0	-3,200.0
U.S. Postal Service	0.0	0.0	0.0	-7,264.7
sub-total*	8,383.2	8,955.0	-571.9	-17,796.4
Agency Assets:				
FmHA-ACIF	295.0	595.0	-300.0	-1,175.0
FmHA-RDIF	3,675.0	3,675.0	0.0	0.0
FmHA-RHIF	20,625.0	21,015.0	-390.0	-1,075.0
DHHS-Health Maintenance Org.	8.1	8.1	0.0	0.0
DHHS-Medical Facilities	23.8	23.8	0.0	0.0
Rural Utilities Service-CBO	4,598.9	4,598.9	0.0	0.0
Small Business Administration	0.1	0.1	0.0	0.0
sub-total*	29,225.9	29,915.9	-690.0	-2,250.0
Government-Guaranteed Loans:				
DOD-Foreign Military Sales	3,322.9	3,335.8	-12.9	-170.1
DHUD-Community Dev. Block Grant	81.0	81.0	0.0	-8.1
DHUD-Public Housing Notes	1,626.8	1,626.8	0.0	-61.7
General Services Administration +	2,318.2	2,324.8	-6.6	51.4
DOI-Virgin Islands	20.2	20.2	0.0	-0.8
DON-Ship Lease Financing	1,382.8	1,382.8	0.0	-49.3
Rural Utilities Service	16,952.2	16,944.3	7.9	-323.3
SBA-Small Business Investment Cos.	0.0	0.0	0.0	-5.5
SBA-State/Local Development Cos.	327.4	331.0	-3.6	-28.4
DOT-Section 511	13.1	13.1	0.0	-1.4
sub-total*	26,044.6	26,059.8	-15.2	-597.3
grand-total*	$ 63,653.6	$ 64,930.7	$ -1,277.1	$-20,643.7

*figures may not total due to rounding
+does not include capitalized interest

DEPARTMENT OF THE TREASURY

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EMBARGO UNTIL 8:30 a.m., PDT
MONDAY, July 29, 1996
As Prepared for Delivery

Remarks of
Treasury Secretary Robert E. Rubin
Town Hall/L.A.
Los Angeles, California

We're here this morning, to discuss the inner cities, a subject that I know you care a great deal about, and I do too.

I'd like to start with a few personal comments, and then I'll outline the Administration's approach to the inner cities, with a special focus on Treasury's capital access programs. Following that, I'll respond to questions or comments on anything you'd like.

As some of you know, I worked at a major investment banking firm for 26 years, on a Treasury Secretary's traditional portfolio of issues: the economy, markets, international trade, banking and the like. But today I'm here to speak about a different matter -- the imperative to bring the residents of the inner city into the economic mainstream.

I developed the view long ago that, unless we succeed in that endeavor, all of us -- no matter where we live or what our incomes -- would be powerfully affected, in lost potential for our economy and in a worsening of the conditions in which we live. Just think of the enormous difference in costs borne by taxpayers, in productivity, and in quality of life for all of us, if we can break the inter-generational cycle of poverty and equip the urban poor to join the economic mainstream.

Being in the White House, and now serving as Secretary of the Treasury, has given me a rare opportunity to act on these issues, but all of us, no matter what we do, can contribute meaningfully to this vital endeavor. Our Chief of Staff at the Treasury, for example, tutors an inner city school kid, a trader I know on Wall Street acts as a big brother to two kids, and others help rehabilitate houses, mentor small businesses, volunteer in medical clinics, and the list of possibilities is endless.

Moreover, in addition to whatever else you do, your involvement is urgently needed to provide political support for the programs of the inner city, at a time when all of these programs -- Head Start, Job Corps, CRA, EITC, and all the rest --are under strenuous attack by too many in Congress.

RR-1199

We need a true marshaling of national will and effort, and my hope -- as I speak here and elsewhere on these issues -- is that the unexpected fact of a Secretary of the Treasury discussing the inner cities as a critical economic concern for all of us, will reinforce those already involved and light a spark that gets others involved.

Community leaders here in L.A., like Juanita Tate of Concerned Citizens for South Central L.A., know what it takes to rebuild our communities -- investing in people to create a productive workforce, safe streets and neighborhoods, and access to capital.

There are programs -- federal, state and local -- that work, but we must choose rigorously in this era of scarce public resources and then apply effective programs on a scale commensurate with the problem.

To start, however, success with our inner cities requires sustained economic growth that creates jobs and through a high level of demand for labor, increases incomes. Too often I think that those focused on the issues of the poor do not focus adequately on the imperative of a good economy for their purposes. Conversely, I also think that too often those who are focused on creating a good economy do not adequately recognize all else that is needed to overcome poverty.

Today, America is in the midst of a sustained economic recovery and has the strongest fundamentals and best conditions we have seen in at least 30 years. The economy has created ten million net new jobs, and the unemployment rate has dropped from 7.3 percent to 5.3 percent over the past three and a half years. The average rate of growth during this period is 50 percent higher than during the prior four years, the rate of inflation substantially lower, and the rate of the new private sector investment that will increase future productivity and growth vastly higher.

And all of this is no accident. While many factors have contributed, the key and indispensable factor was President Clinton's deficit reduction program enacted in 1993 that has now cut the deficit by more than 50 percent, which, in turn, catalyzed the lower interest rates that drove and sustained the recovery.

That stronger national economy has reached into urban America, and to low and moderate income workers. Unemployment has dropped in America's ten largest central cities, including Los Angeles, and 1994 data -- the latest available -- shows real incomes of the lowest paid Americans have had some recent improvement.

All of this is true. But what is also true, as all of you here today know too well, is that there are too many people and too many places in our inner cities that are in trouble and that are not reached -- or reached far too little -- by our improved economy.

The statistics tell us what we intuitively know. The Committee for Economic Development, a well-respected business policy group, tells us that one third of the neighborhoods in our 100 largest cities are distressed or in danger. The Organization for Economic Cooperation and Development, the OECD, ranks us at the top of a list of 16 industrialized nations in income disparity. That same study shows that poor U.S. children are poorer than the children in most other Western industrialized nations.

These are urgent problems. And no matter what happens in the current debate over welfare reform, we must ask and answer these questions: Where will the jobs come from, and how do you produce the economic conditions necessary to create them?

I tend to think of the requisites for moving forward on the inner cities as falling into three categories.

The first, and probably most important, is what could, broadly speaking, be called investment in people. This includes education at all levels, from Head Start to adult skills and technical training, decent housing, health care somewhere other than in the emergency room, and the earned income tax credit and a higher minimum wage, so that work will lift workers above the poverty line and enable them to better care for the next generation. An important objective in the President's great budget battles of this year and last has been to prioritize these areas within the context of going to a balanced budget, rather than cutting significantly in these areas to fund large tax cuts that disproportionately favor the most affluent, as did the vetoed budget of the congressional majority.

The second category is public safety, and, there too, there have been great political battles, this time around the President's successful push to enact the Brady gun control law and the assault weapons ban and our on-going fight against efforts to repeal the assault weapons ban.

The third is access to private sector capital. This has received relatively little public attention, but is critical to revitalizing America's distressed communities.

The last two decades have seen enormous innovations in finance. Information technology and globalization are dramatically changing financial services. Ideas unknown on Wall Street a generation ago are now commonly used to fuel everything from high tech firms to housing in the suburbs. Our financial markets are today the broadest and deepest in the world.

But we still have a shortage of financial institutions and a shortage of credit for the creation of housing and jobs in the inner city. As Robert Kennedy once said, "To ignore the potential contribution of private enterprise is to fight the war on poverty with a single platoon, while great armies are left to stand aside."

The Department of the Treasury has been deeply and energetically involved in bringing its broad-based experience and expertise in capital markets to bear on the inner city, and we have pursued an eight point program which I'd like to review with you.

Step one involves helping capital flow from mainstream financial institutions to creditworthy borrowers. The Community Reinvestment Act, or CRA, was put in place in 1977, to encourage regulated banking institutions to serve creditworthy borrowers in all parts of their communities.

In May 1995, with Treasury's leadership, the banking regulators released new CRA regulations that eased the paperwork burden on banks while better promoting the results all of us want -- more investment capital to distressed communities.

During the last three years, according to nonprofit groups, financial institutions have pledged over $96 billion to community development lending over the next decade. That's more than two-thirds of all commitments made since CRA was enacted in 1977. While these are commitments, not loans made, this is a good indication of what can happen when the private sector sees investment opportunities in America's distressed communities.

During the last year, some in Congress have repeatedly tried to nullify CRA, in whole or in part. That effort has been defeated thus far, with a vigorous defense, but the battle will, I suspect, be ongoing.

Tomorrow, the latest study under the Home Mortgage Disclosure Act is being released in Washington. And for the second year in a row, lending to African-American, Hispanic, and low-income borrowers is rising. In fact, since 1993, lending to African Americans is up nearly 70 percent. Lending to Hispanics is up nearly 48 percent. And lending in low- and moderate-income neighborhoods is up over 25 percent. Much more needs to be done. But CRA, fair lending, a committed Administration and a sound economy are making a real difference.

Step two. The President's 1993 economic plan made permanent the Low Income Housing Tax Credit. As part of their budget last year, the congressional majority tried to repeal this credit. That was explicitly listed as one reason for the President's veto of their budget. The National Council of State Housing Agencies has estimated that the tax credit helps create over 100,000 units of affordable housing every year by encouraging private sector investment in low-income neighborhoods.

The third step is following through on President Clinton's call in 1992 for a nationwide network of community development banks. Two years later, his plan became law. Since then, Treasury has been hard at work bringing that plan to life.

Within Treasury, we now have a community development fund, called CDFI, that will provide seed and expansion capital to community-based banks, credit unions, community loan funds, micro-enterprise lenders, even community venture capital.

Later this week, CDFI will make its first awards. Community-based financial institutions nationwide will receive about $35 million to put capital into their communities, creating jobs and growth. We'll also announce that mainstream financial institutions have joined a $15 million program to increase their lending and support to community development institutions.

Over the next six years, the President's budget contains nearly $1.7 billion for CDFI funding, fully paid for, because of the great promise it holds for empowering communities. But again, even the limited funding so far has required a great struggle in the Congress, including vetoing last year's congressional majority's budget bill, which would have provided no funding for CDFI. We must all work together to realize the great potential for CDFI in the years ahead.

The fourth step is expanding micro-enterprise loans. Micro-enterprise lenders make very small loans -- for example, to a tailor for a sewing machine or to a mechanic to buy specialized tools. This spring, the First Lady and I launched a new Presidential Award for Micro-Enterprise Development, to be awarded this fall.

The fifth step is a new tax incentive to clean up abandoned industrial properties in economically distressed areas and put them back into productive use.

In his State of the Union Address, President Clinton called for adoption of what is called the brownfields tax incentive. This $2 billion proposal, fully paid for in our budget, has been estimated to induce over $10 billion in private sector investment to help clean up 30,000 brownfields sites.

Later today, to highlight the importance of expediting the revitalization of these properties, I will be going to the Lancer site along the Alameda Corridor in South Central L.A. There, the Irvine Foundation will announce a $2 million grant to set up a new community-based organization in Los Angeles called the California Center for Land Recycling -- "See Clear" -- to help communities link with the private sector to clean up brownfields.

Sixth, we've introduced legislation for a new round of Empowerment Zones and Enterprise Communities, also fully paid for in the President's budget. The proposal contains new tax incentives to bolster business investment and growth in 100 more distressed areas, with additional expensing for small businesses and new tax-exempt bonds.

These initiatives all work together. L.A.'s community development bank was born out of your Empowerment Zone, with $430 million from HUD, $210 million from the private sector, and a strong partnership with the city and county of L.A. The bank is scheduled to open tomorrow, which is great news for the city.

These six programs have great power to rebuild housing, create jobs, and boost economic activity. But the cost of progress is constant vigilance. We need to work vigorously to advance these programs, to pass legislation where it's needed, and to protect these programs from on-going attack. I want to tell you about two other areas -- steps seven and eight -- where I think we can also make a real difference going forward.

Seventh, while access to capital is critical, it often needs to be married with advice and mentoring on matters ranging from building markets to managing a balance sheet. The private sector can make an enormous contribution here, by linking up on a pro bono basis with lenders, non-profit, and communities to help inner city small businesses with accounting, business plans, marketing, and the like.

Many businesses are already involved, with real results. Just ask John Bryant of Operation Hope, an organization dedicated to catalyzing business investment and mentoring here in Los Angeles. This is a critically important area that I will be personally involved in pursuing over the coming years.

And number eight, which is still very much a work in progress: If we are able to pool community development loans and resell them to private investors, we can, in effect, recycle a portion of available capital back into inner city community development. After decades, that now happens in our housing markets. Imagine, looking forward some years, what a secondary market for community development lending would mean in terms of increased capital for growth and job creation in our inner cities. Now, this is a tough intellectual and practical challenge, but a joint Treasury/Commerce effort is underway. We hope for some progress in the short term, and then to build on this in the years ahead, even if limited to private placements. If, over the long haul, we can overcome these challenges, it would represent a true breakthrough for community development.

So, in sum, equipping people for the mainstream economy, public safety, and increasing access to capital, taken together, can help make a real break from the past and truly bring America's distressed communities into the economic mainstream.

These tasks are urgent and now, when America is enjoying a durable economic recovery, is the right time to move vigorously ahead. The adage is right -- fix the roof when the sun is shining.

Now, let me close where I started. If we make the right decisions in our public and private sectors, this country, with all of its many strengths, should have a robust economic future. But to realize that potential, we must, for all of our sakes, band together to overcome the problems of our inner cities and to bring the residents of the inner cities into the economic mainstream. It won't be easy; it won't be quick; but it can be done, and it must be done, again, for the benefit of all of us.

Thank you.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR RELEASE AT 3 PM
July 29, 1996

Contact: Jon Murchinson
(202) 622-2960

TREASURY ANNOUNCES MARKET BORROWING ESTIMATES

The Treasury Department announced on Monday that its net market borrowing for the July - September 1996 quarter is estimated to be $45 billion, with a cash balance of $40 billion on September 30. The Treasury also announced that its net market borrowing for the October - December 1996 quarter is estimated to be in the range of $50 billion to $55 billion, with a cash balance of $30 billion on December 31, 1996.

In the quarterly announcement of its borrowing needs on April 29, 1996, Treasury estimated net market borrowing for the July - September quarter to be in a range of $55 billion to $60 billion, assuming a $40 billion cash balance on September 30.

Actual net market borrowing in the April - June quarter was a pay down of $25.7 billion, while the end-of-quarter cash balance was $38 billion. On April 29, Treasury estimated net market borrowing for the April - June quarter to be a pay down of $20 billion, with a $35 billion cash balance on June 30. The improvement was primarily the result of higher than estimated receipts.

The regular quarterly refunding press conference will be held at 1 p.m. on Wednesday, July 31, 1996.

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RR-1200

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
July 29, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $13,045 million of 13-week bills to be issued August 1, 1996 and to mature October 31, 1996 were accepted today (CUSIP: 9127943M4).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.18%	5.32%	98.691
High	5.21%	5.35%	98.683
Average	5.20%	5.34%	98.686

$20,000 was accepted at lower yields.
Tenders at the high discount rate were allotted 24%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$42,562,166	$13,044,666
Type		
Competitive	$36,928,210	$7,410,710
Noncompetitive	1,375,541	1,375,541
Subtotal, Public	$38,303,751	$8,786,251
Federal Reserve	3,582,815	3,582,815
Foreign Official Institutions	675,600	675,600
TOTALS	$42,562,166	$13,044,666

5.15 -- 98.698   5.19 -- 98.688

RR-1201

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
July 29, 1996

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $13,158 million of 26-week bills to be issued August 1, 1996 and to mature January 30, 1997 were accepted today (CUSIP: 9127943X0).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.32%	5.54%	97.310
High	5.34%	5.57%	97.300
Average	5.34%	5.57%	97.300

$20,000 was accepted at lower yields.
Tenders at the high discount rate were allotted 11%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$50,155,096	$13,158,411
Type		
Competitive	$41,330,160	$4,333,475
Noncompetitive	1,338,536	1,338,536
Subtotal, Public	$42,668,696	$5,672,011
Federal Reserve	3,350,000	3,350,000
Foreign Official Institutions	4,136,400	4,136,400
TOTALS	$50,155,096	$13,158,411

5.25 -- 97.346 5.33 -- 97.305

RR-1202

DEPARTMENT OF THE TREASURY

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FOR IMMEDIATE RELEASE
July 29, 1996

Contact: Michelle Smith
(202) 622-2960

STATEMENT BY TREASURY SECRETARY ROBERT RUBIN
ON PENNSYLVANIA AVENUE

"We closed Pennsylvania Avenue to vehicular traffic, with Senator Dole's support, when the U.S. Secret Service said it was necessary to protect the President, the White House complex, tourists and visitors. After losing Americans in Saudi Arabia and Atlanta to terrorism, I know of no law enforcement reason that would cause us to change our position or relax our vigilance in protecting the White House complex or the President."

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RR-1203

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
July 29, 1996

Contact: Peter Hollenbach
(202) 219-3302

BUREAU OF THE PUBLIC DEBT AIDS SAVINGS BONDS OWNERS AFFECTED BY FLOODS IN ILLINOIS

The Bureau of Public Debt took action to assist victims of floods that struck northern Illinois by expediting the replacement or payment of United States Savings Bonds for owners in the affected areas. The emergency procedures are effective immediately for paying agents and owners in those areas of northern Illinois affected by the floods. These procedures will remain in effect through August 31, 1996.

Public Debt's action waives the normal six-month minimum holding period for Series EE savings bonds presented to authorized paying agents for redemption by residents of the affected area. Most financial institutions serve as paying agents for savings bonds.

The counties of Cook, DeKalb, DuPage, Grundy, Kane, Kendall, LaSalle, Ogle, Stephenson, Will and Winnebago are included in the initial declaration. Should additional counties be declared disaster areas the emergency procedures for savings bonds owners will go into effect for those areas.

The replacement of bonds lost or destroyed will also be expedited by Public Debt. Bond owners should complete form PD-1048, available at most financial institutions or the Federal Reserve Bank. Bond owners should include as much information as possible about the lost bonds on the form. This information should include how the bonds were inscribed, social security number, approximate dates of issue, bond denominations and serial numbers if available. The completed form must be certified by a notary public or an officer of a financial institution. Completed forms should be forwarded to Public Debt's Savings Bond Operations Office located at 200 Third St., Parkersburg, West Virginia 26106-1328. Bond owners should write the words "Floods" on the front of their envelopes to help expedite the processing of claims.

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RR-1204

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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Text as Prepared for Delivery
July 30, 1996

REMARKS TO THE TREASURY BORROWING ADVISORY COMMITTEE
OF THE PUBLIC SECURITIES ASSOCIATION
BY THE HONORABLE JOSHUA GOTBAUM
ASSISTANT SECRETARY OF THE TREASURY FOR ECONOMIC POLICY

We are pleased to welcome you again on one of your quarterly visits. Secretary Rubin and the rest of the Treasury team greatly value the insights that only practical market experience such as yours can provide. We are fortunate to have the benefit of your advice. Of course we don't always take it, but you may be sure that your views are always regarded seriously.

There is always a risk, given the volatility of markets, in focusing too much on this week's calendar or last week's results. Like you we await this week's calendar with special interest (as I will discuss in a second), but we should not lose sight of the larger picture: The main point to make is that we continue to enjoy some of the best economic fundamentals in a generation. Consumer demand and business investment have been strong, unemployment is down, job creation is strong, and inflation continues to appear subdued.

Although victory has many fathers, an important cause of this economic strength must be renewed fiscal discipline. As a result of the strong steps taken in 1993, the US budget deficit has been cut by more than half. This year, we project it will fall to $117 billion, 1.6% of GDP. This is the smallest share of GDP since 1974. It is also by far the best performance of any major industrial nation. We all recognize that this milestone is just that: a marker of how far we've come and a reminder that we still have much to do.

Job growth is an essential indicator of the health of the economy. The basic fundamentals are hardly in question. Since January 1993, 10 million jobs have been created in this country. By way of contrast, employment growth in the other major industrial countries taken together has been remarkable by its absence.

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RR-1205

There have been contentious debates in recent years about the quality of U.S job growth. Recently, the Council of Economic Advisors published a review of the data. It is worthwhile reading. While there are plenty of unsettled statistical issues, the paper notes that job growth has increasingly been in higher wage industries and categories, and overwhelmingly full time jobs.

In such a period of rapid job growth, we must of course be watchful for inflationary pressures. But, thus far, the evidence has been encouraging and the signs of acceleration weak. The unemployment rate has fallen to 5.3 percent and remained below 6 percent for more than a year and a half, but inflation still remains remarkably well behaved. Core consumer prices have risen *at a slower pace* this year than last. Energy prices are beginning to recede. Prices for consumer spending in the GDP accounts suggest even less inflation than indicated by the CPI. Producer prices are tame.

Of course, one cannot drive looking exclusively in the rear-view mirror, so we should not concentrate solely on the good statistical record of the past. Even fundamentals cannot safely go unattended. The budget deficit, the job machinery and the control of inflation will all require continuing attention. Things are going very well, but that certainly doesn't justify complacency.

Now what can usefully be said about this week's statistical calendar, or more broadly about the near term outlook? While this week's statistical calendar is obviously the focus of current attention, the lesson this year would seem to me to be the dominance of the fundamentals, not the primacy of the isolated statistic. Big blockbuster, market-moving employment reports have been followed by calmer periods, leaving interest rates pretty much where they started. Whether or not that will be the case this week remains to be seen.

Looking out a little further, the official projection as developed for the Mid-Session Budget Review calls for 2.6 percent real growth over the four quarters of this year. The so-called advance estimate of second-quarter growth will not be known until Thursday but the market is looking for something around 4 percent. We then expect the economy to move at a somewhat slower but sustainable pace in the second half of the year. Things do not always work out as smoothly as expected, and recent history is nothing if not a reminder of quarter-to-quarter variation, but with good fundamentals in place we expect the economy to stay on track.

Those are our views but of course the reason we are here is to learn *yours*. We appreciate your coming and look forward to the meeting.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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EMBARGOED UNTIL 2:30 P.M.
July 30, 1996

CONTACT: Office of Financing
202/219-3350

TREASURY'S WEEKLY BILL OFFERING

The Treasury will auction two series of Treasury bills totaling approximately $26,000 million, to be issued August 8, 1996. This offering will result in a paydown for the Treasury of about $4,150 million, as the maturing weekly bills are outstanding in the amount of $30,153 million.

Federal Reserve Banks hold $7,948 million of the maturing bills for their own accounts, which may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders.

Federal Reserve Banks hold $4,405 million as agents for foreign and international monetary authorities, which may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders. Additional amounts may be issued for such accounts if the aggregate amount of new bids exceeds the aggregate amount of maturing bills.

Tenders for the bills will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

Details about each of the new securities are given in the attached offering highlights.

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Attachment

RR-1206

HIGHLIGHTS OF TREASURY OFFERINGS OF WEEKLY BILLS
TO BE ISSUED AUGUST 8, 1996

July 30, 1996

Offering Amount	$13,000 million	$13,000 million
Description of Offering:		
Term and type of security	91-day bill	182-day bill
CUSIP number	912794 3N 2	912794 2L 7
Auction date	August 5, 1996	August 5, 1996
Issue date	August 8, 1996	August 8, 1996
Maturity date	November 7, 1996	February 6, 1997
Original issue date	May 9, 1996	February 8, 1996
Currently outstanding	$13,554 million	$18,900 million
Minimum bid amount	$10,000	$10,000
Multiples	$ 1,000	$ 1,000

The following rules apply to all securities mentioned above:

Submission of Bids:

Noncompetitive bids . . . . Accepted in full up to $1,000,000 at the average discount rate of accepted competitive bids

Competitive bids . . . .
(1) Must be expressed as a discount rate with two decimals, e.g., 7.10%.
(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position is $2 billion or greater.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Maximum Recognized Bid at a Single Yield . . . . 35% of public offering

Maximum Award . . . . 35% of public offering

Receipt of Tenders:

Noncompetitive tenders . . . . Prior to 12:00 noon Eastern Daylight Saving time on auction day

Competitive tenders . . . . Prior to 1:00 p.m. Eastern Daylight Saving time on auction day

Payment Terms . . . . Full payment with tender or by charge to a funds account at a Federal Reserve Bank on issue date

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FOR IMMEDIATE RELEASE
July 30, 1996

Contact: Jon Murchinson
(202) 622-2960

RUBIN TO AWARD $35.5 MILLION TO COMMUNITY DEVELOPMENT INSTITUTIONS

Treasury Secretary Robert E. Rubin will announce tomorrow, July 31, $35.5 million in awards to 31 community development organizations with operations in 46 states and the District of Columbia. The event will take place at 11:30 a.m. in the Office of Thrift Supervision amphitheater, 1700 G Street N.W., Washington, D.C.

These funds represent the first awards of the Community Development Financial Institutions (CDFI) Fund. CDFIs are specialized private institutions that fill niches in the market traditional financial institutions are not well positioned to serve. They provide a wide range of financial products and services to underserved communities and include such diverse institutions as community development banks, credit unions, loan funds, venture capital funds and micro enterprise funds.

Representatives of 28 of the 31 community development organizations will be available to the press at the OTS amphitheater. The amphitheater will be open for camera set up at 10:30 a.m.

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RR-1207

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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EMBARGOED UNTIL 11:30 AM
July 31, 1996

Contact: Jon Murchinson
(202) 622-2960

RUBIN AWARDS $35.5 MILLION TO COMMUNITY DEVELOPMENT INSTITUTIONS

Treasury Secretary Robert E. Rubin today announced the selection of 31 community development organizations to receive $35.5 million in financial and technical assistance from the Community Development Financial Institutions Fund. These funds will be leveraged with significant private funds and are expected to result, over time, in at least $350 million of lending and investing in distressed urban and rural communities in 46 states and the District of Columbia.

"In 1992, I called for the creation of a nationwide network of community development banks to help our communities help themselves. Local Community Development Financial Institutions will help their neighbors create small businesses, restore housing and rebuild hope in communities accross the country," President Clinton said. "The CDFI Fund is a prime example of a public-private partnership striving to bring work and wealth back to America's distressed communities."

"The CDFI Fund will facilitate the flow of capital to our nation's distressed communities, helping to create jobs and revitalize neighborhoods in areas that have been left behind," Secretary Rubin said.

Community Development Financial Institutions (CDFIs) are specialized private institutions that fill niches in the market traditional financial institutions are not well positioned to serve. They provide a wide range of financial products and services to underserved communities and include such diverse institutions as community development banks, credit unions, loan funds, venture capital funds and microenterprise funds.

The CDFI Fund was developed as part of President Clinton's initiative to support the private sector's creation of a national network of financial institutions dedicated to community development. The fund, which is part of the Treasury Department, represents a new approach to community development that will leverage significant private sector and local resources, promote self-sustaining CDFIs and catalyze new community lending and investment activity by conventional financial institutions.

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COMMUNITY DEVELOPMENT
FINANCIAL INSTITUTIONS FUND

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

CDFIs Selected for Funding

ACCION Texas	San Antonio, Texas
Appalbanc	Berea, Kentucky
Bethex Federal Credit Union	New York, New York
Boston Community Loan Fund	Boston, Massachusetts
Cascadia Revolving Fund	Seattle, Washington
Community Loan Fund of Southwestern Pennsylvania	Pittsburgh, Pennsylvania
Delaware Valley Community Reinvestment Fund	Philadelphia, Pennsylvania
Detroit Development Bancorporation	Detroit, Michigan
Douglass Bancorp	Kansas City, Kansas & Missouri
Enterprise Corporation of the Delta	Jackson, Mississippi
Faith Community United Credit Union	Cleveland, Ohio
FINCA	Washington, DC
First American Credit Union	Window Rock, Arizona
Illinois Facilities Fund	Chicago, Illinois
Kentucky Highlands Investment Corporation	London, Kentucky
Local Initiatives Support Corporation (for Rural LISC)	New York, New York
Louisville Community Development Bank Holding Company	Louisville, Kentucky
Low Income Housing Fund	San Francisco, California
New Hampshire Community Loan Fund	Concord, New Hampshire
Nonprofit Facilities Fund	New York, New York
Northeast Ventures Corporation	Duluth, Minnesota
Quitman County Federal Credit Union	Marks, Mississippi
Richmond Neighborhood Housing Services	Richmond, Virginia
Rural Community Assistance Corporation	Sacramento, California
Santa Cruz Community Credit Union	Santa Cruz, California
Schoolworkers Federal Credit Union	Charlotte, North Carolina
Self-Help	Durham, North Carolina
ShoreBridge Capital	Cleveland, Ohio
Southern Development Bancorporation	Arkadelphia, Arkansas
Tlingit-Haida Regional Housing	Juneau, Alaska
Vermont Community Loan Fund	Montpelier, Vermont

July 31, 1996

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

COMMUNITY DEVELOPMENT
FINANCIAL INSTITUTIONS FUND

Highlights of the First Round of CDFI Program Funding

Types and Amounts of Assistance

- The Fund is selecting 31 organizations for funding for a total of $35,469,500.
- This funding is broken down as follows:

Equity Investments	$ 9,350,000
Grants	$18,690,000
Loans	$ 6,660,000
Technical Assistance	$ 769,500

Organizational Diversity

- 4 community development banks or bank holding companies, one of which is African-American.
- 6 community development credit unions.
- 12 community development loan funds focusing on housing, nonprofit facilities and/or small business, including micro businesses.
- 3 community development venture capital organizations, one of which is an inner-city venture capital fund, while the remaining two serve rural areas.
- 2 microenterprise loan funds.
- 1 Native-American regional housing organization.
- 2 multi-faceted CDFIs, each with a credit union and one or more loan funds.
- 1 national community development intermediary.

Geographic Reach

- The CDFIs selected are headquartered in 20 states plus the District of Columbia.
- The CDFIs selected serve communities in 46 states plus the District of Columbia.
- Approximately 50% of the organizations serve predominantly urban areas, 25% serve predominantly rural areas, with the remainder serving a combination of both.

Impact and Innovation

- Of the 31 organizations selected, 12 represent startups (in existence two years or less) or are launching major geographic expansions.
- In addition, the CDFI funding will assist 8 other organizations in implementing significant new programs, products or services.

Addressing Diverse Needs

- The CDFIs selected provide a wide range of financial services and products to the distressed urban and rural communities and low-income populations they serve. These services and products include commercial loans and equity investments to start or expand small businesses (including micro businesses), loans for first-time home buyers, loans to rehabilitate rental housing, loans for community facilities and consumer loans.

Leverage

- In the near term (two to three years) the $35.5 million of CDFI funds provided is expected to leverage three to four times that amount in total capital raised for these institutions. Over the long term, the $35.5 million of funding is expected to support lending and investment of 10 to 20 times that amount.

EZ/EC Linkage

- 24 of the CDFIs selected serve Empowerment Zones and/or Enterprise Communities.

COMMUNITY DEVELOPMENT
FINANCIAL INSTITUTIONS FUND

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

Community Development Financial Institutions (CDFI) Fund Overview

The CDFI Fund was created as a bipartisan initiative as part of the Riegle Community Development and Regulatory Improvement Act of 1994. The Fund's programs will expand the availability of credit, investment capital, financial and other services in distressed urban and rural communities. By stimulating the creation and expansion of a diverse set of community development financial institutions (CDFIs) and by providing incentives to traditional banks and thrifts through the Bank Enterprise Awards (BEA) Program, the Fund's investments work toward building private markets, creating healthy local economies, promoting entrepreneurship, restoring neighborhoods, generating local tax revenues, and empowering residents.

CDFIs provide a wide range of financial products and services -- such as mortgage financing for first time home buyers, commercial loans and investments to start or expand small businesses, loans to rehabilitate rental housing, and basic retail/consumer financial services needed by low income households. CDFIs comprise a broad range of institution types such as community development banks, community development credit unions, community development loan funds, community development venture capital funds and microenterprise loan funds.

CDFI Fund Initiatives

CDFI Program

The Community Development Financial Institutions (CDFI) Program represents a new generation of community development initiatives. It uses limited public resources to invest in and build the capacity of private, for profit and nonprofit financial institutions, leveraging large amounts of private capital and taking full advantage of private sector talent and creativity. The CDFI Fund invests in CDFIs in a variety of forms -- equity investments, loans, grants, deposits and credit union shares -- depending on market needs and the ability of individual CDFIs to raise private matching funds in comparable form.

BEA Program

This program provides incentives for traditional banks and thrifts to invest in CDFIs and to increase their lending and provision of financial services in distressed communities.

These activities will complement and support the community reinvestment efforts of traditional banks and thrifts.

Training and Technical Assistance
The CDFI Fund intends to implement an ongoing program of training, technical assistance and capacity building to facilitate, in conjunction with the CDFI Program, the long term growth of the industry, while maintaining high quality standards and market discipline.

Secondary Market Initiative
The CDFI Fund is authorized to enhance the liquidity of CDFIs through the creation of a secondary market for community development loans. This initiative has the potential to dramatically leverage new sources of private capital in support of the CDFI industry.

Chronology of Major Events

September 1994
President Clinton signs the Riegle Community Development and Regulatory Improvement Act of 1994 into law. Among other things, the law establishes the Community Development Financial Institutions (CDFI) Fund.

July 1995
The White House, Treasury and Congress negotiate a rescission agreement that changes the Fund's status from an independent agency to a government corporation within Treasury and preserves $50 million in fiscal year 1995 appropriations.

October 1995
The Fund publishes in the Federal Register its interim regulations and notices of funding availability for the CDFI and BEA Programs.

January 1996
On January 29, the Fund receives over 268 applications for the CDFI Program requesting more than $300 million in assistance. The Fund receives 50 applications for the BEA Program. Review of applications begins.

July 1996
Treasury Secretary Rubin announces the selection of the CDFIs to receive $35.5 million in assistance from the CDFI Fund.

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EMBARGOED until 11:30 EDT
Remarks as prepared for delivery
July 31, 1996

Remarks of Treasury Secretary Robert E. Rubin
CDFI Fund Awards Announcement
Washington, D.C.

Thank you, Kirsten. Before we go further, I'd just like to say what a terrific job that you and your staff have done. I think you really bring an entrepreneurial spirit and hard-headed business sense to this project that is essential for the CDFI Fund and the long-term health and growth of local community development financial institutions.

Earlier this week I gave a speech to the business community in Los Angeles. I told them something that I've repeated to business people around the country, indeed, to any one who'll listen. And it is something I've believed for a very long time: Simply put, the United States will fall far short of its economic potential, for all of us, if we do not deal with the problems of our distressed rural communities and inner cities.

I said that I thought there were three essential ingredients to bringing jobs and growth back to America's distressed areas: investing in education, making our streets safe, and increasing access to private sector capital. And I explained eight ways in which the U.S. Treasury has been bringing our broad expertise in capital markets to bear on the problems of America's distressed communities. For, as Robert Kennedy once said, "To ignore the potential contribution of private enterprise is to fight the war on poverty with a single platoon, while great armies are left to stand aside."

From the low income housing tax credit, to CRA and community development banking, to micro-loans, Empowerment Zones, and business mentoring, there are many ways that we can help improve the flow of private capital. Today, we're here to focus on one important approach: bringing new sources of community financial capital to distressed areas, so neighbors can lend to neighbors right in their own communities.

In 1992, President Clinton called for the creation of a nationwide network of community development banks. Two years later, his plan became law. Since then, the Treasury Department has been hard at work bringing his plan to life.
RR-1209

Within Treasury, as you all know, we now have the Community Development Financial Institutions Fund, or CDFI, that will provide seed and expansion capital to community development banks, credit unions, loan funds, micro-lenders, and even venture capital.

The CDFI Fund represents a new approach to community development. By leveraging scarce public resources with private sector matching dollars to invest in local institutions, we can take full advantage of private sector talent and creativity. By emphasizing market discipline, we ensure the long-term viability of community development finance.

Today, we're here to announce the award winners for the first round of CDFI funding. We'll be providing \$35.5 million to 31 institutions around the country. The CDFIs we honor here today deserve special recognition. They have come through an extremely competitive and rigorous process that begin with 268 applicants and requests for funding roughly 10 times the amount of funds available for the initial round.

The awards we announce today represent just the beginning of what we can accomplish in the coming years through building local CDFIs. We intend to fund many other fine organizations in communities around the country in our second and future rounds. And over the next six years, the President's budget contains nearly \$1.7 billion for CDFI funding, fully paid for, because of the great promise it holds for empowering communities. But as you all know too well, we've been in a great struggle with some in Congress to ensure adequate funding for CDFI going forward.

In the past, the federal government has too often prescribed a one-size fits all solution to community development. The CDFI Fund's awards today exemplify an opposite approach: we're funding CDFIs with the kind of capital they need, and we're funding CDFIs of a myriad of type, size and approach, each designed to meet unique local needs and fill local market niches. All these institutions are united by two central facts: high quality and the drive and capacity to serve their communities.

Of the total awards, the Fund will be making equity investments of \$9.4 million, grants of \$18.7 million, loans of \$6.7 million, and technical assistance worth \$770 thousand.

These funds are going into a great diversity of local institutions. We're funding four community development banks, six credit unions, 12 loan funds, three venture capital funds, 2 micro-loan funds, 1 Native American housing fund, 2 multi-faceted CDFIs, and a national community development intermediary.

The CDFIs together serve communities in 46 states and the District of Columbia. About half focus on urban areas, a quarter on rural areas, and the rest serve both rural and urban areas. Twelve of these organizations are startups or major geographic expansions. Twenty-four of the CDFIs serve Empowerment Zones or Enterprise Communities.

These are federal dollars well invested. The CDFI Fund's seed and expansion capital of \$35.5 million is expected to leverage, in just the next two or three years, an additional \$140 million in private sector investment, and significantly more over time.

You should all be proud of the work you have done and are about to do.

We've heard from Kim Burse, President of the new Louisville community development bank holding company. Her story should be an inspiration to all of us; there are programs that work, and people who make them work, in communities all across America. Now, with $2 million in CDFI funds, the bank has plans to bring in over $12 million from the private sector. And working in Louisville's Enterprise Community, the bank will help grow small businesses, rebuild housing, and restore hope.

We've also heard from Donna Fabiani of FINCA, about how micro-loans right here in the District of Columbia can empower low-income individuals and promote self-employment. We've seen micro-lending work around the world, and it can work here too. With the First Lady's leadership, we can work together to bring micro-lending in this country to a broader scale.

We've also heard from Jeff Wells of the Santa Cruz Community Credit Union, where a $1 million grant from CDFI will help them offer the full range of financial services to the communities they serve, including a major expansion to serve low-income residents of Watsonville. I'm told that one of their first borrowers, Odwalla juice company, which started with a $1200 loan in a home garage, went public two years ago.

All of you have fought long and hard to get here today. The CDFI Fund is an important new tool that can help you bring financial capital into your communities, but at bottom, what makes this all work is an active, engaged vibrant community, and people like yourselves in local communities with the idealism and the pragmatism that it takes to rebuild housing, create jobs, and restore hope to neighborhoods long left behind.

Now, let me close where I started. If we make the right decisions in our public and private sectors, this country, with all of its many strengths, should have a robust economic future. But to realize that potential, we must, for all of our sakes, band together to overcome the problems of our distressed communities, and to bring all Americans into the economic mainstream. It won't be easy; it won't be quick; but it can be done, and it must be done, again, for the benefit of all of us.

Thank you.

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DEPARTMENT OF THE TREASURY

TREASURY NEWS

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FOR IMMEDIATE RELEASE
July 31, 1996

Contact: Jon Murchinson
202-622-2960

REMARKS BY DARCY BRADBURY
ASSISTANT SECRETARY FOR FINANCIAL MARKETS
AUGUST 1996 TREASURY QUARTERLY REFUNDING
PRESS CONFERENCE

Good afternoon. I will begin with today's refunding announcement and the terms of the regular Treasury August midquarter refunding. I will also discuss Treasury financing requirements for the balance of the current calendar quarter and our estimated cash needs for the October-December quarter.

1. We are offering $39.0 billion of notes and bonds to refund $17.6 billion of privately held notes maturing on August 15 and to raise approximately $21.4 billion of cash.

The three securities are:

-- First, a 3-year note in the amount of $19.0 billion, maturing on August 15, 1999. This note is scheduled to be auctioned on a yield basis at 1:00 p.m. Eastern time on August 6.
-- Second, a 9 year 11 month note in the amount of $10.0 billion, maturing on July 15, 2006. This is a reopening of the ten-year note originally issued in July. This note is scheduled to be auctioned on a yield basis at 1:00 p.m. Eastern time on Wednesday, August 7.
-- Third, a 30 year bond in the amount of $10.0 billion, maturing on August 15, 2026. This bond is scheduled to be auctioned on a yield basis at 1:00 p.m. Eastern time on Thursday, August 8.

2. On April 11, Treasury announced that on August 15 it would call the 8% bond of 1996-2001. This bond, of which approximately $.7 billion is privately held, will be repaid from available funds. We estimated in April that the Treasury is saving about $55 - $65 million in budget outlays from this call.

RR-1210

3. As announced on Monday, July 29, we estimate a net market borrowing need of $45.0 billion for the July-September quarter. The estimate assumes a $40 billion cash balance at the end of September. Including the securities in this refunding, we have raised $48.1 billion of cash from sales of marketable securities. See the attachment for details.

4. The Treasury will need to paydown $3.1 billion in market borrowing during the rest of the July-September quarter. This financing can be accomplished through regular sales of 13-, 26-, and 52-week bills in August and September and 2- and 5-year notes in August and September. A cash management bill may be needed to cover the low point in the cash balance in early September. The tentative auction calendars for August, September, and October are included in the chart package which was distributed today.

5. We estimate Treasury net market borrowing to be in a range of $50 billion to $55 billion for the October-December quarter, assuming a $30 billion cash balance on December 31.

6. The Treasury has published proposed changes in the state and local government series securities program (commonly called "SLGS") for comment in the *Federal Register*. The changes are designed to make SLGS more flexible, competitive, cost-effective securities. We want to help state and local governments comply with yield restrictions and arbitrage rebate requirements of the Federal tax laws. Among other things, we propose to reduce the Treasury's fee on SLGS which will increase investors' yield. We would eliminate the current so-called "all-or-nothing" rule and permit advance refunding escrows to blend SLGS with securities acquired in the open market. We would also eliminate the current cumbersome certifications and substantially decrease the notice period to purchase SLGS. Copies of the proposed regulation, are available in the back of the room, and we are encouraging public comment.

7. As you know, in May, Secretary Rubin announced Treasury's intention to issue inflation-protection securities. At the same time, we published in the *Federal Register* an Advance Notice of Proposed Rulemaking seeking comments from market participants on what aspects of inflation-protection securities would give them the broadest market appeal.

We have had more than 30 meetings with more than 800 investors, dealers, and other interested parties since then, in Washington, New York, Boston, Chicago, San Francisco, London, Tokyo, and, by videoconference, Australia. We have received approximately 50 comment letters in response to the ANPR. Last week, we held a symposium to explore further the options for structuring principal and interest payments on the inflation-protection securities and we published an additional notice in the Federal Register requesting further comment.

We are currently reviewing and evaluating the comments we have received. Based on those comments and our own review, we have made two decisions:

-- First, a comment we received from many people was that it was important for these new securities to be eligible for our stripping program from the day of issuance. Accordingly, we focussed on that area and are now comfortable that we will be able to make the new securities strippable as of their issuance.

-- Secondly, we have also received numerous comments on the importance of multiple maturities. Accordingly, while we will auction one maturity initially, we plan to introduce a range of maturities as soon as the first maturity is established.

We expect to conclude our review of the comments and to announce our decisions regarding all of the design details of the inflation-protection securities in September. At that time, we will publish a draft for comment of revisions to the Uniform Offering Circular, describing the terms and conditions of the new securities and how they will be auctioned.

8. The November midquarter refunding press conference is scheduled to be held on Wednesday, October 30.

-30-

ATTACHMENT

CASH RAISED

Including the securities announced in this refunding, we have raised $48.1 billion of cash from sales of marketable securities.

This was accomplished as follows:

-- raised $5.3 billion from the 2-year notes issued on July 1 and July 31;
-- raised $7.7 billion from the 5-year notes issued on July 1 and July 31;
-- raised $1.8 billion from the 52-week bills issued July 25;
-- raised $3.1 billion from the sale of the 10-year note issued July 15 to refund the maturing 7-year note;
-- raised $8.8 billion in cash in the regular weekly bills, including those announced yesterday;
-- raised $21.4 billion from the notes and bonds announced today.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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FOR RELEASE WHEN AUTHORIZED AT PRESS CONFERENCE
July 31, 1996

CONTACT: Office of Financing
202/219-3350

TREASURY AUGUST QUARTERLY FINANCING

The Treasury will auction $19,000 million of 3-year notes, $10,000 million of 9-year 11-month 7% notes, and $10,000 million of 30-year bonds to refund $17,596 million of publicly-held securities maturing August 15, 1996, and to raise about $21,400 million new cash.

In addition to the public holdings, Federal Reserve Banks, for their own accounts, hold $3,074 million of the maturing securities that may be refunded by issuing additional amounts of the new securities.

The maturing securities held by the public include $1,628 million held by Federal Reserve Banks as agents for foreign and international monetary authorities. Amounts bid for these accounts by Federal Reserve Banks will be added to the offering.

The 8% Bonds of 1996-01 that were called for redemption on April 11, 1996, are also being redeemed on August 15, 1996. This bond, of which $727 million is publicly held, will be repaid from available funds.

The 9-year 11-month note and 30-year bond being offered today are eligible for the STRIPS program.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

Details about the notes and bond are given in the attached offering highlights.

oOo

Attachment

RR-1211

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC

AUGUST 1996 QUARTERLY FINANCING

July 31, 1996

Offering Amount	$19,000 million	$10,000 million	$10,000 million
Description of Offering:			
Term and type of security	3-year notes	9-year 11-month notes (reopening)	30-year bonds
Series	Y-1999	C-2006	Bonds of August 2026
CUSIP number	912827 Y8 9	912827 Y5 5	912810 EX 2
Auction date	August 6, 1996	August 7, 1996	August 8, 1996
Issue date	August 15, 1996	August 15, 1996	August 15, 1996
Dated date	August 15, 1996	July 15, 1996	August 15, 1996
Maturity date	August 15, 1999	July 15, 2006	August 15, 2026
Interest rate	Determined based on the average of accepted competitive bids	7%	Determined based on the average of accepted competitive bids
Yield	Determined at auction	Determined at auction	Determined at auction
Interest payment dates	February 15 and August 15	January 15 and July 15	February 15 and August 15
Minimum bid amount	$5,000	$1,000	$1,000
Multiples	$1,000	$1,000	$1,000
Accrued interest payable by investor	None	$5.89674 per $1,000 (from July 15 to August 15, 1996)	None
Premium or discount	Determined at auction	Determined at auction	Determined at auction
STRIPS Information:			
Minimum amount required	Not applicable	$200,000	Determined at auction
Corpus CUSIP number	Not applicable	912820 BT 3	912803 BH 5
Due dates and CUSIP numbers for additional TINTs	Not applicable	Not applicable	August 15, 2026 --- 912833 PA 2

The following rules apply to all securities mentioned above:

Submission of Bids:

Noncompetitive bids . . . . Accepted in full up to $5,000,000 at the average yield of accepted competitive bids.

Competitive bids . . . . (1) Must be expressed as a yield with three decimals, e.g., 7.123%.
(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all yields, and the net long position is $2 billion or greater.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Maximum Recognized Bid at a Single Yield . . . . 35% of public offering

Maximum Award . . . . 35% of public offering

Receipt of Tenders:

Noncompetitive tenders . . . . . . Prior to 12:00 noon Eastern Daylight Saving time on auction day

Competitive tenders . . . . Prior to 1:00 p.m. Eastern Daylight Saving time on auction day

Payment Terms . . . . Full payment with tender or by charge to a funds account at a Federal Reserve Bank on issue date

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FOR RELEASE WHEN AUTHORIZED AT PRESS CONFERENCE
July 31, 1996

CONTACT: Office of Financing
202/219-3350

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In addition to the public holdings, Federal Reserve Banks, for their own accounts, hold $3,074 million of the maturing securities that may be refunded by issuing additional amounts of the new securities.

The maturing securities held by the public include $1,628 million held by Federal Reserve Banks as agents for foreign and international monetary authorities. Amounts bid for these accounts by Federal Reserve Banks will be added to the offering.

The 8% Bonds of 1996-01 that were called for redemption on April 11, 1996, are also being redeemed on August 15, 1996. This bond, of which $727 million is publicly held, will be repaid from available funds.

The 9-year 11-month note and 30-year bond being offered today are eligible for the STRIPS program.

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oOo

Attachment

RR-1211

RR-1211

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AUGUST 1996 QUARTERLY FINANCING

July 31, 1996

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Yield	Determined at auction	Determined at auction	Determined at auction
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Minimum bid amount	$5,000	$1,000	$1,000
Multiples	$1,000	$1,000	$1,000
Accrued interest payable by investor	None	$5.89674 per $1,000 (from July 15 to August 15, 1996)	None
Premium or discount	Determined at auction	Determined at auction	Determined at auction
STRIPS Information:			
Minimum amount required	Not applicable	$200,000	Determined at auction
Corpus CUSIP number	Not applicable	912820 BT 3	912803 BH 5
Due dates and CUSIP numbers for additional TINTs	Not applicable	Not applicable	August 15, 2026 --- 912833 PA 2

The following rules apply to all securities mentioned above:

Submission of Bids:

Noncompetitive bids . . . . Accepted in full up to $5,000,000 at the average yield of accepted competitive bids.

Competitive bids . . . . (1) Must be expressed as a yield with three decimals, e.g., 7.123%.
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Noncompetitive tenders . . . . . . Prior to 12:00 noon Eastern Daylight Saving time on auction day

Competitive tenders . . . . Prior to 1:00 p.m. Eastern Daylight Saving time on auction day

Payment Terms . . . . Full payment with tender or by charge to a funds account at a Federal Reserve Bank on issue date

REPORT TO THE SECRETARY OF THE TREASURY
FROM THE
TREASURY BORROWING ADVISORY COMMITTEE
OF THE
PUBLIC SECURITIES ASSOCIATION

July 31, 1996

Dear Mr. Secretary:

Since the Committee's last meeting on May 1, 1996, economic expansion has proceeded at a strong pace. Consumer spending rose briskly in the spring, reinforced by strength in employment and income. Manufacturing output has accelerated, and more recently the industrial-sector strength has broadened. While inflationary pressures have generally remained quiescent, signs of rising wage pressures are becoming evident.

During this period, interest rates on Treasury securities have increased uniformly by 20-30 basis points throughout the yield curve. Monetary policy has remained unchanged since January, although market participants perceive increased risks of the need for credit restraint. Eurodollar rates currently reflect expectations of a 25-50 basis point increase in the Federal Funds rate by year-end. While market participants expect a slowdown in economic activity, many are skeptical that the slowdown will be decisive enough to forestall a modest tightening in monetary policy.

Within this context, to refund the $17.6 billion of privately-held notes maturing on August 15, 1996 and to raise $21.4 billion of cash, the Committee recommends that the Treasury auction $39.0 billion of the following securities:

- $19.0 billion 3-year notes due August 15, 1999;
- $10.0 billion re-opened 7 percent notes due July 15, 2006;
- $10.0 billion 30-year bonds due August 15, 2026.

Of the 18 Committee members present for the meeting, 16 voted in favor of this recommendation. The other two members favored the issuance of $39.0 billion of securities comprising $19.0 billion 3-year notes, $9.0 billion re-opened 7 percent notes due July 15, 2006 and $11.0 billion 30-year bonds. While recognizing tradeoffs that are apparent from quarter to quarter, the majority preferred an approach which emphasized consistency in the sizes of the 10- and 30-year issues. The minority view sought to take advantage of a re-opened 10-year note to offer a somewhat smaller amount of 10-year securities in order to issue a larger bond offering. This approach would reflect the relative expensiveness of the 30-year maturity sector versus the 10-year sector and would promote increased liquidity in the bond sector.

The Committee voted unanimously to re-open the 7 percent notes due July 15, 2006. Such a re-opening would likely improve liquidity in this issue -- the first irregular cycle offering of 10-year notes. The Committee felt that if this issue was not re-opened, it may reduce the market's acceptance of additional 10-year notes issued with July 15 and October 15 maturity dates.

If the Treasury sought to issue a lesser amount of securities in the August refunding than the Committee's recommendation, by a vote of 16-2 the Committee prefers reducing the 3-year note. This is consistent with the Committee's long-held emphasis on longer-dated securities, as well as our earlier recommendation of a minimum size of $10.0 billion for 10- and 30-year securities.

With the aim of achieving a cash balance of $40.0 billion on September 30, the Committee unanimously recommends that, for the remainder of the quarter, the Treasury meet its borrowing requirement in the following manner:

- Two 5-year notes totaling $12.5 billion each, to raise $6.0 billion of new cash;
- Two 2-year notes totaling $18.75 billion each, to raise $0.6 billion of new cash;
- Two 1-year bills totaling $19.25 billion each, to raise $0.7 billion of new cash;
- Weekly issuance of 3- and 6-month bills through the remainder of the quarter, to pay down $19.4 billion of cash;
- The issuance of intra-quarter cash management bills to cover the cash low point in early September; and
- Redemption on August 15 of the bonds called earlier, to reduce cash by $727 million.

Including the $21.4 billion raised in the mid-quarter refunding as well as anticipated foreign add-ons of $5.3 billion, the proposed financing schedule will raise a net amount of $13.9 billion. This amount, when added to the $31.1 billion already raised or announced in the quarter, will accomplish the total net market borrowing requirement of $45.0 billion.

For the October-December quarter, the Treasury estimates a net borrowing requirement in the range of $50-55 billion with a cash balance of $30.0 billion at the end of December. To accomplish the anticipated net borrowing requirement, the Committee unanimously recommends the provisional financing schedule attached to this report.

At the Treasury's request, the Committee considered a number of questions regarding the potential terms and conditions of inflation-protection securities. The Committee recognizes that the Treasury's review of these questions builds upon an extensive body of research and analysis, both prepared at Treasury and submitted as part of the public review and comment process. The Committee commends the Treasury for the thoroughness of its efforts and encourages the Treasury to continue to maintain an open dialogue with market participants as it moves toward final decisions on the plan to issue such securities.

In considering the specific question raised by the Treasury as to the relative market attraction of the so-called "Canadian-style" structure and a "current-pay" inflation floater, the Committee notes that there are a number of theoretical advantages and disadvantages to each structure, which will have different practical consequences for different segments of the investor marketplace. Since no one structure is likely to be ideally suited to all potential investors, the issue is perhaps best approached from the standpoint of which market segment is likely to provide the most significant, dependable long-term demand for inflation protected securities. In that regard, the Committee believes that pension funds and insurance companies represent the segments with the greatest natural interest. For these types of investors, the current tax liability and duration risk issues raised by the Canadian model pose fewer complications, while the reinvestment risk features of that model are relatively attractive. Also, the treatment of deflation risk is likely to be somewhat less complex with the Canadian structure, relative to the current pay model. Finally, there is the relative advantage of existing market experience with the Canadian model.

An important consideration with either model would be features which would enhance subsequent re-engineering via stripping. On this point, there were mixed views on the complexities of stripping either model and a clear sense that more analysis would be important. In this regard, the Committee noted favorably an idea advanced in comment letters that, were the Treasury to chose the Canadian model, it consider establishing an exchange mechanism whereby coupons with the same maturity date, but stripped from different inflation-indexed issues, could be exchanged on the basis of index factors which would equate the coupons. The Committee would emphasize the importance of enhancing stripping features of this security, as that would go a long way to providing market mechanisms to adapt the security to changing patterns of market demand.

The Committee also discussed the relative importance of devising a structure which would promote liquid secondary markets for such securities. Any structural features which would enhance secondary market liquidity, without diminishing investor interest, would be an obvious plus. However, the Committee would stress that even under the best of circumstances, these instruments will not have the degree of secondary market liquidity enjoyed by conventional U.S. Treasury securities. What is important is that they achieve adequate liquidity, given the needs of the investor base to which they will have most appeal. Those investors will most likely regard these assets as core holdings to protect against long-term inflation uncertainty risk, and as an attractive low-risk alternative to holdings of "real" assets. Thus, they are less likely to require the high liquidity typical of Treasury securities and more likely to evaluate the liquidity of these instruments relative to that of substitute assets, which are far less liquid than long-term Treasury securities.

The Committee also considered the trade-offs between issuance in a range of sectors of the yield curve relative to a more focused initial program designed to promote a reasonable degree of market liquidity. Given the limited prospects for liquid secondary markets for these securities, and the Committee's sense that the most promising sources of investor demand favor longer-term assets, the Committee preferred an initial approach focused on issuance of longer-term securities.

As to specific maturity, on balance the Committee favored initial issuance of a 10-year rather than 30-year security, with regular re-openings whenever feasible. The factors weighing in favor of 10-year debt were the lower relative degree of risk in a 10-year security, particularly given uncertainties on liquidity and duration risk; the increased degree of intermediate-term investment focus for defined contribution and 401(k) investment plans; the prospects for some broader appeal to individual investors; and the benchmark status of the 10-year sector for conventional Treasury debt securities. In time, and depending upon market acceptance of the instrument, there could well be demand for issuance of longer-term (20- to 30-year) inflation protection securities. Also, to the extent the Treasury develops practical solutions to the structural issues which would facilitate stripping of these securities, this would lessen the risk of longer-dated issuance by providing a market-based mechanism for balancing supply and demand across maturity sectors.

Regarding auction techniques, the Committee was strongly in favor of the use of single price auctions for these securities, as that technique works best in offerings where there is a significant degree of bidder information risk. This would be especially the case for such a new type of Treasury security. The Committee also believes that a longer-than-normal pre-auction when-issued trading period would facilitate price discovery and contribute to improved auction participation. As concerns the Treasury's right to award less than the full amount of securities being offered, the Committee notes that the Treasury has such a right in all existing offerings and would naturally want to retain it for a new type of security. That option would, of course, be reflected in the offering circular and other materials introducing the new security. In as much as the Committee would expect that the Treasury would only exercise that option in extreme and unusual circumstances, we see no need for the Treasury to make special efforts to highlight this aspect of the offering terms and conditions.

In terms of the choice of inflation index to be used in the inflation-protection securities program, the Committee unanimously recommends the CPI-U index. This index is the most widely known inflation index and is generally accepted as a reasonable indication of inflation. It is similar to indices which other countries use for inflation-linked securities. The CPI-U is also published monthly, which reduces the lag time in adjusting the accrual of principal.

The Committee did not have a strong preference for a seasonally adjusted or non-seasonally adjusted series. However, a finality in determining payment amounts is an important consideration. Therefore, the Committee supports the Treasury's position that revisions of an index reported at an earlier date should not be used for principal or interest calculations.

Mr. Secretary, that concludes the Committee's report. We welcome any comments or questions.

Respectfully submitted,

Richard M. Kelly
Chairman

Estimated Treasury Marketable Borrowing
(billions of dollars)
October-December 1996

	Amount Maturing	Amount Offered	Foreign Add-ons	Cash Raised
Treasury bills				
Regular weekly bills	$347 5	360.0	--	$12.5
52-week bills				
October 17	18.5	19.25	--	0.75
November 14	18.9	19.25	--	0.35
December 12	18.8	19.25	--	0.45
Cash management bills*	--	15.0	--	15.0
Total bills	403.7	432.75		29.05
Treasury coupons				
Oct. 10-year	7.6	10.0	0.5	2.9
Oct. 2-year	18.4	18.75	1.5	1.85
Oct. 5-year	8.5	12.5	0.5	4.5
Nov. 3-year		19.0	1.2	
Nov. 10-year		10.0	0.3	
Nov. 30-year		10.0		
Refunding subtotal	36.7	39.0	1.5	3.8
Nov. 2-year	18.7	18.75	1.5	1.55
Nov. 5-year	9.6	12.5	0.5	3.4
Dec. 2-year	18.4	18.75	1.5	1.85
Dec. 5-year	9.4	12.5	0.5	3.6
Total coupons	127.3	142.75	8.0	23.45
Total borrowing	531.0	575.50	8.0	52.5

*Cash management bills totaling $15.0 billion to be issued in early November and maturing on January 23, 1997 Also assumes that intra-quarter cash management bills will be needed to cover cash low points during the quarter.

MINUTES OF THE MEETING OF THE TREASURY BORROWING ADVISORY COMMITTEE OF THE PUBLIC SECURITIES ASSOCIATION July 30 and 31, 1996

July 30

The Committee convened at 11:35 a.m. at the Treasury Department for the portion of the meeting that was open to the public. All members were present, except Mr. Kessenich. The Federal Register announcement of the meeting and a list of Committee members are attached.

Deputy Assistant Secretary for Financial Federal Finance Roger Anderson welcomed the Committee and the public to the meeting. Assistant Secretary for Economic Policy Gotbaum summarized the current state of the U.S. economy. Jill Ouseley, Director, Office of Market Finance, presented the chart show, which had been released to the public on July 29, updating Treasury borrowing estimates and providing statistical information on recent Treasury borrowing and market interest rates.

The public meeting ended at 12:10 p.m.

August refunding

The Committee reconvened in closed session at the Madison Hotel at 2:15 p.m. The members were present who had attended the public briefing. Deputy Assistant Secretary Anderson gave the Committee its Charge, which is also attached.

The Committee began by considering the attached proforma financing plan for the July-September quarter that had been prepared in advance by one of the members, using the market borrowing estimates that were released by the Treasury on July 29. The Committee began with a discussion of whether to recommend reopening the 10-year note issued in July 1996. They voted unanimously to recommend reopening that note in part to add to its liquidity in the secondary market.

The Committee then discussed the sizes of the refunding issues. Two packages were presented:

$19 billion of 3-year notes, $10 billion of 9-11/12 year notes in a reopening, and $10-billion of 30-year bonds -- which received 16 votes; and

$19 billion of 3-year notes, $9 billion of 9-11/12 year notes in a reopening, and $11 billion of 30-year bonds -- which received 2 votes.

The Committee did not see a need for cash management bills as part of the August refunding. The consensus was that, if the Treasury were to trim the size of the refunding package, the 3-year note size should be reduced. The Committee also foresees that the Treasury will need to issue short-term cash management bills for the period from early September until after the September 15 tax payment date.

The Committee consensus was that the proforma financing plan suggested for the October-December seemed appropriate.

Inflation-protection securities

The Chairman opened the discussion with a description of the Canadian structure and the current pay structure that the Treasury had published as possibilities for inflation-protection securities. Deputy Assistant Secretary provided a brief summary of the discussion at the symposium held at the Treasury on July 24,, 1996, on the structure of the inflation-protection securities.

The Committee began by discussing the possible impact of deflation on the value of the inflation-protection bonds, then turned to the specific questions in the Charge:

Structure: In the Canadian model the impact of inflation on the principal accrues over the life of the bond and a fixed-interest coupon is paid currently on the inflation-adjusted principal. In the current-pay method, all of the return that is attributable to inflation and a fixed interest rate are paid each 6 months. The Committee consensus was each model has advantages. The Canadian model would attract pension funds, insurance companies, and individual self-directed retirement savings through 401(k) plans. The current pay structure would attract mutual funds and other investors that are not tax-advantaged and accounts that need greater liquidity. The Committee pointed out that there are tradeoffs between trying to provide inflation protection over the longer term and the short-term considerations pertaining to market liquidity.

Multiple maturities: The Committee consensus recommendation is that the Treasury pick one maturity at least in the beginning, with the preference being for 10 years.

Awarding less than the announced amount: The Committee consensus is that the Treasury should cut back from the announced amount only under extreme circumstances.

Other: The consensus was that when-issued trading for inflation-protection securities should be longer than that for conventional Treasury securities to give market participants more time for price discovery. A 1-week minimum for the WI period was suggested, although this is no longer than the usual WI period for the regular midquarter refunding operation.

The meeting adjourned at 4:15 p.m.

July 31

The Committee reconvened at 8:30 a.m. at the Treasury in closed session. All members were present, except Mr. Kessenich and Mr. Lodge. The Chairman presented the Committee report (copy attached) to Assistant Secretary Bradbury and Deputy Assistant Secretary Anderson.

In response to questions, the Committee discussed briefly the amount of time needed by dealers and investors between the Treasury's final announcement of details of inflation-protection securities and the first auction. It will be necessary for market participants to make computer systems changes, and to test them, before the first auction. That time period was estimated in a range of 3 to 6 months.

The meeting adjourned at 9:05 a.m.

Jill K. Ouseley
Jill K. Ouseley, Director
Office of Market Finance
Domestic Finance
July 31, 1996

Attachments

Certified by: Richard Kelly
Richard Kelly, Chairman
Treasury Borrowing Advisory Committee
of the Public Securities Association
July 31, 1996

Estimated Number of Respondent: 600.

Estimated Burden Hours Per Respondent: 5 minutes.

Frequency of Response: O

Estimated Total Reporting Burden: 170 hours.

Clearance Officer: Garrick Shear (202) 622–3869, Internal Revenue Service, Room 5571, 1111 Constitution Avenue, NW., Washington, DC 20224.

OMB Reviewer: Milo Sunderhauf (202) 395–7340, Office of Management and Budget, Room 10226, New Executive Office Building, Washington, DC 20503.

Lois K. Holland,

Departmental Reports Management Officer.

[FR Doc. 96–17696 Filed 7–11–96; 8:45 am]

BILLING CODE 4830–01–P

Departmental Offices; Debt Management Advisory Committee; Meeting

Notice is hereby given, pursuant to 5 U.S.C. App. section 10(a)(2), that a meeting will be held at the U.S. Treasury Department, 15th and Pennsylvania Avenue, NW., Washington, DC, on July 30 and 31, 1996, of the following debt management advisory committee:

Public Securities Association
Treasury Borrowing Advisory Committee

The agenda for the meeting provides for a technical background briefing by Treasury staff on July 30, followed by a charge by the Secretary of the Treasury or his designate that the committee discuss particular issues, and a working session. On July 31, the committee will present a written report of its recommendations.

The background briefing by Treasury staff will be held at 11:30 a.m. Eastern time on July 30 and will be open to the public. The remaining sessions on July 30 and the committee's reporting session on July 31 will be closed to the public, pursuant to 5 U.S.C. App. section 10(d).

This notice shall constitute my determination, pursuant to the authority placed in heads of departments by 5 U.S.C. App. section 10(d) and vested in me by Treasury Department Order No. 101–05, that the closed portions of the meeting are concerned with information that is exempt from disclosure under 5 U.S.C. section 552b(c)(9)(A). The public interest requires that such meetings be closed to the public because the Treasury Department requires frank and full advice from representatives of the financial community prior to making its final decision on major financing operations. Historically, this advice has been offered by debt management advisory committees established by the several major segments of the financial community. When so utilized, such a committee is recognized to be an advisory committee under 5 U.S.C. App. section 3.

Although the Treasury's final announcement of financing plans may not reflect the recommendations provided in reports of the advisory committee, premature disclosure of the committee's deliberations and reports would be likely to lead to significant financial speculation in the securities market. Thus, these meetings fall within the exemption covered by 5 U.S.C. 552b(c)(9)(A).

The Office of Domestic Finance is responsible for maintaining records of debt management advisory committee meetings and for providing annual reports setting forth a summary of committee activities and such other matters as may be informative to the public consistent with the policy of 5 U.S.C. 552b.

Dated: July 8, 1996.

John D. Hawke, Jr.,

Under Secretary of the Treasury for Domestic Finance.

[FR Doc. 96–17742 Filed 7–11–96; 8:45 am]

BILLING CODE 4810–25–M

Customs Service

Entry of Certain Goods Assembled Abroad From Components Cut to Shape in the U.S. From Foreign Fabric

AGENCY: U.S. Customs Service, Treasury.

ACTION: General notice.

SUMMARY: This document sets forth instructions for the proper entry under the Harmonized Tariff Schedule of the United States of certain goods assembled abroad from components cut to shape in the U.S. from foreign fabric.

FOR FURTHER INFORMATION CONTACT: Craig Walker, Special Classification and Marking Branch, Office of Regulations and Rulings (202–482–6980).

SUPPLEMENTARY INFORMATION:

Background

1. Entry of Section 334(b)(4)(A) Goods Under 9802.00.8065

Section 10.25, Customs Regulations (19 CFR 10.25) implements section 334(b)(4)(A) of the Uruguay Round Agreements Act ("the Act") (codified at 19 U.S.C. 3592), which provides that where components are cut to shape in the U.S. from foreign fabric and exported to another country for assembly into an article that is returned to the U.S. and entered, or withdrawn from warehouse, for consumption on or after July 1, 1996, the dutiable value of the article shall not include the value of such components. In the final rule document implementing the provisions of section 334 of the Act, published in the **Federal Register** on September 5, 1995 (60 FR 46188), Customs stated the following regarding 19 CFR 10.25:

> Under section 334(b)(4) where goods are assembled abroad from components cut in the United States from foreign fabric (even though under section 334 the cut components are not products of the United States and the assembling country is the country of origin) the assembled goods, when imported into the United States, will continue to receive the same duty treatment presently accorded to such goods under subheading 9802.00.80, HTSUS * * * section 334(b)(4) serves to preserve a tariff treatment that otherwise would no longer be available under the section 334 origin rules * * *

Section 10.25 incorporates by reference the same operational, valuation, and documentation requirements applicable to goods entered under subheading 9802.00.80, HTSUS. Accordingly, in promulgating 19 CFR 10.25, Customs expressed its intent to continue to allow entry of these goods under subheading 9802.00.80, on and after July 1, 1996. Thus, imported goods entitled to a duty allowance under 19 CFR 10.25 are to be entered under subheading 9802.00.8065, HTSUS, and, solely for purposes of calculating the duty allowance under this subheading, Customs will treat these textile components as if they were "U.S. fabricated components".

It is important to note, however, that permitting the entry of section 10.25 goods under subheading 9802.00.8065, in order to implement the duty allowance provided under section 334(b)(4)(A) of the Act, should not be interpreted as a determination of the country of origin of these cut components. The determination of the country of origin of textile components cut in the U.S. from foreign fabric will be made under a general application of the section 334 rules of origin, as implemented by section 102.21, Customs Regulations (19 CFR 102.21).

Thus, it is possible that a shipment of assembled goods will be eligible for a partial duty allowance under subheading 9802.00.8065 pursuant to 10.25, but the country of origin of those goods, for quota, marking and other general origin purposes, will be neither the country of assembly nor the U.S.

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July 30, 1996

COMMITTEE CHARGE

The Treasury would like the Committee's specific advice on the following:

Treasury financing

- the composition of a financing to refund $17.6 billion of privately held notes maturing on August 15 and to raise approximately $20 billion of cash in 3-, 10-, and 30-year notes and bonds;

- reopening the July 10-year note in the refunding;

- the composition of Treasury marketable financing for the remainder of the July-September quarter and the October-December quarter.

Inflation protection securities

The Treasury is in the final stages of considering the terms and conditions of inflation-protection securities. We would like to have the Committee's views on the following:

- The comment letters that we have received indicate interest in both a Canadian-style structure and a current-pay inflation floater. Does the Committee have a view as to which structure would attract the broadest market?

- Most commenters suggest a range of maturities (2-5 years, 10 years and 30 years). How could we develop a range of maturities and promote market liquidity at the same time?

- Would you recommend single price auctions, in which investors would bid the real rate? Would you recommend that the Treasury announce, as part of the terms of the auction, that we would retain the option to award less than the full amount offered, if there were an extremely long tail between the yield necessary to sell, for example, 95 percent of the announced size and the remaining 5 percent.

- Do you have any other comments on the structure or inflation index to be used in the inflation-protection securities program?

Other topics

We would welcome any comments that the Committee might wish to make on related matters.

Summary of July to September 1996
Estimated Net Marketable Borrowing
(Billions of dollars)

Net new money raised or announced as of 7/29/96 :

Regular weekly Treasury bills (includes $1.75 billion foreign add-ons)	12.7
52-week bills (includes $795 million foreign add-ons)	1.8
Cash management bills	0.0
2-year notes (includes $3.92 billion foreign add-ons)	5.2
5-year notes (includes $1.65 billion foreign add-ons)	7.7
10-year note less 7-year redemption (includes $800 million foreign add-ons)	3.8
	31.2

Net new money left to be raised:

Regular weekly Treasury bills	-16.6
52-week bills	0.8
Cash management bills	0.0
2- & 5-year notes	6.6
Refunding	20.8

Total net marketable borrowing:	
(assumes a total of $11 billion foreign add-ons)	44.8

Note: Assumes an end-of-quarter cash balance of $40 billion.

Summary of October to December 1996
Estimated Net Marketable Borrowing
(Billions of dollars)

Net new money to be raised:

Regular weekly Treasury bills	10.0
52-week bills	1.6
Cash management bills	15.0
2- & 5-year notes	10.7
Refunding	2.3
10-year note less 7-year redemption	2.4
	42.1

Total net marketable borrowing in quarter:	
(assumes a total of $10 billion foreign add-ons)	52.1

Note: Assumes an end-of-quarter cash balance of $30 billion

DEFICIT SUMMARY
BILLIONS OF DOLLARS

FY1996

	1995 Oct	1995 Nov	1995 Dec	1996 Jan	1996 Feb	1996 Mar	1996 Apr	1996 May	1996 Jun	1996 Jul	1996 Aug	1996 Sep
	(a)	(a)	(a)	(a)	(a)	(a)	(a)	(a)	(a)			
Receipts	95.6	90.0	138.3	142.9	89.4	89.0	203.4	90.0	151.9	100.0	103.0	159.9
Outlays	118.4	128.5	133.0	123.6	133.6	136.3	131.0	143.3	117.8	129.0	140.5	135.0
Surplus/Deficit	-22.8	-38.5	5.3	19.3	-44.3	-47.3	72.4	-53.3	34.1	-29.0	-37.5	24.9
Other Net Fin. Sources	-6.3	-12.8	17.0	-1.4	-16.9	22.3	-9.5	-10.2	8.1	-5.0	2.0	6.0
Borrowing	12.3	56.2	-27.9	-0.9	54.9	15.7	-36.4	19.7	-8.6	32.3	16.8	-8.5
Marketable	14.8	58.3	-25.0	5.3	55.3	16.5	-36.5	20.0	-9.1	37.7	16.1	-8.8
Non-Marketable	-2.5	-2.2	-2.9	-6.3	-0.5	-0.8	0.1	-0.4	0.5	-5.4	0.7	0.3
Change in Cash	-16.8	4.9	-5.6	17.0	-6.3	-9.3	26.4	-43.8	33.5	-1.7	-18.7	22.4
Cash Balance	21.2	26.1	20.5	37.5	31.2	21.9	48.3	4.5	38.0	36.3	17.6	40.0
End-of-quarter CB Target:			20.0			20.0			35.0			40.0

Summary Totals	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1996 FY
Receipts	323.9	321.3	445.3	362.9	1453.4
Outlays	379.8	393.6	392.1	404.5	1570.0
Deficit	-55.9	-72.3	53.2	-41.6	-116.6
ONFS	-2.1	4.0	-11.6	3.0	-6.7
Borrowing	40.6	69.7	-25.4	40.6	125.4
Marketable	48.1	77.2	-25.7	45.0	144.6
Non-Marketable	-7.6	-7.5	0.2	-4.4	-19.3
Change	-17.5	1.4	16.2	2.0	2.1
Cash Balance	20.5	21.9	38.0	40.0	40.0

FY1997

	1996 Oct	1996 Nov	1996 Dec	1997 Jan	1997 Feb	1997 Mar	1997 Apr	1997 May	1997 Jun	1997 Jul	1997 Aug	1997 Sep
Receipts	99.8	97.0	140.3	149.5	95.3	93.8	208.7	94.5	159.2	100.4	105.0	161.5
Outlays	121.8	131.6	137.4	129.5	136.5	139.0	133.8	146.4	132.0	131.5	142.4	148.8
Surplus/Deficit	-22.0	-34.6	2.9	20.0	-41.2	-45.2	74.9	-51.9	27.2	-31.1	-37.4	12.7
Other Net Fin. Sources	-1.0	-7.4	1.9	1.0	-7.3	5.6	-4.0	-2.2	-7.7	1.5	-4.8	0.4
Borrowing	3.0	47.0	0.2	-16.0	43.5	29.6	-45.9	14.1	10.5	29.6	27.2	6.9
Marketable	3.5	47.5	1.2	-12.5	43.5	30.1	-46.2	14.0	11.5	33.4	26.5	7.1
Non-Marketable	-0.5	-0.5	-1.0	-3.5	0.0	-0.5	0.3	0.1	-1.0	-3.8	0.7	-0.2
Change in Cash	-20.0	5.0	5.0	5.0	-5.0	-10.0	25.0	-40.0	30.0	0.0	-15.0	20.0
Cash Balance	20.0	25.0	30.0	35.0	30.0	20.0	45.0	5.0	35.0	35.0	20.0	40.0
End-of-quarter CB Target:			30.0			20.0			35.0			40.0

Summary Totals	1996 Q4	1997 Q1	1997 Q2	1997 Q3	1997 FY
Receipts	337.1	338.6	462.4	366.9	1505.0
Outlays	390.8	405.0	412.2	422.7	1630.7
Deficit	-53.7	-66.4	50.2	-55.8	-125.7
ONFS	-6.5	-0.7	-13.9	-2.9	-24.0
Borrowing	50.2	57.1	-21.3	63.7	149.7
Marketable	52.2	61.1	-20.7	67.1	159.7
Non-Marketable	-2.0	-4.0	-0.6	-3.4	-9.9
Change	-10.0	-10.0	15.0	5.0	0.0
Cash Balance	30.0	20.0	35.0	40.0	40.0

U.S. TREASURY FINANCING SCHEDULE FOR 3RD QUARTER 1996

BILLIONS OF DOLLARS

ISSUE	ANNOUNCEMENT DATE	AUCTION DATE	SETTLEMENT DATE		OFFERED AMOUNT	MATURING AMOUNT	INTEREST PAYMENT	NEW MONEY	FOREIGN ADD-ONS
3&6 MONTH BILLS	06/25	07/01	07/05		29.2 A	27.7		1.51	0.57
	07/02	07/08	07/11		29.2 A	27.7		1.49	0.07
	07/09	07/15	07/18		28.2 A	22.7		5.52	0.59
	07/16	07/22	07/25		27.1 A	23.2		3.97	0.53
	07/23	07/29	08/01		26.0 A	27.6		-1.58	
	07/30	08/05	08/08		26.0	30.2		-4.15	
	08/06	08/12	08/15		26.0	27.4		-1.38	
	08/13	08/19	08/22		26.0	26.9		-0.89	
	08/20	08/26	08/29		26.0	26.5		-0.48	
	08/27	09/02	09/05		26.0	29.9		-3.92	
	09/03	09/09	09/12		26.0	28.5		-2.46	
	09/10	09/16	09/19		25.2	27.1		-1.89	
	09/17	09/23	09/26		25.2	26.6		-1.40	
					346.13	351.79		-5.66	
1-YEAR BILLS									
	07/12	07/18	07/25		19.37 A	18.36		1.01	0.80
	08/09	08/15	08/22		19.25	18.46		0.79	
	09/06	09/12	09/19		19.25	19.28		-0.02	
					57.87	56.10		1.77	
CASH MANAGEMENT BILLS									
16-Day Bill Matures 9/18/96	08/30	09/02	09/03		15.00	15.00		0.00	
COUPONS									
2-Year Note	06/19	06/25	07/01		18.79 A	18.09	4.50	0.70	2.02
5-Year Note	06/19	06/26	07/01		12.50 A	9.36		3.14	0.75
10-Year Note	07/03	07/09	07/15		10.00 A	7.00	2.75	3.00	0.80
2-Year Note	07/17	07/23	07/31		18.79 A	18.17	5.58	0.62	1.90
5-Year Note	07/17	07/24	07/31		12.50 A	9.60		2.90	0.90
3-Year Note	07/31	08/06	08/15		19.00				
10-Year Note	07/31	08/07	08/15	39.00	10.00	18.22 #	21.33	20.78	
30-Year Note	07/31	08/08	08/15		10.00				
2-Year Note	08/21	08/27	09/03		18.75	18.43	5.52	0.32	
5-Year Note	08/21	08/28	09/03		12.50	9.33		3.17	
2-Year Note	09/18	09/24	09/30		18.75	18.44	5.59	0.31	
5-Year Note	09/18	09/25	09/30		12.50	9.71		2.79	
					174.08	136.35		37.73	8.92

NET CASH RAISED IN 3rd QUARTER	33.84
FOREIGN ADD-ONS / MISC. PURCHASES	11.00
TOTAL NEW MONEY RAISED IN 3rd QUARTER	44.84

A = Announced

* Maturing 7-Year Note

\# Includes $700 million of the 8% of 2001 which was called in April.

U.S. TREASURY FINANCING SCHEDULE FOR 4TH QUARTER 1996
BILLIONS OF DOLLARS

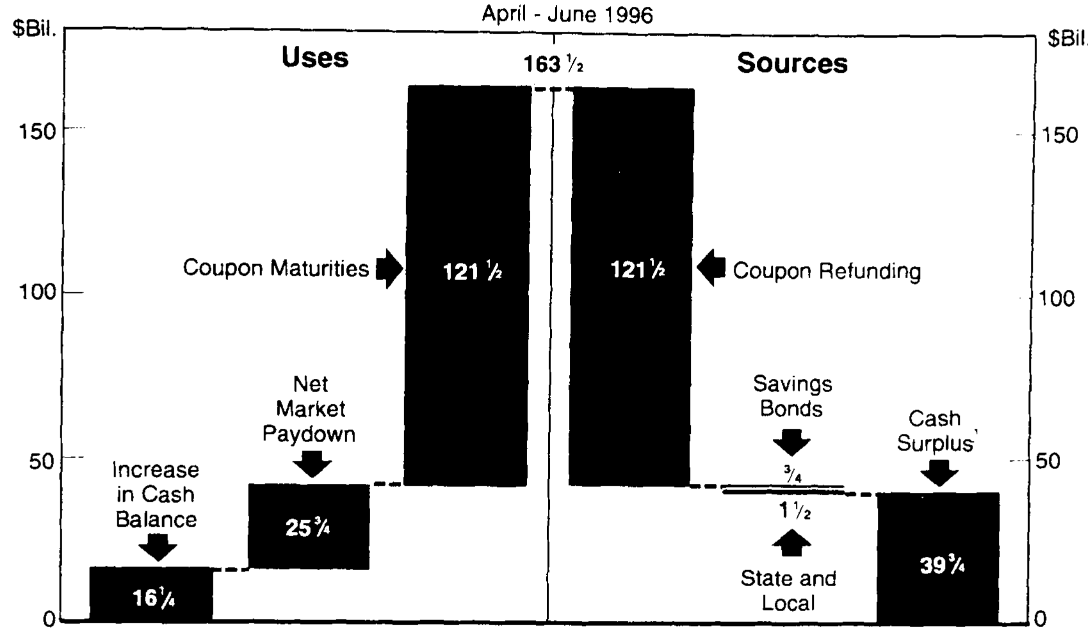
ISSUE	ANNOUNCEMENT DATE	AUCTION DATE	SETTLEMENT DATE		OFFERED AMOUNT	MATURING AMOUNT	INTEREST PAYMENT	NEW MONEY	FOREIGN ADD-ONS
3&6 MONTH BILLS	09/24	09/30	10/03		26.0	28.2		-2.20	
	10/01	10/07	10/10		27.0	28.1		-1.14	
	10/08	10/14	10/17		27.0	24.7		2.29	
	10/15	10/21	10/24		28.0	25.3		2.72	
	10/22	10/28	10/31		28.0	26.6		1.38	
	10/29	11/04	11/07		28.0	26.5		1.48	
	11/05	11/11	11/14		28.0	26.7		1.32	
	11/12	11/18	11/21		28.0	26.6		1.38	
	11/19	11/25	11/29		28.0	27.1		0.93	
	11/26	12/02	12/05		28.0	27.7		0.31	
	12/03	12/09	12/12		28.0	28.6		-0.57	
	12/10	12/16	12/19		27.0	26.1		0.87	
	12/17	12/23	12/26		27.0	25.7		1.27	
					358.00	347.98		10.02	
1-YEAR BILLS									
	10/04	10/10	10/17		19.25	18.48		0.77	
	11/01	11/07	11/14		19.25	18.87		0.38	
	11/29	12/05	12/12		19.25	18.79		0.46	
					57.75	56.14		1.61	
CASH MANAGEMENT BILLS									
48-Day Bill	10/29	10/30	11/01		8.00	8.00		0.00	
Matures 12/19/96									
83-Day Bill	10/29	10/30	11/01		15.00	0.00		15.00	
Matures 1/23/97									
17-Day Bill	11/27	11/29	12/02		15.00	15.00		0.00	
Matures 12/19/96									
COUPONS									
10-Year Note	10/02	10/08	10/15		10.00	7.61	2.84	2.39	
2-Year Note	10/16	10/22	10/31		18.75	18.40	5.62	0.35	
5-Year Note	10/16	10/23	10/31		12.50	8.50		4.00	
3-Year Note	10/30	11/05	11/15		19.00				
10-Year Note	10/30	11/06	11/15	39.00	10.00	36.67	22.03	2.33	
30-Year Bond	10/30	11/07	11/15		10.00				
2-Year Note	11/13	11/19	12/02		18.75	18.68	5.76	0.07	
5-Year Note	11/13	11/20	12/02		12.50	9.66		2.84	
2-Year Note	12/11	12/17	12/31		18.75	18.36	4.50	0.39	
5-Year Note	12/11	12/18	12/31		12.50	9.44		3.07	
					142.75	127.31	40.76	15.44	

NET CASH RAISED THIS QUARTER	42.07
FOREIGN ADD-ONS / MISC. PURCHASES	10.00
TOTAL NEW MONEY RAISED THIS QUARTER	52.07

* Maturing 7-Year Note
A = Announced

TREASURY FINANCING REQUIREMENTS

April - June 1996



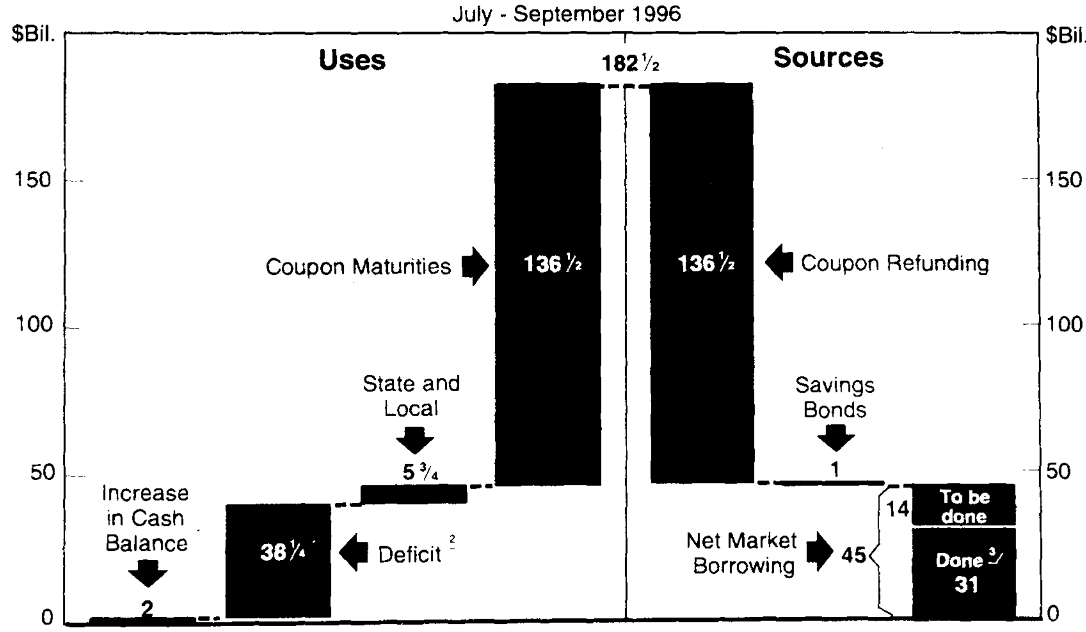
1 Includes budget deficit, direct loan activity, changes in accrued interest and checks outstanding and minor miscellaneous debt transactions.

Department of the Treasury
Office of Market Finance

July 29, 1996-1

TREASURY FINANCING REQUIREMENTS

July - September 1996



1 Assumes a $40 billion cash balance on September 30, 1996.

2 Includes budget deficit, direct loan activity, changes in accrued interest and checks outstanding and minor miscellaneous debt transactions.

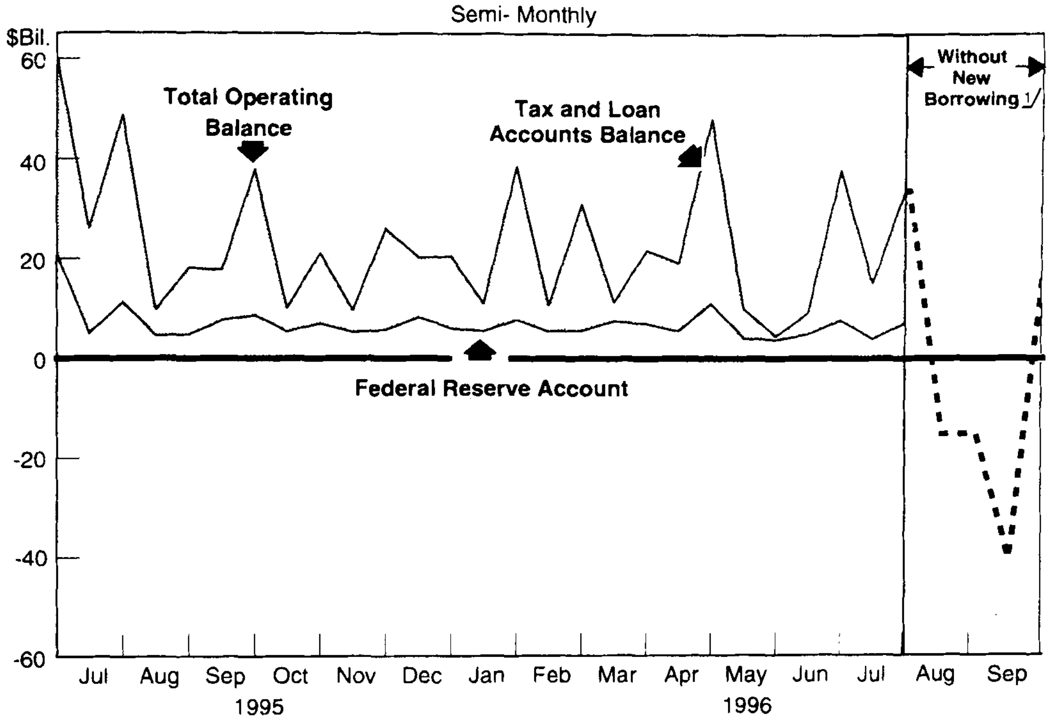
3 Issued or announced through July 26, 1996.

Department of the Treasury
Office of Market Finance

July 31, 1996-2

TREASURY OPERATING CASH BALANCE

Semi- Monthly

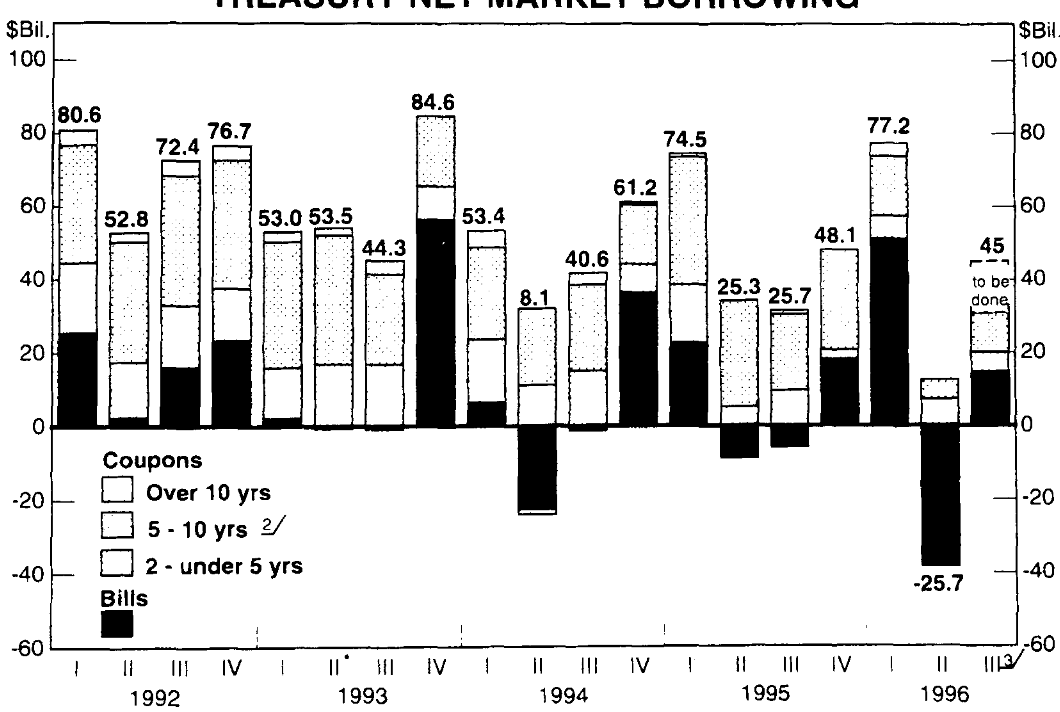


1/ Assumes refunding of maturing issues.

Department of the Treasury
Office of Market Finance

July 29, 1996-3

TREASURY NET MARKET BORROWING 1/



1/ Excludes Federal Reserve and Government Account Transactions.

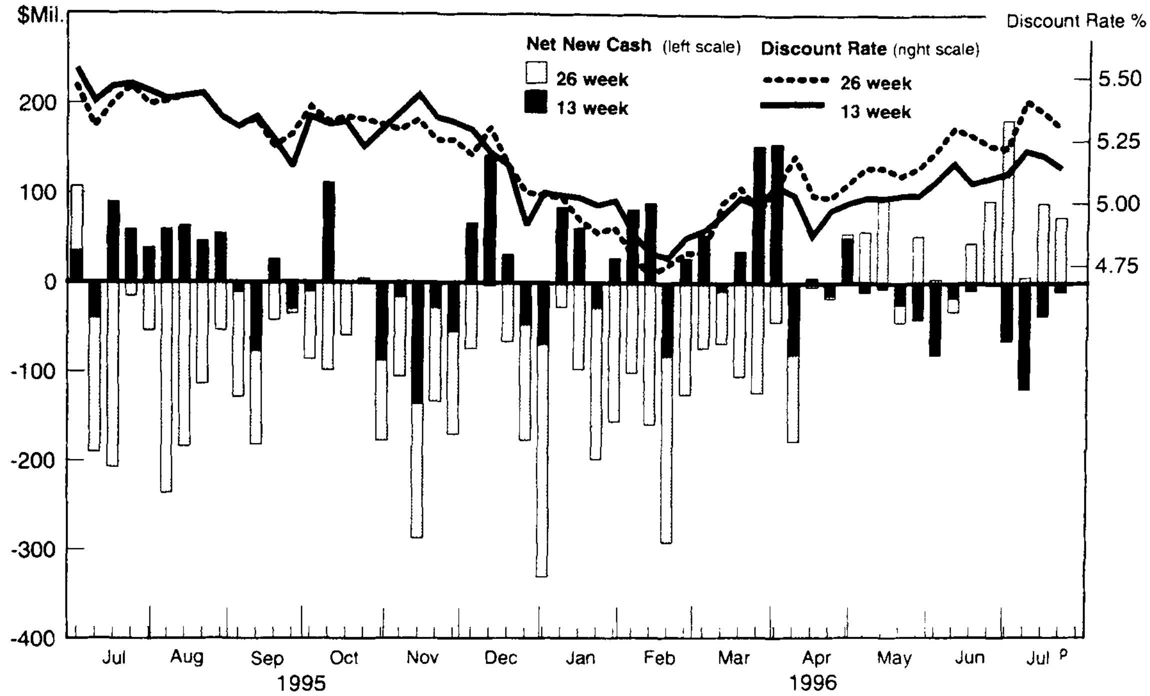
2/ 7 year note discontinued after April 1993.

3/ Issued or announced through July 26, 1996.

Department of the Treasury
Office of Market Finance

July 31, 1996-4

NET NEW CASH FROM NONCOMPETITIVE TENDERS IN WEEKLY BILL AUCTIONS 1/



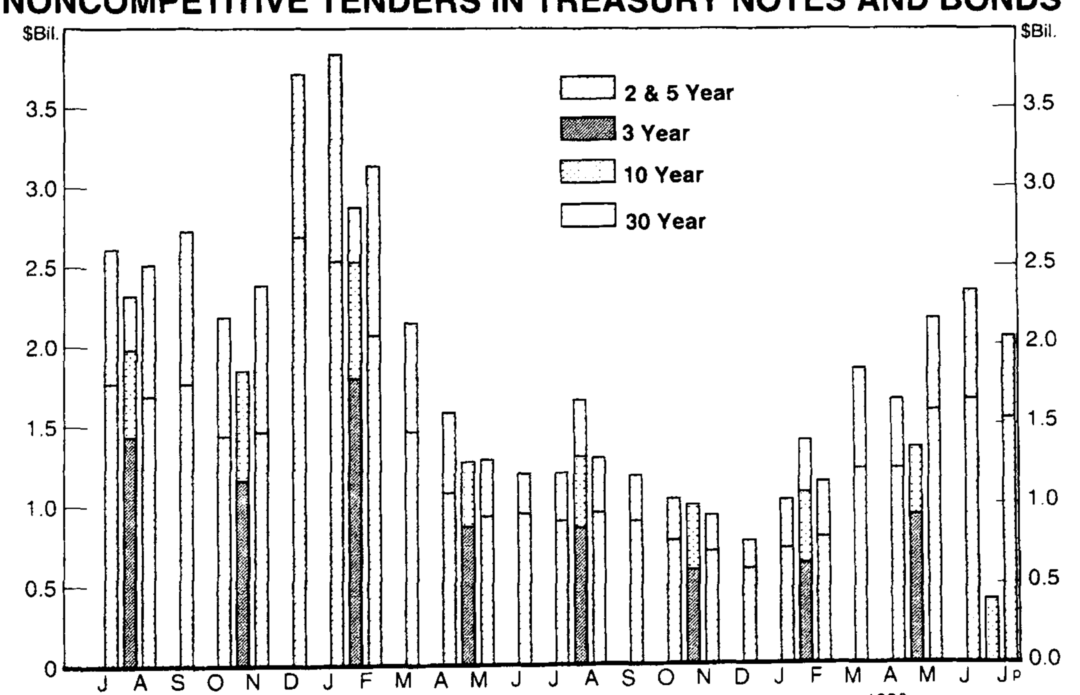
1/ Excludes noncompetitive tenders from foreign official accounts and the Federal Reserve account.

p Preliminary

Department of the Treasury
Office of Market Finance

July 29, 1996-5

NONCOMPETITIVE TENDERS IN TREASURY NOTES AND BONDS 1/



1/ Excludes noncompetitive tenders from foreign official accounts and the Federal Reserve account

p Preliminary

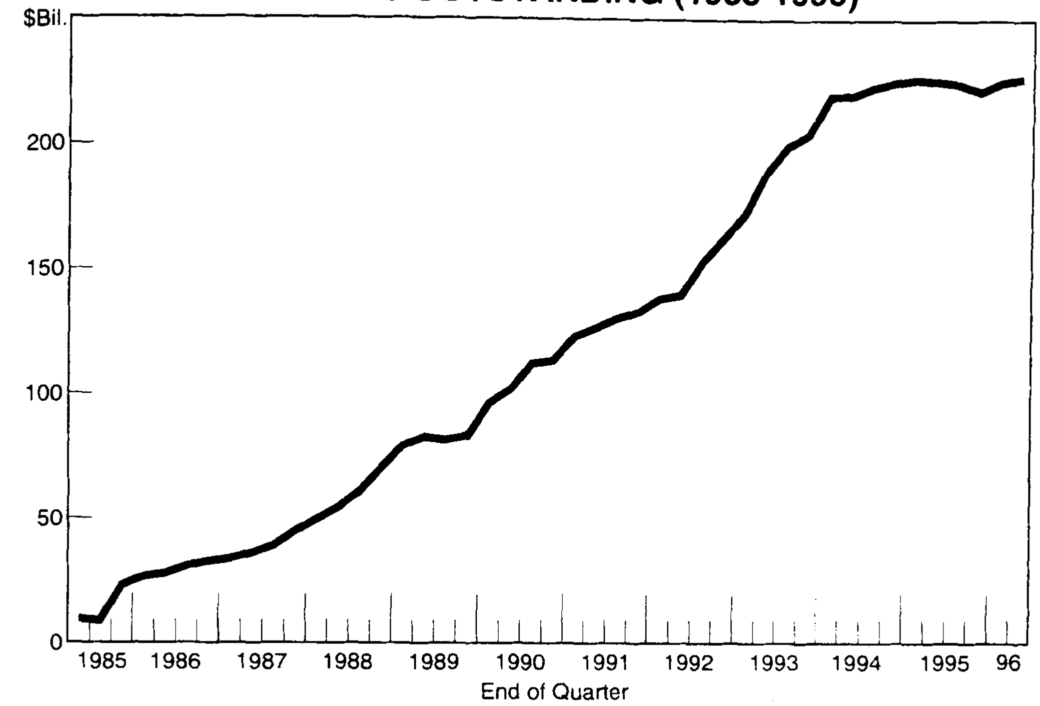
The maximum noncompetitive award to any noncompetitive bidder is $5 million, effective November 5, 1991

Effective February 11, 1992, a noncompetitive bidder may not hold a position in WI trading, futures, or forward contracts, nor submit both competitive and noncompetitive bids for its own account.

Department of the Treasury
Office of Market Finance

July 29, 1996-6

NET STRIPS OUTSTANDING (1985-1996)*



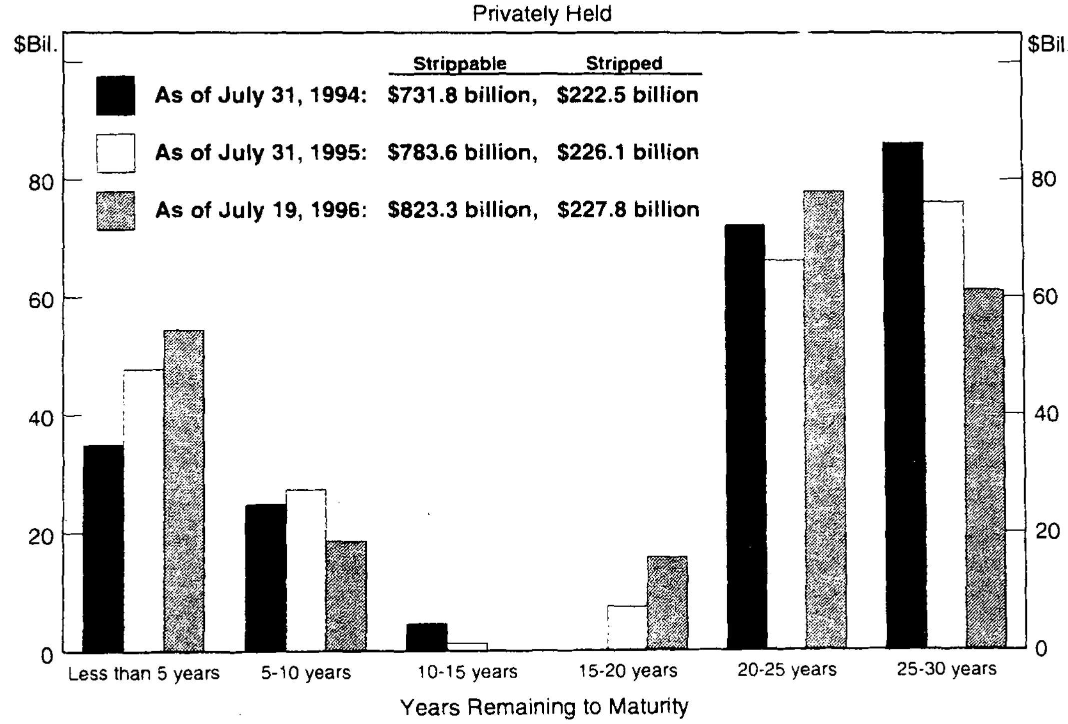
*Strips program began February 15, 1985.
Reconstitution began May 1, 1987.

Department of the Treasury
Office of Market Finance

July 29, 1996-7

SECURITIES HELD IN STRIPS FORM 1994-1996

Privately Held



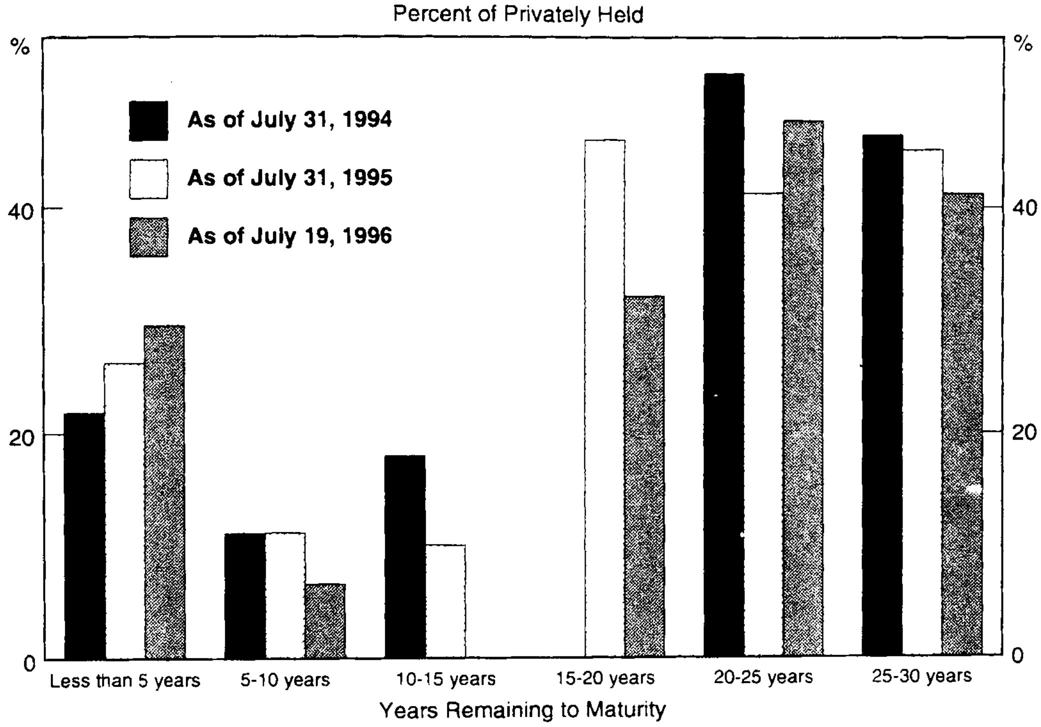
Note: The STRIPS program was established in February 1985. The 11 5/8% note of November 15, 1994, issued on November 15, 1984, was the first STRIPS-eligible security to mature.

Department of the Treasury
Office of Market Finance

July 29, 1996-8

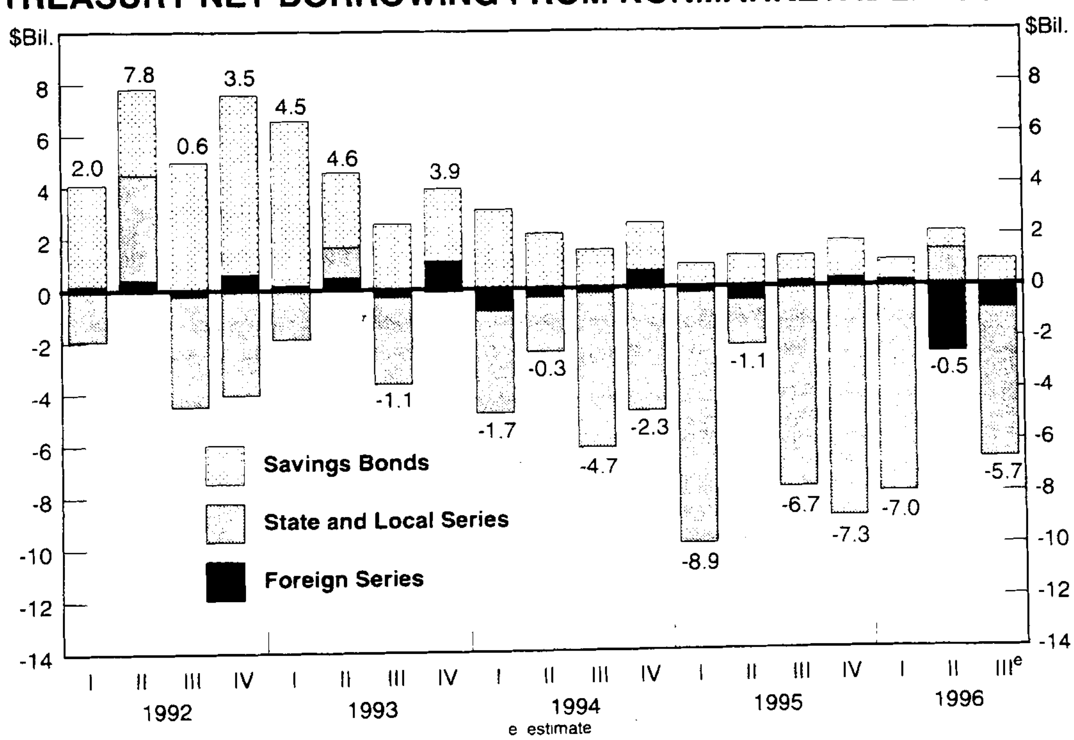
SECURITIES HELD IN STRIPS FORM 1994-1996

Percent of Privately Held



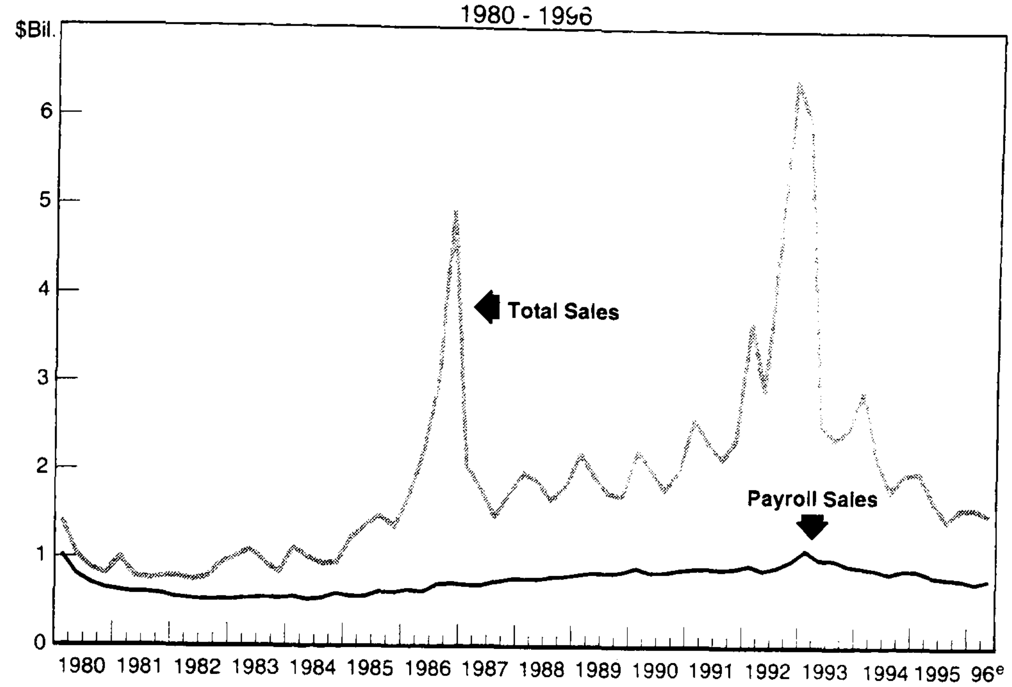
Note: The STRIPS program was established in February 1985. The 11 5/8% note of November 15, 1994, issued on November 15, 1984, was the first STRIPS-eligible security to mature.

TREASURY NET BORROWING FROM NONMARKETABLE ISSUES



SALES OF UNITED STATES SAVINGS BONDS

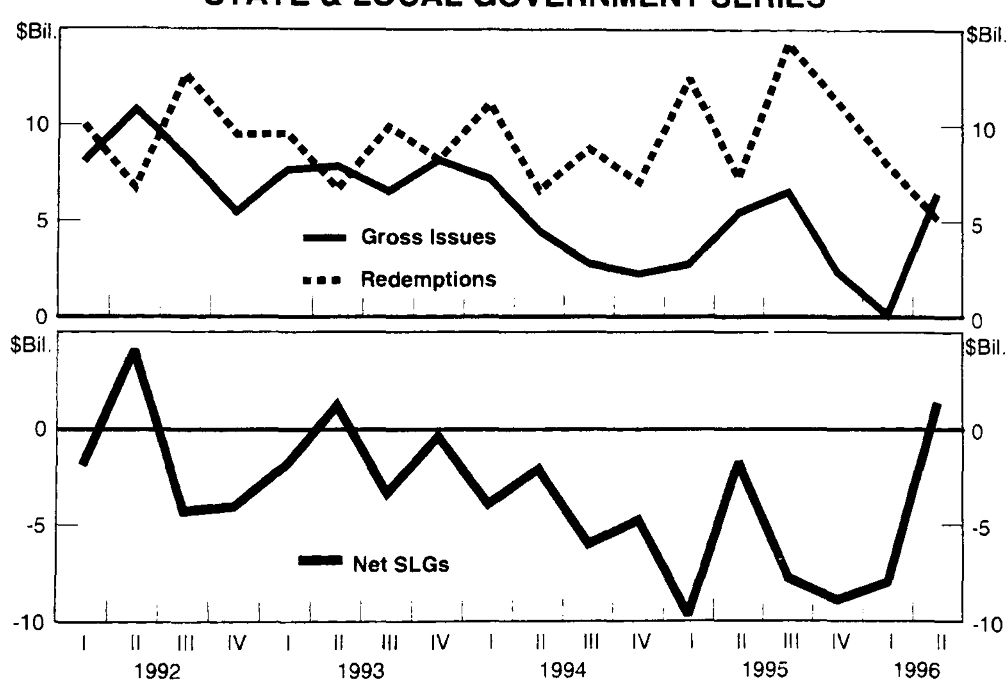
1980 - 1996



Department of the Treasury
Office of Market Finance

July 29, 1996-11

STATE & LOCAL GOVERNMENT SERIES

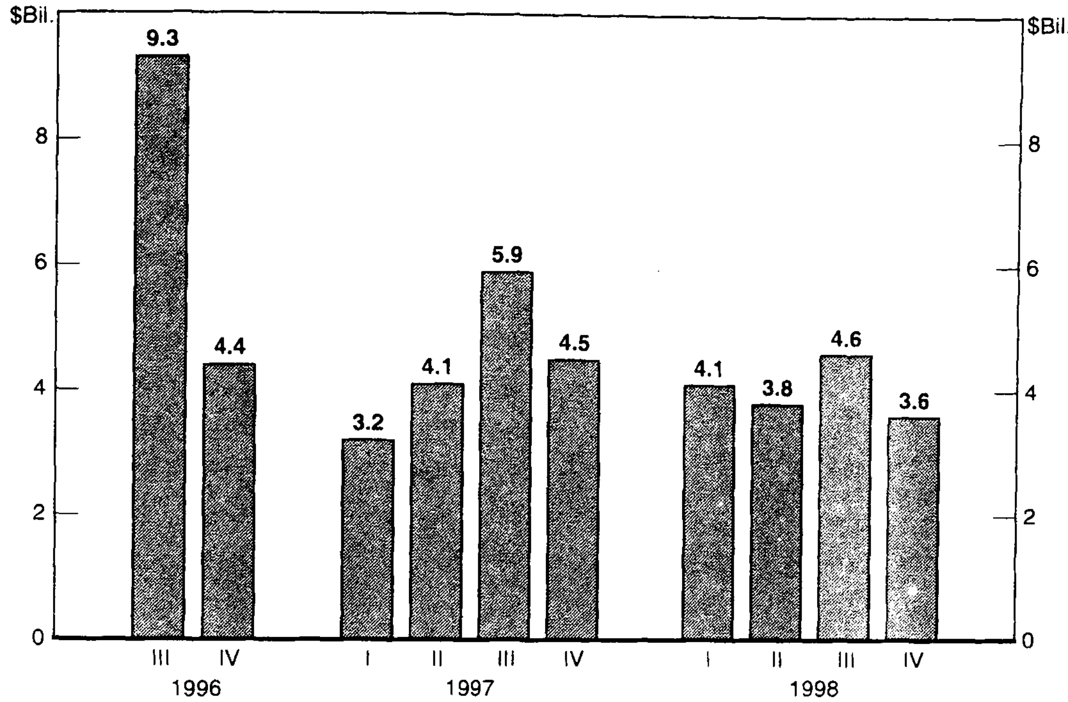


Note: SLGS sales were suspended from October 18, 1995 to March 29, 1996.

Department of the Treasury
Office of Market Finance

July 29, 1996-12

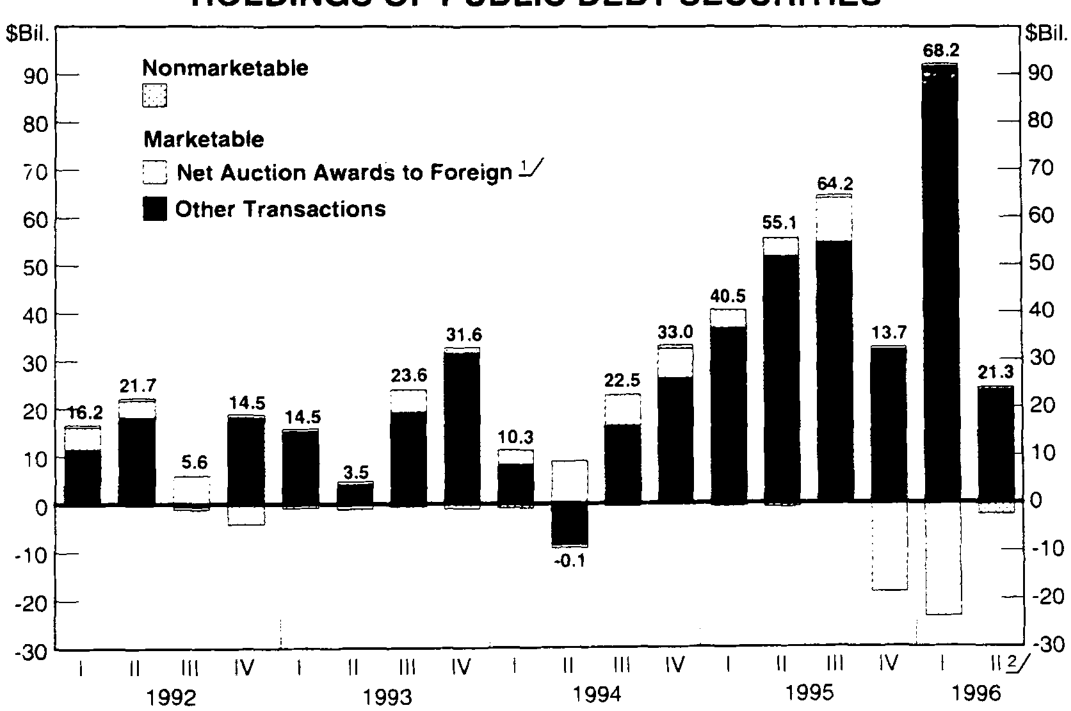
STATE AND LOCAL MATURITIES 1996-1998



Department of the Treasury
Office of Market Finance

July 29, 1996-13

QUARTERLY CHANGES IN FOREIGN AND INTERNATIONAL HOLDINGS OF PUBLIC DEBT SECURITIES



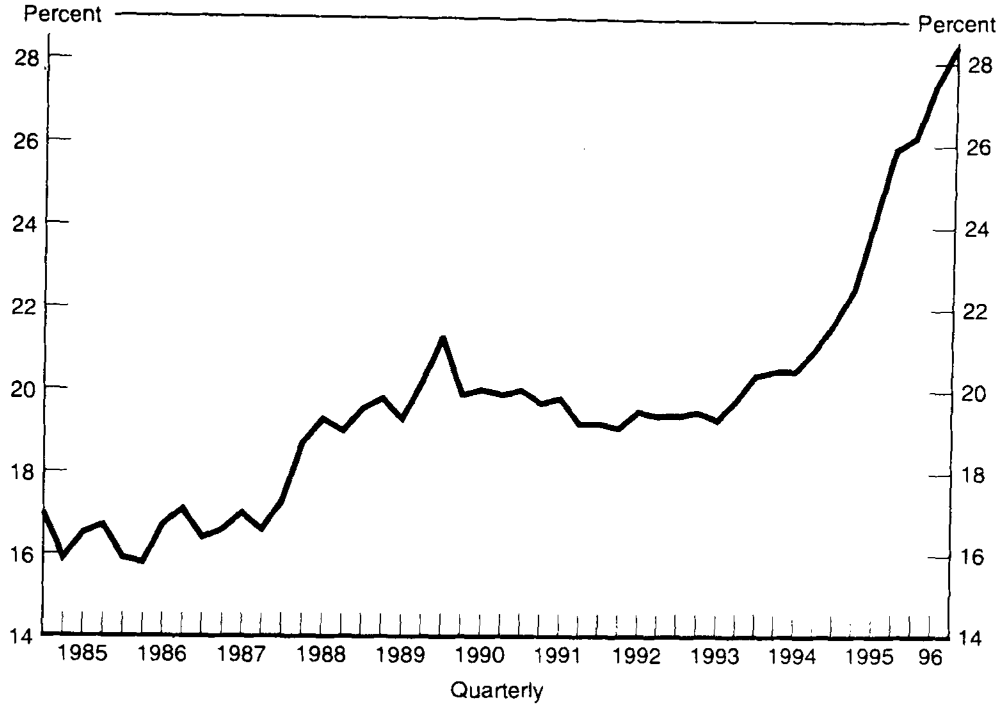
1/ Noncompetitive awards to foreign official accounts held in custody at the Federal Reserve in excess of foreign custody account holdings of maturing securities. Foreign add-ons prohibited from October 18, 1995 to March 29, 1996 to avoid exceeding the debt limit.

2/ Data through May 31, 1996.

Department of the Treasury
Office of Market Finance

July 29, 1996-14

FOREIGN HOLDINGS AS A PERCENT OF TOTAL PRIVATELY HELD PUBLIC DEBT



MAJOR FOREIGN HOLDERS OF TREASURY SECURITIES

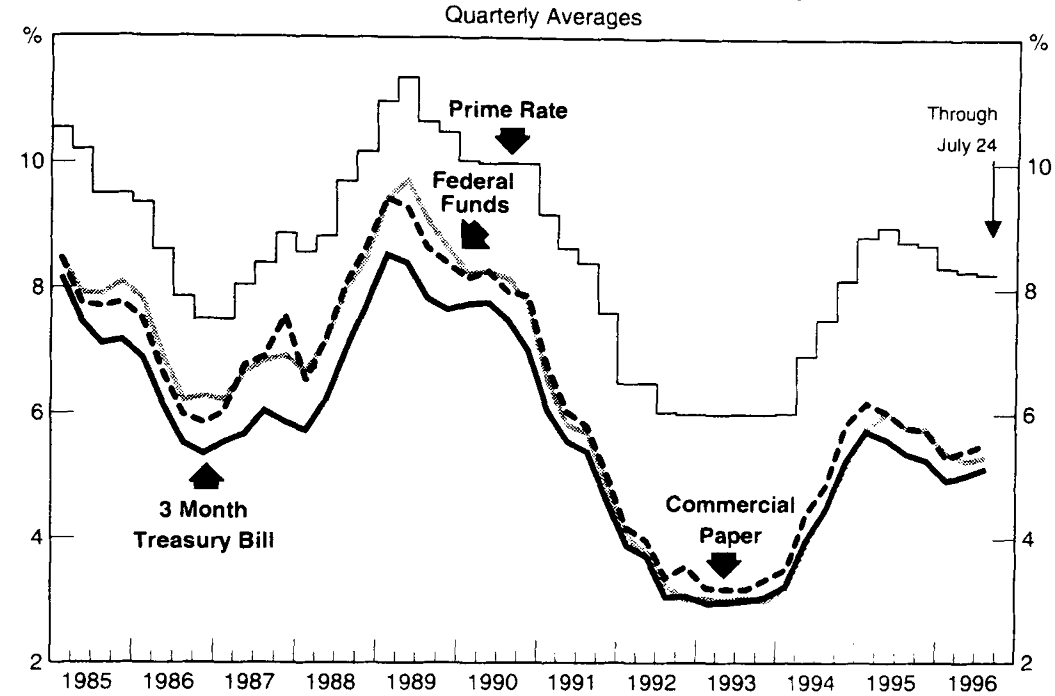
	December 31, 1994			December 31, 1995			May 31, 1996		
Country	$ Billions	As a % of Total Foreign	As a % of Total Private	$ Billions	As a % of Total Foreign	As a % of Total Private	$ Billions	As a % of Total Foreign	As a % of Total Private
Japan	$175.7	25.5%	5.5%	$219.9	25.5%	6.7%	$255.1	26.8%	7.6%
United Kingdom	91.0	13.2%	2.9%	123.6	14.3%	3. 8%	141.5	14.9%	4.2%
Germany	54.4	7.9%	1.7%	53.7	6.2%	1.6%	63.9	6.7%	1.9%
Netherland Antilles	27.6	4.0%	0.9%	50.9	5.9%	1.5%	35.7	3.8%	1.1%
Singapore	21.9	3.2%	0.7%	29.7	3.4%	0.9%	35.5	3.7%	1.1%
Switzerland	32.4	4.7%	1.0%	37.0	4.3%	1.1%	34.5	3.6%	1.0%
Mainland China	20.5	3.0%	0.6%	34.9	4.0%	1.1%	34.3	3.6%	1.0%
OPEC	25.6	3.7%	0.8%	28.0	3.2%	0.8%	32.1	3.4%	1.0%
Spain	27.9	4.1%	0.9%	19.3	2.2%	0.6%	31.4	3.3%	0.9%
Canada	24.6	3.6%	0.8%	25.1	2.9%	0.8%	30.4	3.2%	0.9%
Taiwan	25.8	3.7%	0.8%	24.0	2.8%	0.7%	21.1	2.2%	0.6%
Hong Kong	13.8	2.0%	0.4%	18.8	2.2%	0.6%	19.9	2.1%	0.6%
Mexico	7.9	1.1%	0.2%	16.4	1.9%	0.5%	16.8	1.8%	0.5%
Belgium	13.1	1.9%	0.4%	12.7	1.5%	0.4%	13.1	1.4%	0.4%
France	9.7	1.4%	0.3%	9.2	1.1%	0.3%	12.7	1.3%	0.4%
Other	116.8	16.9%	3.7%	158.9	18.4%	4.8%	173.5	18.2%	5.2%
Estimated Foreign Total	688.7	100.0%	21.7%	862.1	100.0%	26.2%	951.5	100.0%	28.3%

Note: RP's are included in "other". Detail may not add to totals due to rounding.

Source: Treasury Foreign Portfolio Investment Survey benchmark as of end-year 1989 and monthly data collected under the Treasury International Capital reporting system.

SHORT TERM INTEREST RATES

Quarterly Averages

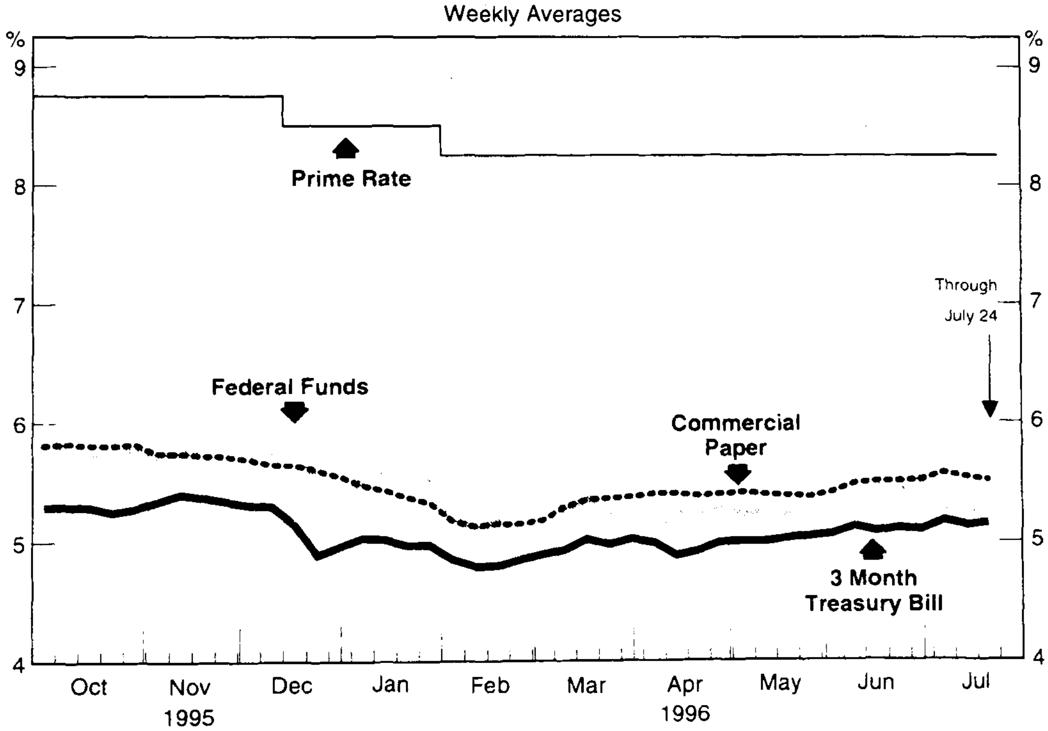


Department of the Treasury
Office of Market Finance

July 29, 1996-18

SHORT TERM INTEREST RATES

Weekly Averages

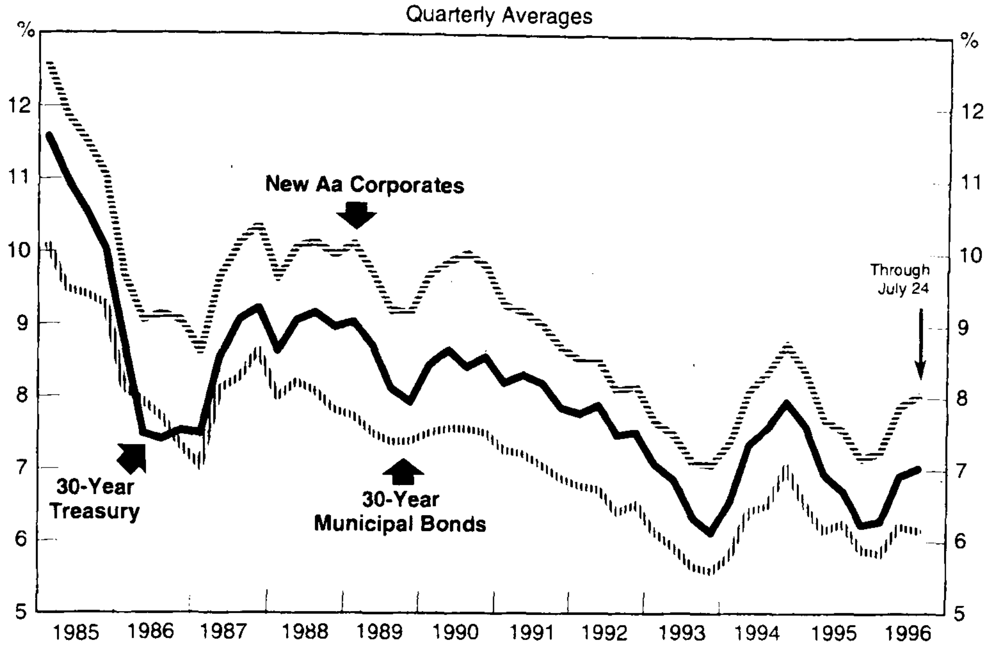


Department of the Treasury
Office of Market Finance

July 29, 1996-19

LONG TERM MARKET RATES

Quarterly Averages

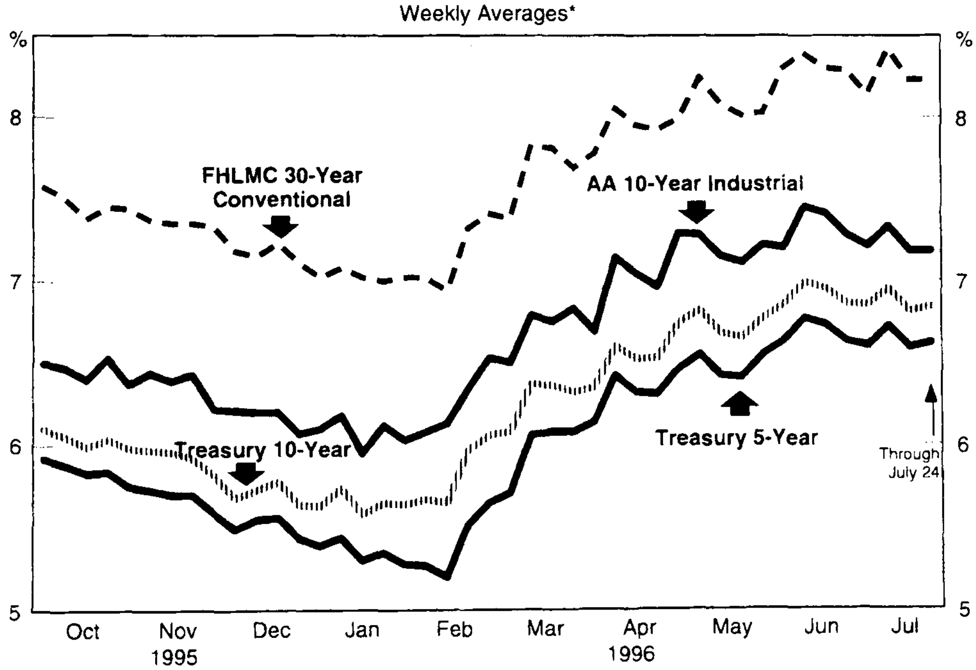


Department of the Treasury
Office of Market Finance

July 29, 1996-20

INTERMEDIATE TERM INTEREST RATES

Weekly Averages*

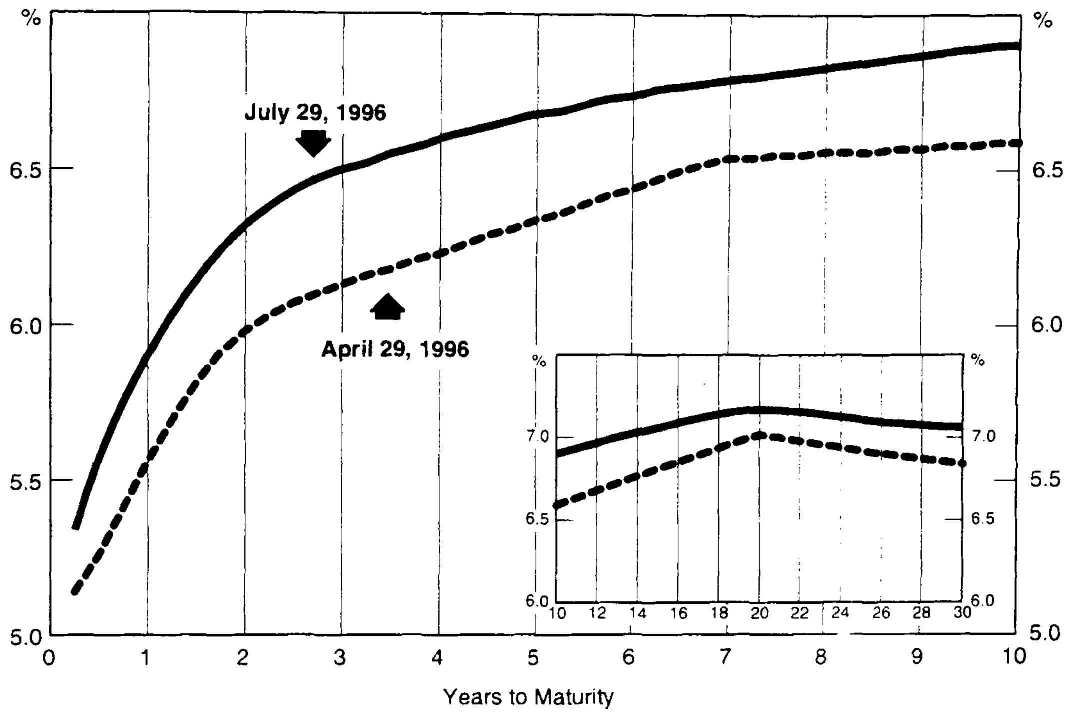


* Salomon 10-yr. AA Industrial is a Thursday rate.

Department of the Treasury
Office of Market Finance

July 29, 1996-21

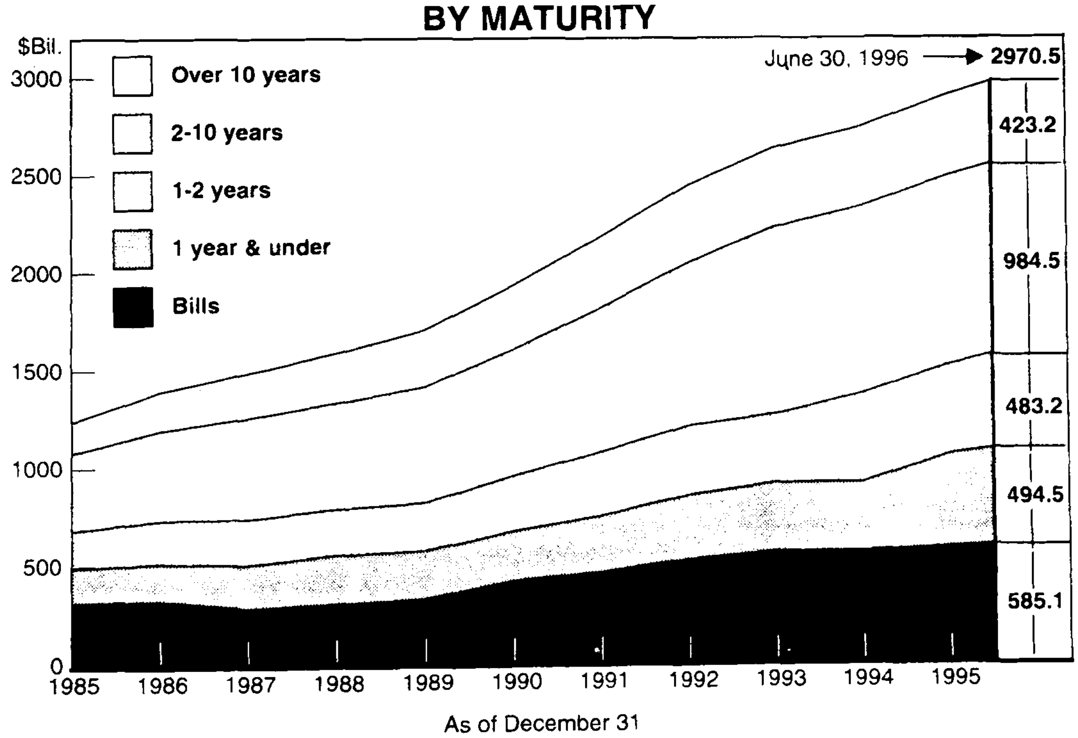
MARKET YIELDS ON GOVERNMENTS



Department of the Treasury
Office of Market Finance

July 30, 1996-22

PRIVATE HOLDINGS OF TREASURY MARKETABLE DEBT BY MATURITY

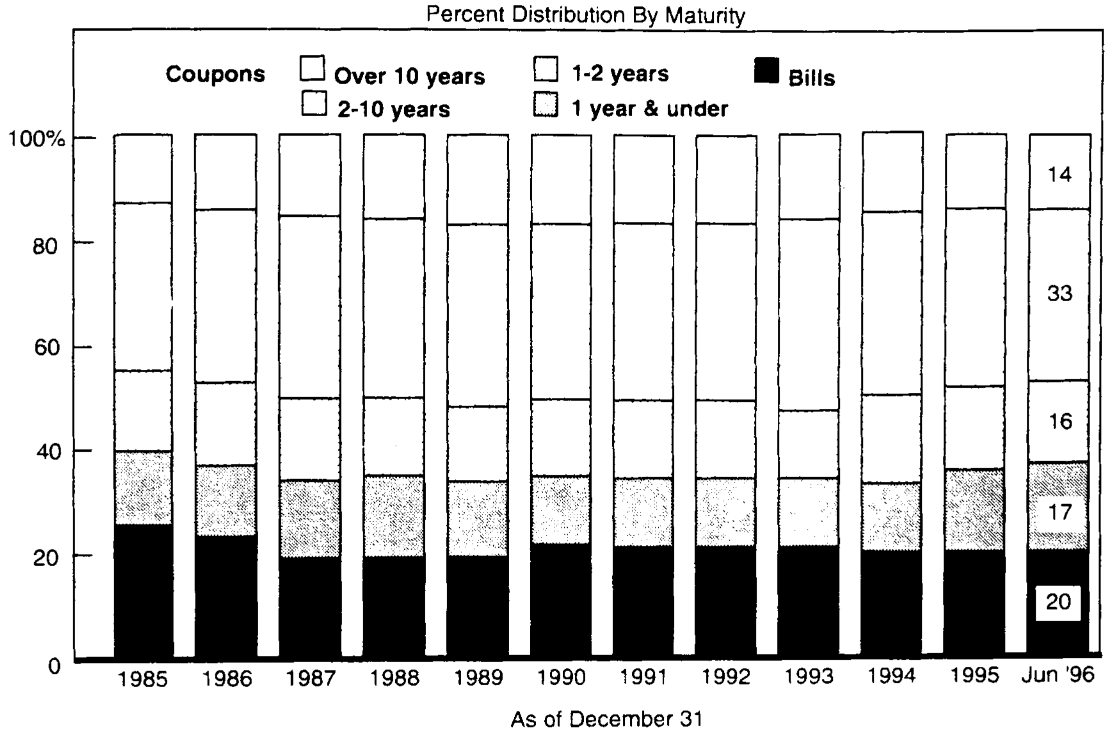


Department of the Treasury
Office of Market Finance

July 29, 1996-23

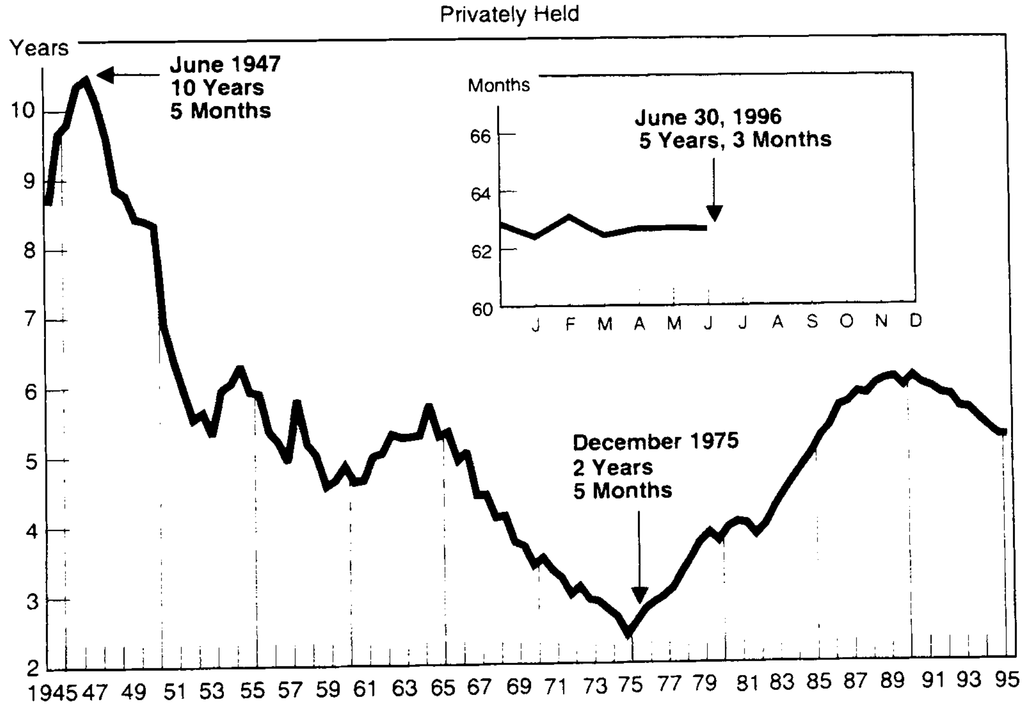
PRIVATE HOLDINGS OF TREASURY MARKETABLE DEBT

Percent Distribution By Maturity



AVERAGE LENGTH OF THE MARKETABLE DEBT

Privately Held



MATURING COUPON ISSUES

August - December 1996

(in millions of dollars)

Maturing Coupons	June 30, 1996			
	Total	Held by		
		Federal Reserve & Government Accounts	Private Investors	Foreign[1/] Investors
4 3/8% Note 08/15/96	20,670	3,074	17,596	2,076
8 % Bond 08/15/96-01[2/]	1,485	758	727	0
7 1/4% Note 08/31/96	9,825	499	9,326	478
6 1/4% Note 08/31/96	19,292	810	18,482	2,781
7 % Note 09/30/96	10,088	381	9,707	360
6 1/2% Note 09/30/96	19,639	1,200	18,439	2,786
8 % Note 10/15/96	7,989	375	7,614	158
6 7/8% Note 10/31/96	28,331	1,395	26,936	3,493
7 1/4% Note 11/15/96	20,259	1,129	19,130	1,522
4 3/8% Note 11/15/96	22,065	4,528	17,537	4,813
6 1/2% Note 11/30/96	9,871	210	9,661	1,267
7 1/4% Note 11/30/96	18,940	265	18,675	4,772
6 1/8% Note 12/31/96	9,635	200	9,435	655
7 1/2% Note 12/31/96	19,608	1,275	18,333	3,264
Totals	217,697	16,099	201,598	28,425

1/ F.R.B. custody accounts for foreign official institutions; included in Private Investors.

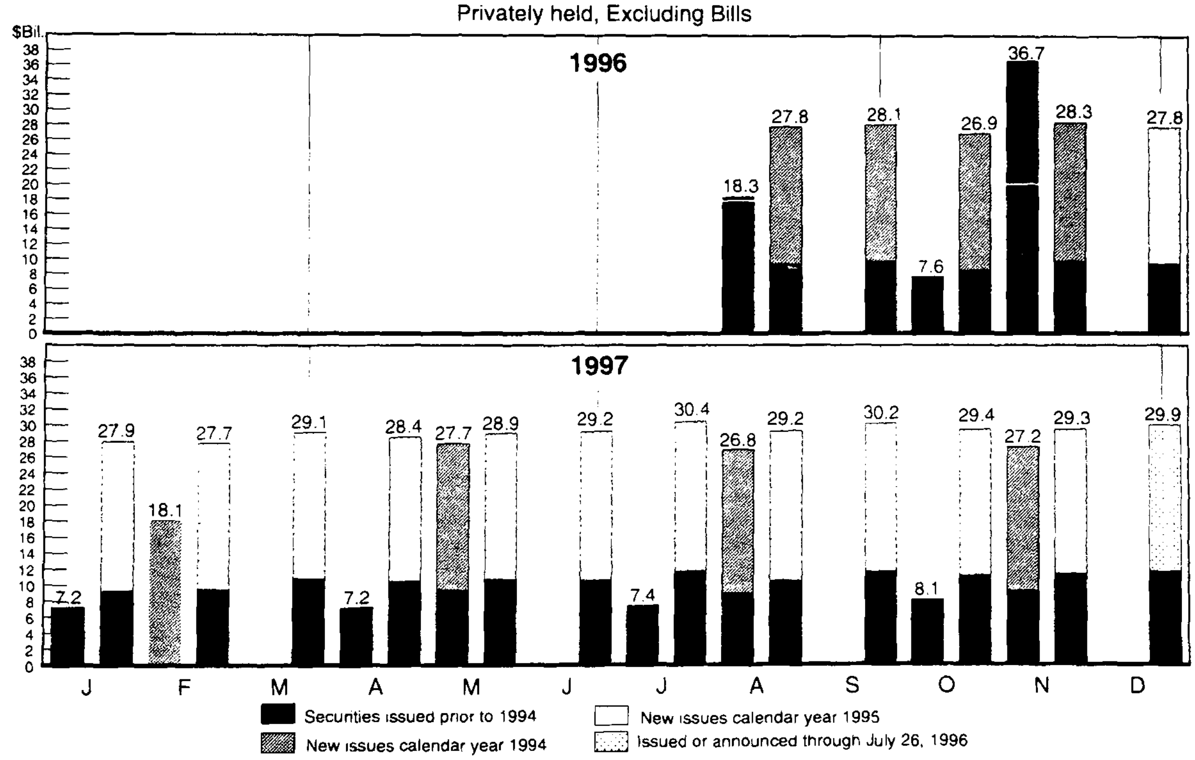
2/ On April 11, Treasury announced the call for redemption at par on August 15, 1996, the 8% 1996-01, dated August 16, 1976, due August 15, 2001.

Department of the Treasury
Office of Market Finance

July 29, 1996-26

TREASURY MARKETABLE MATURITIES

Privately held, Excluding Bills

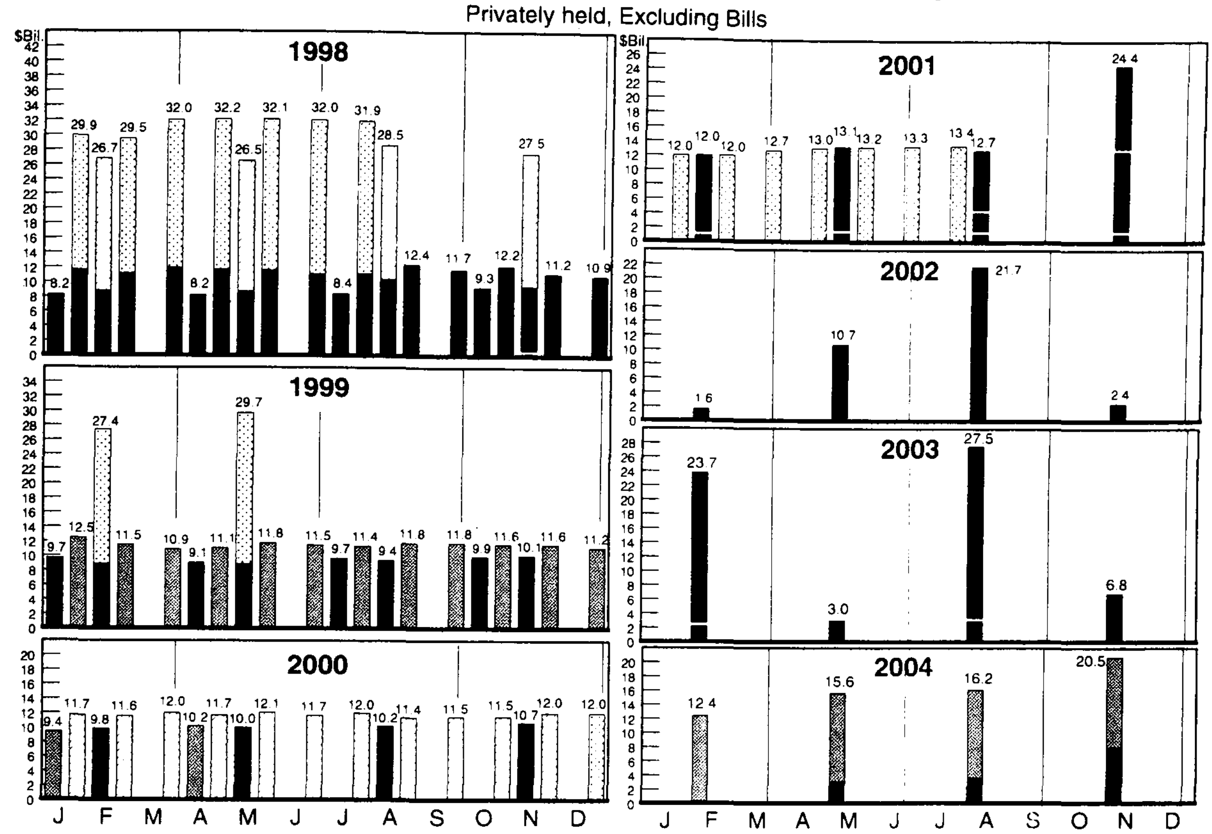


Department of the Treasury
Office of Market Finance

July 29, 1996-27

TREASURY MARKETABLE MATURITIES

Privately held, Excluding Bills



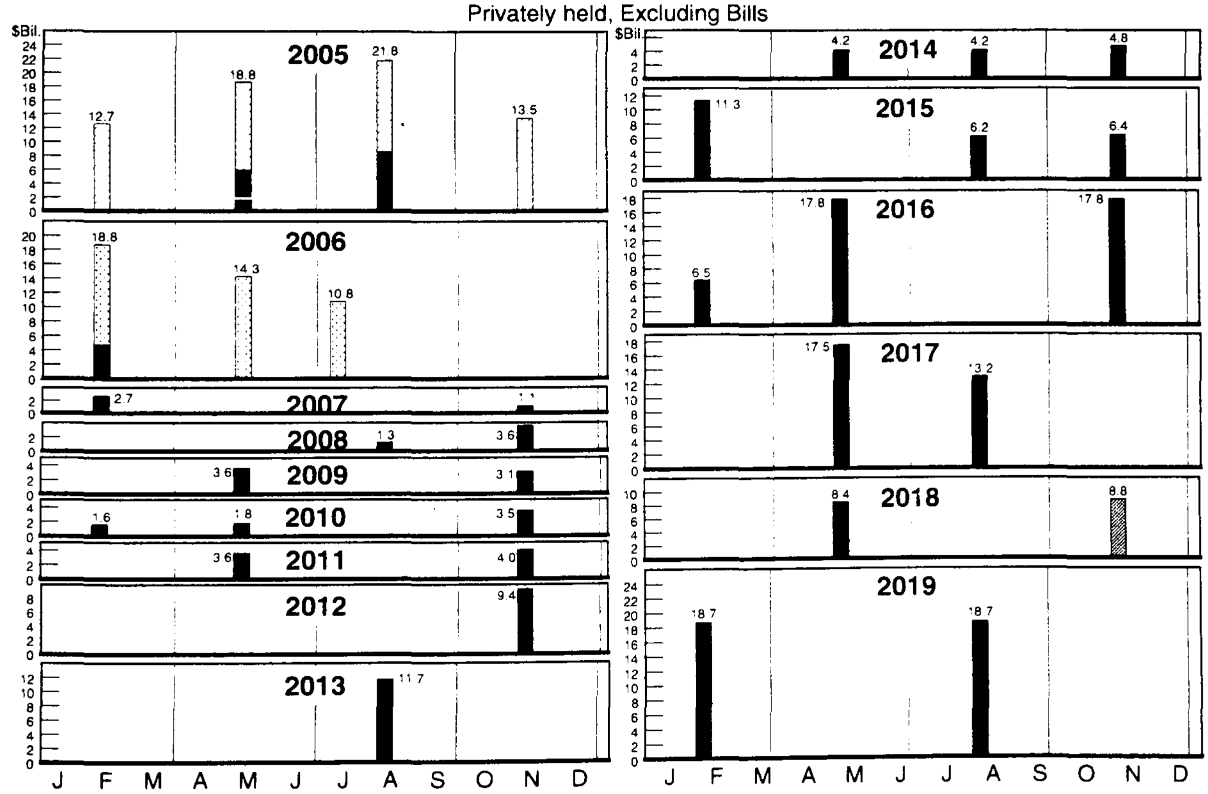
Securities issued prior to 1994
New issues calendar year 1994
New issues calendar year 1995
Issued or announced through July 26, 1996

Department of the Treasury
Office of Market Finance

July 29, 1996-28

TREASURY MARKETABLE MATURITIES

Privately held, Excluding Bills



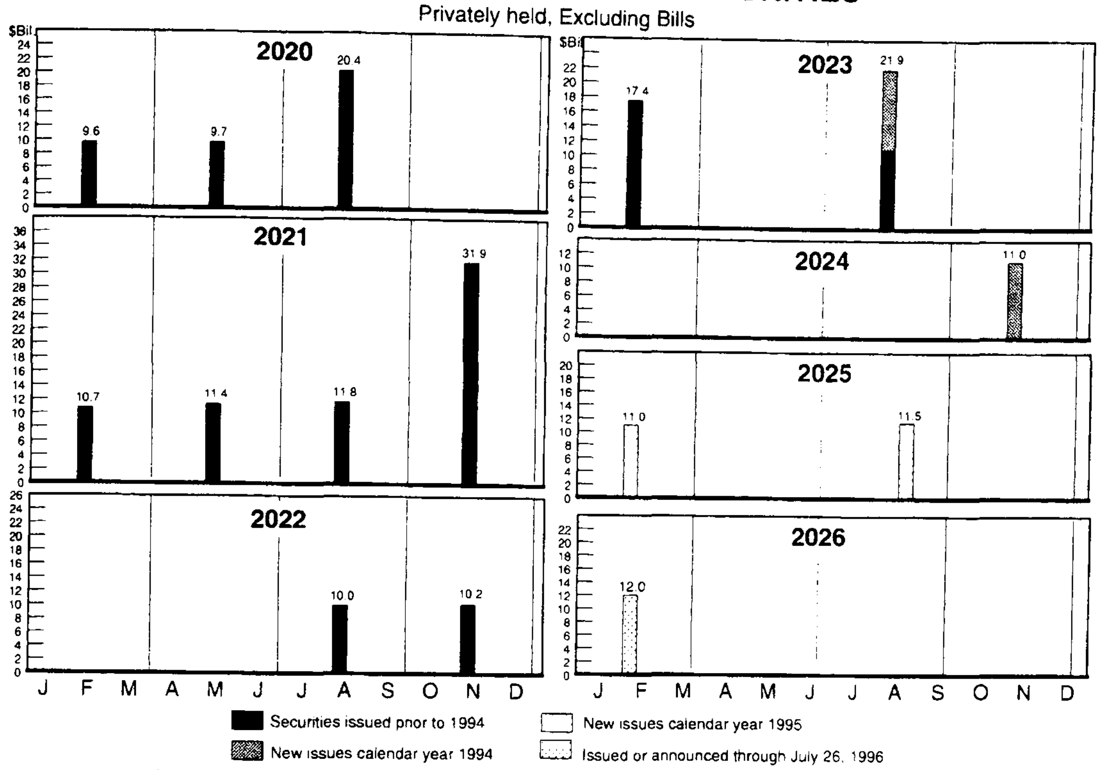
Securities issued prior to 1994
New issues calendar year 1994
New issues calendar year 1995
Issued or announced through July 26, 1996

Department of the Treasury

July 29, 1996-29

TREASURY MARKETABLE MATURITIES

Privately held, Excluding Bills



Department of the Treasury
Office of Market Finance

July 29, 1996-30

TENTATIVE SCHEDULE OF ISSUES TO BE ANNOUNCED AND AUCTIONED IN AUGUST 1996 1/

Monday	Tuesday	Wednesday	Thursday	Friday
			1	2
5	6 Auction 3 year 2/	7 Auction 10 year 2/	8 Auction 30 year 2/	9 Announce 52 week
12	13	14	15 Auction 52 week 3/	16
19	20	21 Announce 2 year 5 year	22	23
26	27 Auction 2 year 4/	28 Auction 5 year 4/	29	30

1/ Does not include weekly bills
2/ For settlement August 15
3/ For settlement August 22
4/ For settlement September 3

Department of the Treasury
Office of Market Finance

July 31, 1996-31

TENTATIVE SCHEDULE OF ISSUES TO BE ANNOUNCED AND AUCTIONED IN SEPTEMBER 1996 1/

Monday	Tuesday	Wednesday	Thursday	Friday
2 Holiday	3	4	5	6 Announce 52 week
9	10	11	12 Auction 52 week 2/	13
16	17	18 Announce 2 year 5 year	19	20
23	24	25 Auction 2 year 3/	26 Auction 5 year 3/	27
30				

1/ Does not include weekly bills
2/ For settlement September 19
3/ For settlement September 30

Department of the Treasury
Office of Market Finance

July 31 1996-32

TENTATIVE SCHEDULE OF ISSUES TO BE ANNOUNCED AND AUCTIONED IN OCTOBER 1996 1/

Monday	Tuesday	Wednesday	Thursday	Friday
	1	2 Announce 10 year	3	4 Announce 52 week
7	8 Auction 10 year 2/	9	10 Auction 52 week 3/	11
14 Holiday	15	16 Announce 2 year 5 year	17	18
21	22 Auction 2 year 4/	23 Auction 5 year 4/	24	25
28	29	30	31	

1/ Does not include weekly bills
2/ For settlement October 15
3/ For settlement October 17
4/ For settlement October 31

Department of the Treasury
Office of Market Finance

July 31 1996-33

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

Monthly Report
by the
Secretary of the Treasury

Pursuant to the
Mexican Debt Disclosure Act
of 1995

Contents

July 1996

Treasury Secretary's Report to Congress
July 1996

I. Overview

In providing assistance to Mexico under the February 21, 1995 Agreements, the U.S. government acted to protect vital U.S. interests: American exports and jobs, the security of our common border, and the stability of other emerging market economies. U.S. and other international support in 1995 has allowed Mexico to implement the policies necessary to avert default, regain access to capital markets, and restore the basis for sustainable growth.

On July 25, the Government of Mexico announced that, in August 1996, it will prepay $7 billion of the $10.5 billion still outstanding to the United States. The majority of Mexico's prepayment, $6 billion, will come from a new private bank floating rate note issue, backed by oil export proceeds released from the facility backing the U.S. loan. Mexico will fund an additional $1 billion prepayment to the United States from other market financings, including proceeds of the recent Brady Bond exchange. As another sign of its financial health, Mexico has announced that it will also prepay the IMF $1 billion from proceeds of recent market financings.

Mexico has met all payment obligations under the U.S. financial support program. Not including the August prepayment, Mexico has repaid a net $2 billion in outstanding short-term swaps to the Treasury and Federal Reserve. By August, not only will Mexico have repaid nearly three-quarters of its debt to the United States well ahead of schedule, it also will have made interest payments totalling $1.29 billion, including a $239 million payment on July 1.

All of Mexico's obligations to the United States under the February 21, 1995 Agreements are backed by proceeds from Mexico's crude oil, oil products, and petrochemical product exports. Payments for these exports flow through a special account at the Federal Reserve Bank of New York. Approximately $12.6 billion had passed through this account as of July 22.

Though the effects of the deep recession of 1995 are still being felt, data indicate that an economic recovery is underway in Mexico. Through the first quarter of 1996, GDP growth has averaged 2.4% (seasonally-adjusted, quarter-over-quarter) for the past three quarters.

Monetary policy remains firm. Inflation was 1.6% in June, the lowest monthly rate since December 1994, and 0.73% during the first half of July. Rates on the benchmark 28-day *cetes* were 28.89% at the July 23 auction, down from 32.94% in the July 16 auction, but up from 28.29% in the June 25 auction. The peso depreciated slightly in July, and, as of July 24, Mexico's stock market was down

8.3% since the end of June, though still above its pre-crisis level in peso terms. Mexico's international reserves have risen to $15.4 billion from the year-end 1994 level of $6.1 billion, though they are down slightly from year-end 1995.

Although the situation of Mexico's banking system remains difficult, its restructuring continues. The National Banking and Securities Commission (CNBV) has announced a second round of recapitalization for three more banks: Bital, Bancrecer, and Banorte. Falling interest rates have brought down the cost of Mexico's debtor relief programs and have helped keep the level of nonperforming loans stable, though they remain high. The newly formed Agency for Valuation and Sale of Assets (VVA), similar to the RTC in the U.S., has begun the sale of the P100 billion in assets now under the control of FOBAPROA.

On July 23, the Government of Mexico announced a plan to relieve as much as 40% of the debt burden of farmers. The program, starting in September, combines debt relief and restructuring, and is estimated by the government to cost P30 billion, split evenly between the government and banks. As with other assistance programs, costs are spread out over many years.

II. Current Condition of Mexico's Economy

a. Economic Developments

Available data suggest that the recovery continued in the second quarter of 1996

Mexico's trade balance remained strongly in surplus in June -- according to preliminary figures, the surplus was $591 million.

- In June, exports and imports rose by 13% and 17%, respectively, on a year-over-year basis. In the first half of 1996, exports and imports were both 18% higher than the first half of 1995.

- For the first half of 1996, the trade surplus was $3.9 billion, $700 million higher than in the same period of 1995.

Indicators sensitive to domestic demand have been strengthening, but remain below their pre-crisis level.

- Retail sales rose 0.7% in May on a year-over-year basis, the first year-over-year increase in sixteen months, which was in line with analysts' expectations. They were up 5.7% on a monthly basis following an 8.5% decline in April.

- Domestic vehicle sales increased by 3.5% in May from April, the eighth monthly increase in the last eleven months.

Labor indicators have been mixed. The open unemployment rate, a narrow rate of joblessness in the urban formal sector, rose from 5.4% in May to 5.6% in June and was higher than private analysts had expected. It fell to 5.6% in the second quarter from 6.2% in the first quarter.

- Adding the number of employees who involuntarily work less than 35 hours a week, a measure of underemployment, the rate rose from 7.0% in May to 7.6% in June. However, it fell from 8.3% in the first quarter to 7.5% in the second quarter of 1996.

- Permanent registrations in the social security system (IMSS), a measure of employment in the formal economy, rose by 0.6% from May to June (preliminary), and were 5.3% above the low of July 1995.

While uncertainties continue, the economy is projected to grow in 1996

- In a June survey by *Consensus Economics*, private analysts revised upward their forecast of 1996 GDP growth, from 2.3% in the April survey to 3.2%. This is higher than the Government of Mexico's official projection of 3.0%.

II. b. Monetary and Fiscal Policy

Monetary aggregates indicate policy remains on track

- In 1996, net domestic credit (NDA), the monetary base less international reserves, has fallen by about P24 billion, through July 19. Net international reserves (NIR) increased by P20 billion during the same period.

  -- Mexico met its second quarter monetary program targets, with reserves much higher than expected and similar over-performance on NDA.

- Since January 1 of this year, base money has fallen about 6.4%, to P62.5 billion.

Mexico continues firm fiscal stance

- The public sector first quarter budget results were better than planned.

  -- Mexico posted a budget surplus of P1.5 billion, a solid P8 billion better than the programmed goal of a deficit of P6.4 billion. The primary surplus, too, came in P8 billion stronger than targeted, at P26.6 billion.

Inflation continues to come down

- Inflation was 1.6% in June, the lowest monthly rate since December 1994, and 0.73% during the first half of July.

II. c. Financial Sector Developments

Restructuring continues in the banking system

- The National Banking and Securities Commission (CNBV) has announced a second round of recapitalization for three more banks: Bital, which will put up

P1.5 billion in new capital; Bancrecer, which will put up P2.5 billion; and Banorte, which will put up P1 billion. FOBAPROA, the central bank insurance fund, will buy P5 billion in loans from the three banks, at a rate of 2 pesos in loans for every 1 peso in new capital put up by shareholders.

-- Under the bank restructuring program, the 12 non-intervened banks have now provided or pledged P51 billion in new capital, while selling P96 billion in loans to FOBAPROA. Thus, 22% of loans outstanding in the banking system as of the end of 1994, the beginning of the crisis, have now been sold to FOBAPROA.

- The CNBV has stated its intention to end FOBAPROA'S 100% guarantee of interbank liabilities, though not the full guarantee of bank deposits.

- The newly formed Agency for Valuation and Sale of Assets (VVA), similar to the RTC in the U.S., has begun the sale of roughly P100 billion in assets now under the control of FOBAPROA.

Government announces new farm debt relief program

- The Government of Mexico announced a plan to relieve as much as 40% of the debt burden of farmers.

  -- The program, starting in September, combines debt relief and restructuring, and is estimated by the government to cost P30 billion, split evenly between the government and banks. As with other assistance programs, costs are spread out over many years.

Financial asset quality remains a concern

The level of nonperforming loans (including those of the intervened banks) stayed roughly flat from the end of April to the end of May.

- As of May 31, nonperforming loans for the entire private banking system, plus loans sold to FOBAPROA, represented 18.2% of all loans; this ratio has held steady for the last six months.

- The CNBV stated that the reported level of nonperforming loans will double as Mexican banks begin reporting under U.S. GAAP this year. The CNBV had previously estimated an increase of 70%.

II. d. Financial Markets

The peso depreciated and interest rates rose

- The peso depreciated 0.24% during July, closing at P7.61 on July 24, from its June 28 close of P7.59. The peso remains 7% above its low of P8.14, reached in Ncvember 1995.

  -- The real exchange rate remained flat from the end of June to mid-July, leaving the real peso 11.7% above its level at the beginning of 1996. At its current level, the peso is 26.7% below its pre-devaluation level (November 1994) in real terms.

- The July 23 primary auction resulted in 28-day cetes yields of 28.89% (on an annualized basis), down from their July high of 32.94% in the July 16 auction, but up from 28.29% in the June 25 auction.

  -- Rates on Udibonos rose from 7.13% at their introduction on May 28, to 7.56% on June 25 and 9.15% on July 23. (These bonds yield a "real" rate, in that their principal is indexed to Mexican inflation.)

Financial asset prices were mixed

- As of July 24, Mexico's stock market, in peso terms, was down 8.3% since the end of June, though it is up 26% over pre-crisis levels, and up 103% since the February 1995 low. In dollar terms, the Bolsa index is down 42% from pre-crisis levels, but up 90% from its March 1995 low.

- The Mexican Brady Par Bond yield spread over U.S. Treasuries, adjusted to remove the effect of partial collateralization, has fallen from 6.69% on June 28 to 6.50% on July 24. This is more than twelve percentage points below the 19.37% spread reached in March 1995.

- Mexico's 30-year uncollateralized dollar global bond, which was priced to yield a spread of 552 basis points over U.S. Treasuries on April 30, was trading in the secondary market on July 24 at 566 basis points over the Treasury bond of comparable maturity.

Mexico continues to attract international capital

The Mexican government and its agencies have raised over $18 billion in the international capital markets in the past twelve months. This includes the recently announced oil-backed $6 billion private bank floating rate notes, the proceeds of which will be used to prepay Treasury ESF swaps.

II. e. International Reserves

Net international reserves (BOM measure) were roughly unchanged in July -- $15.37 billion on July 12, or $31 million below their level at the end of June. July reserves were $370 million below their level at the end of 1995.

- Net international reserves according to the IMF measure were $1.69 billion on July 12, also virtually unchanged from the end of June.

- Reserves (BOM measure) continue to exceed total 1996 amortizations of external debt owed by the Government of Mexico and its agencies. Reserves continue to exceed three months of *non-maquiladora* imports -- despite strong import growth this year.

III. Mexico's Financial Transactions

In accordance with the February 21, 1995 Agreements, Mexico requested, and Treasury authorized, the use of the funds disbursed to redeem *tesobonos* and other short-term, dollar-denominated debt of the Mexican government and its agencies. All funds have been used to redeem *tesobonos*, which are now fully retired.

IV. Disbursements, Swaps, Guarantees and Compensation to the U.S. Treasury

As of July 31, 1996, $10.5 billion remain outstanding under the U.S. support program, all in the form of medium-term swaps. No principal payments are due until June 30, 1997. However, the Mexican government has announced plans to prepay $7 billion in outstanding medium-term swaps in early August, 1996.

- A total of $13.5 billion in U.S. funds has been disbursed to Mexico under the support program: $3 billion in short-term swaps and $10.5 billion in medium-

Amortization Schedule of ESF and Federal Reserve Swaps with Mexico

Quarter Ending	*Amount Disbursed* (U.S. Millions)	*Repayments to date (bold); Scheduled Repayment for outstanding balance (US$ million)*							*Due (US$ million)*	
		Short-term swaps* provided on:			**Medium-term swaps provided on:**				**Quarterly**	**Annually******
		01/11/95	**01/13/95**	**02/02/95*****	**03/14/95**	**04/19/95**	**05/19/95**	**07/05/95**		
	13,500	500	500	2,000	3,000	3,000	2,000	2,500	10,500	10,500
		Current Interest Rate:								
		n/a	n/a	n/a	7.50%	10.16%	10.16%	9.20%		
Mar-31-95	6,000	**500 (Mar 14)**	**500 (Mar 14)**							
Jun-30-95	5,000									
Sep-30-95	2,500									
Dec-31-95				**700 (Oct 11)**						
Mar-31-96				**1,300 (Jan 29)**	0	0	0	0		
Jun-30-96					0	0	0	0		
Sep-30-96					0	0	0	0		
Dec-31-96					0	0	0	0		
Mar-31-97					0	0	0	0		
Jun-30-97					0	245**	170**	0	415	
Sep-30-97					0	245	170	205**	620	
Dec-31-97					0	245	170	205	620	1,655
Mar-31-98					0	245	170	205	620	
Jun-30-98					375**	245	170	205	995	
Sep-30-98					375	245	170	205	995	
Dec-31-98					375	245	170	205	995	3,605
Mar-31-99					375	245	170	205	995	
Jun-30-99					375	245	170	205	995	
Sep-30-99					375	245	170	205	995	
Dec-31-99					750	245	170	205	1,370	4,355
Mar-31-2000					0	305	130	205	640	
Jun-30-2000					0	0	0	245	245	
Sep-30-2000					0	0	0	0	0	
Dec-31-2000					0	0	0	0	0	885

* Short-term swap totals for each period represent equivalent amounts for ESF and Federal Reserve.

**All medium-term swaps payments are due on last date in each calendar quarter.

***$2 billion in short term swaps disbursed on February 2, 1995 were rolled over for an additional 90 day period on May 3, 1995, and August 1, 1995, for a new maturity date of October 30, 1995. On October 11, Mexico repaid $700 million of these obligations. The outstanding $1.3 billion was rolled over for an additional 90 day period on October 30, for a new maturity date of January 29, 1996, when they were repaid.

**** This column represents the sum of quarterly payments in a given year; it does not represent an additional payment.

term swaps. (Swap arrangements are described in the Semi-Annual Report.) Of this total, no more than $12.5 billion has been outstanding at any one time. The United States has not extended any securities guarantees to Mexico under the support program.

Mexico has not missed any interest payments or required principal repayments under any of the swaps.

- To date, the United States has received $1.23 billion in interest payments from Mexico, including $239 million in interest on medium-term swaps paid to the ESF on July 1.

V. Status of the Oil Facility

The payment mechanism, established under the Oil Proceeds Facility Agreement, continues to function smoothly. This has been confirmed by independent reviews (in August 1995 and February 1996).

- In each review, Petroleos Mexicanos' (PEMEX) independent public auditors, Coopers & Lybrand, analyzed the information utilized for the previous two quarterly export reports prepared by PEMEX and provided to the U.S. Treasury pursuant to the Oil Proceeds Facility Agreement.

- According to the reviews, the quarterly reports "fairly present" information related to both PEMEX's oil exports and the collection of proceeds from such exports. The next semi-annual review is expected in August.

The Framework Agreement and the Oil Purchase Facility Agreement will be amended to permit Mexico's new $6 billion floating rate note issue, the proceeds of which will be used to prepay some of the outstanding medium-term ESF swaps.

- This new note issue is backed by Mexican oil export revenues released from the oil facility.

- Additional oil export revenues will be released to facilitate an addition $1 billion prepayment by Mexico.

- Adequate coverage of the $3.5 billion in swaps that will remain outstanding will be preserved, as the share of oil proceeds "carved out" will be less than the share of U.S. swaps prepaid.

Payments through the Federal Reserve Bank of New York account

As of July 22, approximately $12.6 billion had flowed through Mexico's special funds account at the Federal Reserve Bank of New York, a daily average of $25 million since the oil agreement went into effect in early March 1995. To date, there have been no set-offs against the proceeds from Mexico's crude oil, petrochemical, and refined product exports.