U.S. Treasury Dept.

ANNUAL REPORT

of the Secretary of the Treasury on the State of the Finances

FOR THE FISCAL YEAR ENDED JUNE 30, 1975

DEPARTMENT OF THE TREASURY

DOCUMENT NO. 3266

Secretary

U.S. GOVERNMENT PRINTING OFFICE, WASHINGTON : 1975

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price $5.15 (paper cov.)
Stock Number 048-000-00278-1
Catalog Number T 1.1:975

THE SECRETARY OF THE TREASURY
WASHINGTON

October 6, 1975

Dear Sirs:

I have the honor to transmit to you the annual report on the state of the finances of the United States Government for the fiscal year ended June 30, 1975. This submission is in accordance with 31 U.S.C. 1027.

Sincerely yours,

William E. Simon

William E. Simon

President of the Senate

Speaker of the House of Representatives

The statistical tables to this Annual Report will be published in a separate STATISTICAL APPENDIX.

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Tax Policy

International Monetary and Investment Affairs

STATISTICAL APPENDIX

The tables to this Annual Report will be published in the separate Statistical Appendix.

NOTE.—Details of figures may not add to totals because of rounding.

Secretaries, Deputy Secretaries, Under Secretaries, General Counsels, Assistant Secretaries, Deputy Under Secretaries, and Treasurers of the United States serving in the Department of the Treasury from January 21, 1973, through June 30, 1975 [1]

Term of service		Officials
From	To	
		Secretaries of the Treasury:
June 12, 1972	May 8, 1974	George P. Shultz, New York.
May 8, 1974	....	William E. Simon, New Jersey.
		Deputy Secretaries:
Jan. 22, 1973	May 8, 1974	William E. Simon, New Jersey.
July 31, 1974	....	Stephen S. Gardner, Pennsylvania.
		Under Secretaries for Monetary Affairs:
Jan. 27, 1969	July 8, 1974	Paul A. Volcker, New Jersey.
July 9, 1974	....	Jack F. Bennett, Connecticut.
		Under Secretaries (Counselors): [2]
June 12, 1972	Mar. 17, 1973	Edwin S. Cohen, Virginia.
Mar. 15, 1974	July 8, 1974	Jack F. Bennett, Connecticut.
July 9, 1974	....	Edward C. Schmults, New York.
		General Counsels:
July 1, 1970	June 1, 1973	Samuel R. Pierce, Jr., New York.
June 2, 1973	July 8, 1974	Edward C. Schmults, New York.
Aug. 1, 1974	....	Richard R. Albrecht, Washington.
		Assistant Secretaries:
Apr. 1, 1969	Jan. 21, 1973	Eugene T. Rossides, New York.
Dec. 12, 1971	....	Edgar R. Fiedler, New York.
Apr. 11, 1972	....	Warren F. Brecht, Connecticut.
June 12, 1972	July 1, 1974	John M. Hennessy, Massachusetts.
Aug. 1, 1974	....	Charles A. Cooper, Florida.
Aug. 18, 1972	....	Frederic W. Hickman, Illinois.
Jan. 22, 1973	Feb. 1, 1974	Edward L. Morgan, Arizona.
May 8, 1974	....	David R. Macdonald, Illinois.
May 28, 1974	....	Frederick L. Webber, Virginia.[3]
June 24, 1974	....	Gerald L. Parsky, Washington, D.C.[3]
		Deputy Under Secretaries:
Aug. 18, 1972	Mar. 14, 1974	Jack F. Bennett, Connecticut.
Aug. 22, 1972	July 4, 1973	James E. Smith, Virginia.
Aug. 3, 1973	Apr. 13, 1974	William L. Gifford, New York.
		Fiscal Assistant Secretary:
June 15, 1962	....	John K. Carlock, Arizona.
		Treasurers of the United States: [4]
Dec. 17, 1971	Feb. 14, 1974	Romana Acosta Banuelos, California.
June 21, 1974	....	Francine I. Neff, New Mexico.

[1] For officials from Sept. 11, 1789, to Jan. 20, 1973, see exhibit 81, 1973 Annual Report.
[2] Act of May 18, 1972, which established the Deputy Secretary position, permitted the Under Secretary position to be used as a counselor to the Secretary and so designated by the President as desired.
[3] Act of May 18, 1972, provided for two Deputy Under Secretaries, to be designated Assistant Secretaries by the President as desired.
[4] Treasury Department Order 229, Jan. 14, 1974, raised the position of Treasurer of the United States from the operating level of the Department to the Office of the Secretary.

PRINCIPAL ADMINISTRATIVE AND STAFF OFFICERS OF THE DEPARTMENT OF THE TREASURY AS OF JUNE 30, 1975

Secretary of the Treasury	William E. Simon
Deputy Secretary of the Treasury	Stephen S. Gardner
Under Secretary for Monetary Affairs	Jack F. Bennett
Under Secretary	Edward C. Schmults
General Counsel	Richard R. Albrecht
Office, Secretary of the Treasury:	
Adviser to the Secretary (Counsellor to the Chairman, Economic Policy Board)	Sidney L. Jones
Executive Assistant to the Secretary	John C. Gartland
Director, Executive Secretariat	Margaret Hovell (acting)
Confidential Assistant to the Secretary	Barbara A. Jensen
Senior Consultant	Paul W. McCracken
Office, Deputy Secretary of the Treasury:	
Executive Assistant to the Deputy Secretary	(Vacancy)
Special Assistant to the Deputy Secretary	Alan M. Arsht
Office, Under Secretary for Monetary Affairs:	
Assistant Secretary (International Affairs)	Charles A. Cooper
Deputy Assistant Secretary for International Monetary and Investment Affairs	F. Lisle Widman
Deputy Assistant Secretary for Developing Nations Finance	John A. Bushnell
Deputy Assistant Secretary for Research and Planning	Robert L. Slighton
Deputy to the Assistant Secretary for International Monetary Affairs	George H. Willis
Inspector General for International Finance	Weir M. Brown
Deputy to the Assistant Secretary	Oscar M. Mackour
Assistant Secretary (Trade, Energy, and Financial Resources Policy Coordination)	Gerald L. Parsky
Deputy Assistant Secretary (Trade and Raw Materials Policy)	J. Robert Vastine
Deputy Assistant Secretary for Energy Policy	Edward Symonds
Deputy Assistant Secretary for Financial Resources Policy Coordination	(Vacancy)
Assistant Secretary (Economic Policy)	Edgar R. Fiedler
Deputy to the Assistant Secretary	(Vacancy)
Director, Office of Domestic Gold and Silver Operations	Thomas W. Wolfe
Director, Office of Financial Analysis	John H. Auten
Fiscal Assistant Secretary	John K. Carlock
Deputy Fiscal Assistant Secretary	David Mosso
Assistant Fiscal Assistant Secretary	Sidney Cox
Assistant Fiscal Assistant Secretary	Lester W. Plumly
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Deputy Special Assistant to the Secretary	Gerald W. Nensel
Special Assistant to the Secretary (Debt Management)	Ralph M. Forbes
Director, Office of Debt Analysis	Edward P. Snyder

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Special Assistant to the Under Secretary for Revenue Sharing and Intergovernmental Relations	Kent A. Peterson
Assistant Secretary (Administration)	Warren F. Brecht
Deputy Assistant Secretary for Administration and Director, Office of Management and Organization	J. Elton Greenlee
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Director, Office of Audit	Wilbur R. DeZerne
Director, Office of Budget and Finance	John Garmat (acting)
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Special Assistant to Assistant Secretary	Jay T. Scheck, Jr.
Special Assistant to Assistant Secretary	Thomas J. McDowell
Special Assistant to Assistant Secretary	Pamela J. Sullivan
Assistant Secretary (Enforcement, Operations, and Tariff Affairs)	David R. Macdonald
Deputy Assistant Secretary	James B. Clawson
Director, Office of Operations	William F. Hausman
Director, Foreign Assets Control	Stanley L. Sommerfield (acting)
Deputy Assistant Secretary for Enforcement	James J. Featherstone
Director, Office of Law Enforcement	(Vacancy)
Chief, Interpol (National Central Bureau)	Louis B. Sims
Deputy Assistant Secretary for Tariff Affairs	Peter O. Suchman
Director, Office of Tariff Affairs	Ben L. Irvin
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Deputy Special Assistant to the Secretary	John O. Mongoven
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Assistant General Counsel	(Vacancy)
Assistant General Counsel	Hugo A. Ranta
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Deputy Director	Kenneth A. DeHart

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Assistant Commissioner, Comptroller	Steve L. Comings
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Assistant Commissioner (Field)	Martin French
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Assistant Director (Police Training)	Alvin C. Turner
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Assistant Commissioner (Compliance)	Singleton B. Wolfe
Assistant Commissioner (Employee Plans and Exempt Organizations)	Alvin D. Lurie
Assistant Commissioner (Inspection)	Warren A. Bates
Assistant Commissioner (Planning and Research)	Anita F. Alpern
Assistant Commissioner (Technical)	Lawrence B. Gibbs
Chief Counsel	Meade Whitaker

OFFICE OF THE COMPTROLLER OF THE CURRENCY

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Executive Assistant	Richard D. Chotard, Jr.
Special Assistant	James T. Keefe
Special Assistant (Strategic Policy Planning)	David H. Jones

Staff Assistant	Palmer Hamilton
First Deputy Comptroller	Justin T. Watson
Deputy Comptroller	Thomas G. DeShazo
Deputy Comptroller	Robert A. Mullin
Deputy Comptroller (Economics)	David C. Motter
Chief National Bank Examiner	Kenneth W. Leaf
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Deputy Comptroller (FDIC Affairs)	Joseph M. Ream
Deputy Comptroller (Mergers and Branches)	Richard J. Blanchard
Deputy Comptroller (Trusts)	Dean E. Miller
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Deputy Chief Counsel	C. Westbrook Murphy
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Assistant Commissioner (Internal Affairs)	William A. Magee, Jr.
Assistant Commissioner (Enforcement Support)	Alfred R. DeAngelus
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Director of Advertising and Promotion	Louis F. Perrinello

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Assistant Director (Inspection)	Myron I. Weinstein
Assistant Director (Investigations)	Burrill A. Peterson
Assistant Director (Protective Forces)	Clinton J. Hill
Assistant Director (Protective Intelligence)	Thomas J. Kelley

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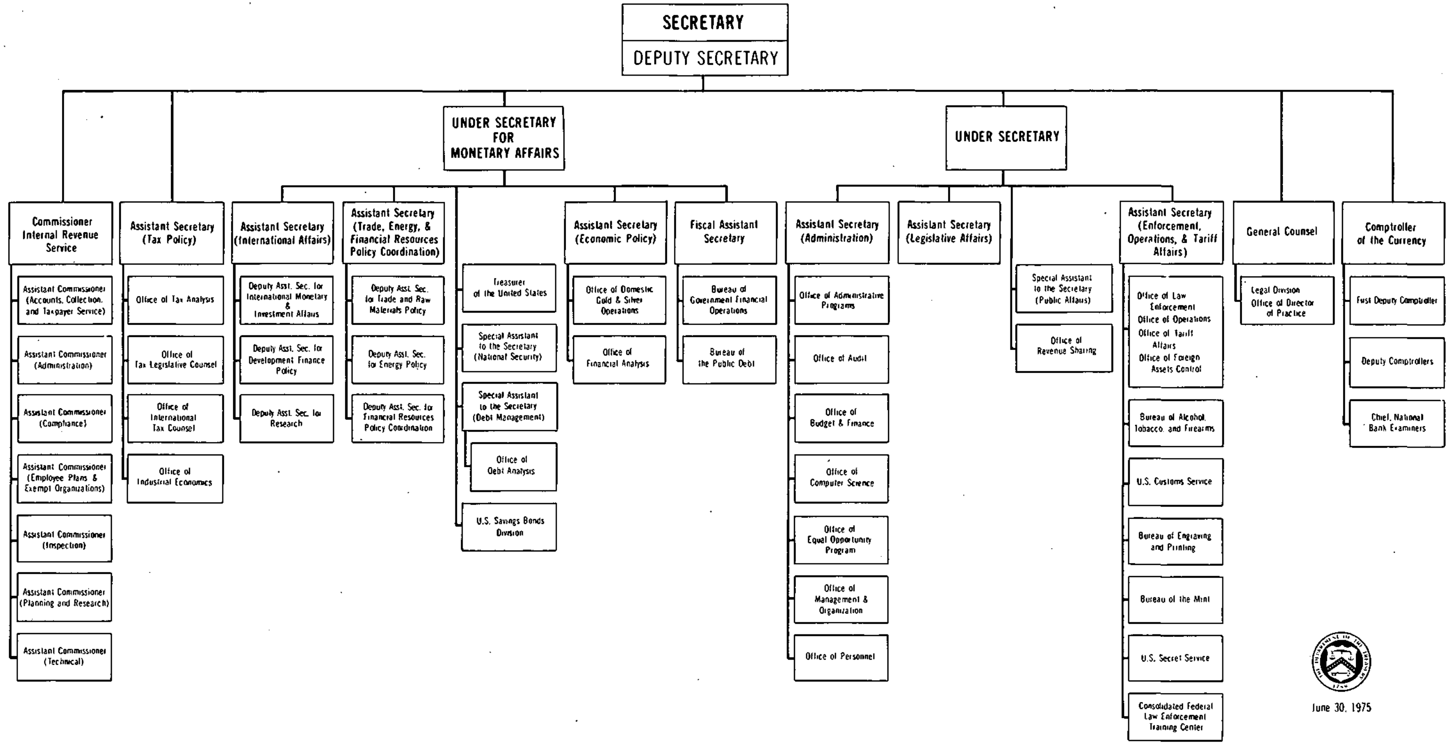
ORGANIZATION OF THE DEPARTMENT OF THE TREASURY



INTRODUCTION

This statement reviews some of the major domestic and international economic developments which affected Treasury areas of interest and responsibility during fiscal 1975. Detailed information on the operating and administrative activities of the Department of the Treasury is provided in the main text of the report and supporting exhibits. Further information is contained in a separate Statistical Appendix.

DOMESTIC DEVELOPMENTS

The Domestic Economy

The U.S. domestic economic situation changed rapidly during the course of fiscal 1975. At the beginning of the fiscal year the domestic economy had apparently stabilized following the sharp decline in economic activity that occurred during the first 3 months of 1974. The gross national product in constant prices did decline during the quarter of July through September, but the domestic economy appeared to be correcting the most severe output distortions even though inflation remained intense and the unemployment rate was beginning to rise.

The consensus among most economic forecasters—both inside and outside of Government—was that nothing worse than a period of slow growth or slight decline seemed to be in prospect. At the time of the Financial Conference on Inflation held in late September, the general view was that economic policies should still be aimed primarily at the containment of inflation. Indeed, the rate of growth in prices, as measured by the GNP implicit price deflator, accelerated to a 12-percent annual rate during the July through September period and to a 14-percent annual rate during the last 3 months of calendar 1974. By the fall it was also apparent that consumer spending had slowed abruptly, that inventories were becoming excessive, and that a full-scale recession adjustment was occurring. During the final 3 months of calendar 1974, the real GNP stated in constant dollars declined sharply at a seasonally adjusted annual rate of 9 percent. Real GNP fell off sharply at a 9-percent annual rate in the fourth quarter.

As the pace of economic activity slowed there was also a sharp decline in consumer confidence which further restricted the strength of personal spending. High rates of inflation and declining consumer real income and personal financial asset positions appeared to be major factors explaining the decline in consumer confidence. The dropoff in the volume of consumer purchases was especially pronounced during the closing months of calendar 1974. Personal consumption expenditures in 1958 dollars fell from a seasonally adjusted annual rate of $547.2 billion during the July through September period to $528.2 billion in the final 3 months of 1974—an annual rate of decline of about 13 percent. The bulk of this decline was in consumer purchases of durable goods and was exaggerated by some anticipatory buying of automobiles prior to price increases imposed in September at the beginning of the 1975 model year.

The sudden, and largely unexpected, reduction in consumer purchases set in motion a massive inventory adjustment. Business inventories were accumulated at an $18 billion annual rate (current prices) during the last 3 months of 1974, about double the rate of accumulation during the preceding 3 months. Most of this inventory buildup was involuntary and led to a sharp reduction in orders by retailers. Inventory-sales ratios increased, production and employment were cut back, and the classic pattern of inventory cyclical adjustments occurred.

Business inventories declined at about a $19 billion annual rate during the first 3 months of calendar 1975 and at about a $31 billion rate during the second 3-month period. The rapid runoff of inventories resulted in a resumption in new orders for durable goods beginning in April 1975, and retail inventories began to rise again in June 1975. Continued inventory adjustments were still taking place at the manufacturing level throughout the spring and summer of 1975, but the bulk of the inventory adjustment had been completed by the end of fiscal 1975.

From January through March of calendar 1975, real output fell at about an 11½-percent annual rate while inventories were being run off. Nevertheless, there were some clear signs of improvement. Final sales (total GNP less the change in inventories) in constant prices had begun to stabilize in early 1975 and were rising at a relatively strong pace by the summer.

Unfortunately, inflation continued to create problems for the economic recovery even though the rate of price increases did moderate. These inflation problems and resulting financial constraints continued to restrict the strength of residential construction even though some improvement did occur following the low point of new housing starts recorded in April. But even the improved rate of homebuilding after April was still far below the normal historical rate of residential construction activity.

The recent recession turned out to be the most severe decline experienced during the postwar era. However, the threat of a full-scale depression was fortunately averted. Furthermore, a wide range of economic evidence indicates that the direction of the economy turned by April and that the process of recovery was well underway by the end of fiscal 1975. Major factors which clouded the outlook for sustained recovery were the persistence of very high rates of inflation, a fairly pervasive feeling of caution on the part of consumers as a result of recent economic experience, and reduced liquidity and equity ratios on the part of business. In addition, the financial markets had been severely strained by inflation and were having to finance Government deficits that were extremely large by all previous standards.

Unfortunately, the recession caused the rate of unemployment to rise very sharply in late 1974 and early 1975. The peak level of unemployment of 9.2 percent was recorded in April. By June 1975, the total unemployment rate had declined to 8.6 percent. The level of employment did begin to rise in April and the number of hours worked in manufacturing and overtime hours had improved by the end of fiscal 1975. Unemployment assistance—totaling nearly $15 billion during fiscal 1975 and budgeted close to $20 billion in fiscal 1976—tempered the severity of the adjustment. Nevertheless, the recession imposed heavy costs, and very high rates of unemployment among younger people and minority groups were a source of concern.

While the recession conformed in many respects to previous U.S. cyclical experience, there were some important differences. The coexistence of high rates of unemployment and high rates of inflation—sometimes termed "stagflation"—persisted to an unusual degree. Cyclical movements in the United States and major foreign countries were also more closely synchronized. To some extent, this could be related to the international impact of the oil embargo and resulting price rise. More basically, it appeared to reflect a reaction to the prolonged period of world inflation. The U.S. recession was the direct result of the failure to deal effectively with inflation.

Domestic Economic and Energy Policies

As the recession impact became more apparent, domestic economic policy responded to the sharp decline in production and employment. In preparing the Federal budget for fiscal 1976, it was recognized that the underlying economic situation had changed appreciably and that there was a need for antirecession stimulus. The administration proposed a one-time, temporary tax reduction of $16 billion—$12 billion to individual taxpayers and $4 billion to business taxpayers. However, the effort to contain inflation was continued. No new spending initiatives other than those for energy development programs were proposed in the budget. Limitations were recommended on Federal pay increases and on increases in various benefit programs linked to increases in the cost of living. The intent was to use the budget as an instrument of economic stabilization while continuing to make progress against inflation.

A sweeping program was also outlined in the President's January 15, 1975, state of the Union message to deal with the energy problem but this was designed to be neutral from an overall fiscal point of view. The program included the following major elements: Import fees on crude oil and petroleum products to be imposed in stages by Presidential order and to be replaced by a $2-per-barrel excise tax on domestic crude oil and an import fee on crude oil and petroleum products, an excise tax of comparable magnitude on natural gas, removal of Federal price regulation from new natural gas supplies, removal of price control on domestic crude oil, conversion of powerplants and other major users from oil to coal, and a windfall profits tax on oil companies.

The new energy conservation taxes were estimated to raise $30 billion annually as follows: Oil excise tax, $6 billion; natural gas excise tax, $8.5 billion; import fee increase, $3.5 billion; and windfall profits tax, $12 billion. It was proposed to return that $30 billion to the economy through individual income tax cuts of $16.5 billion (in addition to the one-time $12 billion rebate to individual taxpayers), payments of $2 billion to nontaxpayers, a $0.5 billion tax incentive for energy conservation improvements in homes, a $6 billion corporate tax cut, payments of $2 billion to State and local governments, and $3 billion to offset higher costs of energy purchased directly by the Federal Government for its use.

From the outset there was strong congressional support for antirecession fiscal stimulus, but reaction to the administration's energy program was mixed. The $22.8 billion Tax Reduction Act of 1975 was passed in March which combined key elements of the administration's recommendations along with modifications proposed by the Congress. However, no consensus could be reached between the administration and the Congress during the fiscal year on what legislative steps should be taken to deal with the energy problem. An import fee of $1 per barrel on foreign crude oil was imposed by the President on February 1, and additional fees of $1 per barrel on foreign crude oil and $0.60 on refined products were imposed in late May to become effective on June 1. By the end of the fiscal year, the administration and the Congress had not reached agreement on a comprehensive plan to deal with the energy problem. Much of the disagreement centered upon the way in which the removal of price controls on domestic crude oil production might be harmonized with other features of a total program.

Inflation Experience

During the last 6 months of 1974, inflation continued at double-digit rates before moderating somewhat during the first half of 1975. That shift contributed to a gradual improvement in consumer attitudes and helped promote the recovery of the economy. Unfortunately, inflation expectations are deeply embedded in the economy. Food and energy prices are still rising more rapidly than wanted and the outlook for rapid progress toward lower rates of inflation is still a matter of great concern. Nevertheless, there has been a substantial improvement in the cost-price situation and the economy responded favorably.

In terms of the broadest measure of price performance—the GNP implicit price deflator—the rate of inflation fell from more than a 13-percent annual rate during the last 6 months of 1974 to less than 7 percent in the first half of 1975. The Consumer Price Index averaged rates of annual increase in the 12- to 13-percent range during the last 6 months of 1974 and then fell to the 5- to 7-percent range in the first 6 months of 1975. The more volatile Wholesale Price Index increased at a 30- to 35-percent annual rate until November of 1974 before moderating sharply and then registered actual monthly declines in February and March 1975 as a result of falling agricultural prices.

By mid-1975, the rate of inflation at both wholesale and consumer levels had turned upward again, primarily because of food and energy price increases. Both consumer and wholesale prices rose by a seasonally adjusted 1.2 percent in the month of July. Large monthly price increases may occur during the coming months, but it is unlikely that double-digit inflation will return in the near future as the economic recovery occurs. However, the continuing strength of price pressures in the early stages of economic recovery indicates that inflationary risks remain.

The continued price increases throughout the severe recession of late 1974 and early 1975 occurred in an underemployed economy. Fortunately, the cost situation improved significantly as fiscal 1975 progressed. Output per man-hour in the private nonfarm economy declined at an average annual rate of roughly 2½ percent from mid-1974 until March 1975 but then rebounded to nearly a 6-percent rate of growth from April through June 1975. Compensation per man-hour grew more steadily throughout the fiscal year at an 8- to 9-percent annual rate. As a consequence, unit labor costs rose at double-digit rates in the first three quarters of the fiscal year but at only a 2-percent rate in the final quarter.

Short-term variations in economywide productivity and costs are frequently erratic and should not be interpreted as representing longrun significance. However, the improvement toward the end of fiscal 1975 is consistent with the usual cyclical pattern of more rapid productivity gains during the recovery phase. Improving productivity should help hold down inflationary pressures over the coming months despite the persistence of relatively high rates of employee compensation and strong inflationary expectations.

Capital Investment Needs

The major economic problems during fiscal 1975 concerned energy policies, output declines, unemployment, and inflation. However, increased attention was focused on the question of the adequacy of U.S. investment for satisfactory longrun growth, particularly the creation of jobs and moderation of inflation. During the 1960's, the U.S. economy recorded an annual growth rate for real output of approximately 4 percent. That performance was in line with our historical experience but it ranked near the bottom of the rankings for real output gains of the major industrial nations.

There are, of course, some favorable aspects in the U.S. savings-investment record. Capital investment has continued to increase in the United States and the capital-to-labor ratio is still relatively high. However, other nations have allocated a substantially larger share of their resources to new capital formation. Furthermore, the gap between the U.S. level of investment, measured as a share of national output, and the commitment of other leading nations has increased. Total U.S. fixed investment as a share of national output during the time period 1960 through 1973 was 17.5 percent.* The U.S. figure ranked last among a group of 11 major industrial nations for the period in question.

Several factors help to explain the relatively slower rate of capital investment in the United States. First, the size of the U.S. economy and its advanced stage of economic development means that our rate of additional growth might well be somewhat lower than those of other nations without reflecting any serious tendency for the United States to underinvest. Second, the United States has historically placed a high priority on consumption, and the pattern is deeply ingrained in our society. Third, a relatively large share of our total capital outlays are committed to the services category which includes housing, government, and other services. Fourth, a relatively large share of our investment must be used for replacement and modernization of existing

*OECD (Organization for Economic Cooperation and Development) concepts of investment and national product. The OECD concept includes nondefense Government outlays for machinery and equipment in the private investment total which required special adjustment in the U.S. national accounts for comparability. National output is defined in this study as "gross domestic product," rather than the more familiar measure of gross national product, to conform with OECD definitions.

facilities, and increasingly a large share of investment goes to satisfy environmental and other requirements which may raise the quality of life but do little to increase productivity in the usual sense of the term. Fifth, the United States has generally not resorted to capital allocation and special incentive programs that are used intensively by other countries in an effort to encourage additional investment.

Some of the factors explaining slower U.S. capital formation are a matter of deliberate choice. However, there are serious risks in having a slow rate of capital investment for an extended period of time. A number of studies have indicated a close relationship between capital investment and various measures of economic growth and productivity. And, productivity gains in the United States have been disappointingly low, particularly in recent years. From 1948 to 1954, output per man-hour in the private economy rose by 4.0 percent per year, from 1955 to 1964 it rose by 3.1 percent, from 1965 to 1974 it rose by 2.1 percent, and from 1970 to 1974 it rose by only 1.6 percent per year.

In the future, U.S. capital investments will be significantly increased to meet a variety of goals including improvement in the quantity and quality of housing; development of new energy resources, protection of the quality of the environment; rehabilitation of the existing transportation system; continuation of the mechanization of agriculture; construction of new office buildings, communications systems, medical facilities, schools, and other facilities; and to meet the massive needs for new plants and equipment. Although the specific capital needs are difficult to predict, a number of independent studies suggest that total U.S. capital needs over the 1974 to 1985 period could range from \$4 to \$4½ trillion. By way of contrast, total outlays for capital investment from 1962 through 1973 in a smaller economy were \$1½ trillion.

Future capital requirements of \$4 to \$4½ trillion from 1974 to 1985 imply a need to raise the ratio of gross private domestic investment to gross national product by perhaps 1 percentage point. The ratio has averaged close to 15 percent over the past decade and may need to average closer to 16 percent over the next decade. Such a shift in the composition of national output is certainly feasible, and would apparently be desirable, but may require some fairly extensive changes in public policy. Beginning in May 1975, the Treasury presented testimony to Congress on three separate occasions concerning the need to improve capital formation efforts. In July the Treasury recommended a tax program for increased national savings.

The Budget and Fiscal Developments

Primarily as a result of the recession the Federal budget moved sharply into deficit during fiscal 1975. The initial budget estimates published in February 1974 projected receipts of \$295.0 billion, outlays of \$304.4 billion, and a deficit of \$9.4 billion. By February 1975, receipts were estimated at \$278.8 billion, outlays at \$313.4 billion, and the deficit at $34.7 billion. Final figures for receipts were $281.0 billion; outlays, $324.6 billion; and the deficit, $43.6 billion. An even larger budget deficit is in prospect for the 1976 fiscal year.

Large budget deficits were inevitable given the severity of the economic recession. As pointed out in the 1976 Budget of the U.S. Government, aid to the unemployed and the recession-induced shortfall in tax receipts more than accounted for the deficits proposed by the administration for fiscal years 1975 and 1976. However, there were other, more disturbing aspects of the Federal fiscal position. Budget deficits had occurred in 14 of the past 15 years and continued deficits are anticipated in future years. The rapid growth in Federal outlays is also discouraging because the upward momentum of spending erodes our flexibility in responding to changing national priorities and continues to increase the role of Government in the total economy. In fiscal 1975, Federal outlays increased 21 percent over the previous year.

In addition to the rapid growth of expenditures, the problems inherent in the financing of very large Federal deficits were an increasing cause of concern. Although it was generally agreed that the Treasury would be successful in meeting its financial requirements, there was some uncertainty about the prospects for private sector financing even though such demands were expected to be held down by the recession. Nevertheless, there appeared to be a real risk that "crowding out" would occur on an extensive scale if large Federal deficits were to be continued very far into the period of economic recovery. For the first time in the postwar period, there appeared to be a potential financial constraint to recovery resulting from the debt financing requirements of the Federal Government. Therefore, fiscal decisions must be made with increasing regard for their financial consequences.

Domestic Finances

Financial markets in fiscal 1975 reflected the difficult economic situation caused by continued concerns about inflation and the severe recession. The flexibility and resiliency of the financial markets was once again demonstrated as a wide variety of changing credit demands was accommodated and the decline in the demand for funds by the private sector enabled the financial markets to meet the unprecedented demands of the Federal Government.

The changing pattern of credit demands was evidenced by the sectoral demand for funds. Approximately $181 billion of nonfinancial corporate funds were raised, relatively unchanged from fiscal 1974. Funds raised by the public sector, however, increased from $20.5 billion to $67.3 billion with nearly all of the increase represented by Federal sector demands—an increase of $46.6 billion from fiscal 1974.

Short-term interest rates fell almost continuously throughout the fiscal year from the historic highs reported in the summer of 1974. At that time, rates such as the commercial paper rate and the Federal funds rate were between 12 and 14 percent, and Treasury bill rates were in the 8- to 10-percent range. After September, short-term interest rates began to fall and by the summer of 1975 the declines in rates ranged from 4 to as much as 7 full percentage points.

Long- and intermediate-term interest yields also rose to historic highs during the summer of 1974. The Aa corporate new issue rate peaked at over 10 percent, and intermediate-term Treasury securities yielded over 8 percent. New home mortgage rates rose to the 9-percent level. These longer term rates fell somewhat during the fall and winter months but the declines were more gradual and less decisive than for short-term rates. By spring, these declines had generally halted, or reversed somewhat, and by mid-1975 these interest rates had stabilized and some had actually turned upward.

The municipal bond market was under considerable stress during fiscal 1975. Fundamental factors included a lessening of bank demand for new municipal securities due to other offsets to taxable income, development of a general preference for higher quality issues which led to widening rate spreads, and the continuing financial problems of New York City.

The Treasury securities market was dominated by the need to finance the largest Government deficit in the postwar period. The deficit was financed by a $45.5 billion increase in the outstanding privately held markable securities and by an increase of $2.5 billion in nonmarketable issues. The increase in marketable securities was about evenly divided between bills and coupon issues. Bills increased by $23.5 billion, and notes and bonds by $25.5 billion. Savings bonds increased by $3.5 billion.

The Federal Financing Bank completed its first full year of activity. During 1975, the bank made loans totaling $15.8 billion to Federal agencies, making the bank the major instrument through which Federal agencies financed their programs. Bank lending rates were 1/8 of 1 percent above the new issue rate of marketable U.S. Treasury securities with similar maturities.

INTERNATIONAL DEVELOPMENTS

The fiscal year ending on June 30, 1975, was notable internationally for an unprecedented combination of recession and inflation. Among the seven major industrial countries taken together,* industrial pro-

*Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

duction appears to have peaked in the final quarter of 1973, and to have continued near the peak levels until the last quarter of 1974, when a steep decline set in. In April 1975, the level of production was highest in Canada at 119 percent of the 1970 base. Germany, the United Kingdom, and the United States showed the smallest advances over the 1970 level in April, at 102½, 103, and 103, respectively.

In terms of sharpness of the decline from the 1973 peak, the steepest curves were those of Japan, the United States, France, and Italy. The rate of decline was more gentle for the United Kingdom, Canada, and Germany. Japan and the United States appear to have shown the earliest tendencies for industrial production to level out or to rise in 1975.

According to the International Monetary Fund's tabulation of the annual rate of change in consumer prices during the preceding 12 months, the worldwide inflation rate began to rise in 1973 and reached a peak of about 16 percent at an annual rate in November 1974. It had subsided to an annual rate of about 14 percent by March 1975. For the developed areas of the world, this measure of inflation had declined to an annual rate of about 11 percent by June 1975, down nearly 3 percentage points from November 1974. In the less developed areas, the timing was somewhat different. The average rate of inflation rose rapidly in 1972 and 1973, from a little less than 10 percent in 1971 to over 20 percent in 1973. It reached an annual rate peak of 30.5 percent in September 1974, receding to about 26 percent in March 1975.

The growth of real GNP did not fall off so rapidly in the smaller industrial countries as in the seven largest economies, and this was also true for the primary producing countries as a group, even excluding the oil producers. Thus for a time their continued growth has helped to sustain total world output and incomes. However, the appearance of recession before inflation really subsided, and the continuing threat of a revival of an inflationary cost-price spiral, presented new and difficult problems.

In some industrial countries inflationary pressures were made more severe by a tendency for wage increases to advance even more rapidly than prices, and to lead rather than follow the rising curve of prices. More broadly, aggressive use of bargaining power by wider segments of the public appears to have accelerated inflation pressures, concentrating even more severe pressure on the narrowing segment of groups with the weakest bargaining power. Thus recovery has tended to be impeded more than in the past by rapid and competitive rises in the money incomes of particular bargaining groups. Moreover, the severity of repeated shocks to some extent temporarily weakened the confidence of consumers, which sustained the world economy so well during the postwar years.

Despite these problems, the decline has been arrested and recovery has begun in Japan and the United States. As the cumulative forces of recovery appear in other countries, world output and income will recover at a moderate but persistent pace, thus reducing the danger of renewed inflation.

Financing of Current Account Surpluses and Deficits

In international payments, changes were dominated by the higher cost of petroleum. The current account surplus of the Organization of Petroleum Exporting Countries (OPEC) has been estimated at $67 billion in 1974 and $47 billion in 1975, as compared with $3 billion in 1963 by the Organization for Economic Cooperation and Development (OECD). In 1974, the current account position of OECD countries shifted from a small $2 billion surplus the preceding year to a deficit of $34 billion. In 1975, the continued deficit of the OECD countries as a group is estimated at only about one-third of the smaller OPEC surplus. Moreover, within the OECD the current account deficits of the seven leading industrial countries may be rather small. Thus the general picture at midyear 1975 was one in which the deficits that offset the OPEC surpluses were shifting toward the smaller industrial countries and the developing world. This may prove to be a passing phenomenon, to be partly reversed as the industrial countries recover further. It does, however, imply that for calendar 1975 a current deficit of about $45 billion for the smaller industrial countries and the developing world may need to be financed, compared with a total need of about $35 billion in 1974.

Thus the financial markets continue to be faced with substantial movements of funds through direct or indirect channels from the surplus oil producers to the deficit countries. To date, most of this financing has been carried out through private financial channels, with the IMF and other official lending institutions providing perhaps something like one-tenth of the total financing of the OPEC current account surplus. The initial fears of difficulty in financing these huge amounts have not been realized. However, there are signs that some of the developing countries may be cutting back on their other imports and slowing down their rates of growth to reduce their financing problems.

World Trade

While the dollar value of world trade is estimated to have increased by nearly one-half in 1974 over 1973, most of this was due to higher prices of internationally traded goods, particularly for energy. The physical volume of trade is estimated to have expanded by only about 5 percent, compared with an average annual rate of growth of 8½ percent during the 1960's. Incomplete data indicate that even weaker volume figures can be anticipated for the first half of 1975. The only part of world trade that was expanding early in 1975 was the movement of imports into the oil-exporting countries.

Exchange Market Developments

Since March 1973, the world has operated under what may be broadly described as a tripartite system of exchange policies. By June 30, 1975, about 40 percent of world trade was accounted for by 16 countries whose currencies were independently floating, with discretionary intervention. About 30 percent of global trade was recorded by seven continental European countries (including France after July 10, 1975) that adhered to a "common margins" agreement among themselves, with their currencies as a group floating against outside currencies. The remaining roughly 30 percent of total international trade was reported by countries that were under some form of loose or tight pegging of currencies to the dollar, to the pound sterling, to the French franc, to the special drawing right (SDR), or to some other composite unit in which several currencies were combined.

This tripartite system has worked well in helping the world to make adjustments to unprecedented peacetime shifts in international payments balances. Exchange crises have been avoided and no dramatic closings of official exchange markets such as occurred in earlier years have taken place. The very steep rise in the foreign exchange reserves of industrial countries, that was associated with those currency crises, pushed the total holdings from $12 billion in 1965 to $70 billion in early 1973. Since exchange rates for the dollar were permitted to float, the rise in foreign exchange reserves has leveled off. In fact, for a number of such countries, effective net reserves have been reduced by official borrowing abroad, though the gross reserves have held at about $70 billion. The substantial accumulations of dollars and other reserves since March 1973 have been concentrated in the holdings of the oil-producing countries. These holdings are in the nature of investments, rather than the byproduct of disruptive flows across the exchange markets.

During fiscal 1975, the composite exchange rate for the dollar, weighted by bilateral trade figures with about 50 countries, showed an appreciation of 3.8 percentage points, from a depreciation against the May 1970 rates of 10.6 percent at the end of June 1974, to a depreciation of 6.8 percent at the end of June 1975. Calculated on a narrower trade-weighted geographical base, the dollar also showed a slight rise of 0.5 percentage points vis-a-vis the OECD currencies as a group, ending the year at a 16-percent depreciation from May 1970. In terms of SDR's, however, which give a smaller weight to the Canadian dollar than the trade-weighted averages, the dollar depreciated about 2½ percent during the fiscal year.

The currencies of the European common margins group (commonly called the "snake") did, however, appreciate against the dollar rather steadily from about August 1974 to March 1975, and then depreciated moderately through June 1975. The French franc, before rejoining the snake at its original relationship in July, rose from March to June. At the end of June, the dollar prices of some European currencies had reached their earlier 1973 peaks and, in the case of the Swiss franc, had moved considerably above those levels. After the end of the fiscal year, however, there was a sharp reversal in the exchange rates, with the European currencies falling steeply in terms of the dollar. The pound sterling, reflecting very high rates of inflation in Great Britain, moved steadily downward in the second quarter of 1975. The Italian lira and the Japanese yen ended the year without much change, with the authorities giving considerable guidance and support to the exchange market in both cases.

Money Markets and Interest Rates

Short-term market interest rates in monetary terms were generally at unusually high levels of 10 to 14 percent, or even higher, in a number of industrial countries in the summer of 1974. They receded from these levels in most countries during the final 6 months of 1974, particularly in the United States, and then began to level off or rise moderately again during the April–June 1975 time period. Long-term interest rates changed more slowly, but were moderately higher than the 1973 average in most industrial countries in the first half of 1975.

International Monetary and Financial Negotiations

The Committee of the Board of Governors of the International Monetary Fund on Reform of the International Monetary System and Related Issues, at its final meeting on June 13, 1974, agreed on a program of immediate action, as well as transmitting to the Governors for publication its final report on the longer range approach to international monetary reform. The elements in this action program have provided the principal agenda items for international discussions during the year. Among other provisions, they included: (a) Establishment of an advisory Interim Committee of the Board of Governors, pending amendment of the Articles of Agreement of the IMF to confer decisionmaking powers on a permanent and representative Council, (b) establishment of guidelines for the management of floating rates, (c) establishment of a facility in the IMF to assist members in meeting the initial impact of higher oil prices, (d) further study of reform of gold arrangements, (e) valuation of the SDR in terms of a "basket" of currencies, (f) preparation of draft amendments to the Articles of Agreement, and (g) establishment of a Joint Ministerial Committee of the Boards of Governors of the IMF and World Bank to carry forward the study of the broad question of the transfer of real resources to developing countries and to recommend measures to implement its conclusions.

The Interim Committee of the Board of Governors of the International Monetary Fund on the International Monetary System held its inaugural meeting in Washington on October 3, 1974, and selected Finance Minister Turner of Canada as Chairman for 2 years. It called upon the IMF to examine the adequacy of private and official arrangements for financing oil-related payments deficits. The Committee decided to give priority to the issues of the adjustment process, quotas in the IMF, and amendments of the IMF Articles, including amendments on gold and on the link between development assistance and SDR allocations. The Joint Ministerial Committee of the Boards of Governors of the World Bank and the International Monetary Fund on the Transfer of Real Resources to Developing Countries was organized on October 2, 1974.

In November 1974, the United States proposed a "three-track" approach to multilateral financial arrangements designed to supplement private financing channels. This called for use of IMF regular resources as the first recourse, augmented by a quota increase, and by more effective policies for use of members' subscriptions to the Fund. This would be supplemented by a new Financial Support Fund designed to help industrial countries that could not arrange sufficient financing on reasonable terms from private sources and the Fund making them less vulnerable to financial pressures. The third proposal involved the creation of a temporary trust fund in the IMF, in the amount of $1.5–$2 billion, to be financed by sale in the market of some of the IMF's gold, and by contributions from member countries. This trust fund would be designed to provide concessional financing to the developing countries most seriously affected by the high cost of petroleum.

After several months of negotiations, the Financial Support Fund Agreement among participating members of the OECD was signed on April 9, 1975, on behalf of the United States, subject to the necessary legislative action. The quotas of participants in the Financial Support Fund total SDR 20 billion (about $25 billion), with the U.S. share amounting to 27.8 percent of the total, or about $7 billion.

The quotas of members determine voting rights, shares in financing the Financial Support Fund, and borrowing rights, as well as establishing a maximum limit on the risk of loss shared by a member in its operations. The United States intends to meet its share of any financing required by the Financial Support Fund principally through the issuance of guarantees providing a basis for market borrowing by the Fund. Legislation authorizing U.S. participation in the new facility had been introduced and was under consideration in the Congress at the end of the fiscal year.

Enlargement of the quota contributions to the International Monetary Fund was also discussed extensively during the past year. The United States has argued that consideration of such an increase in quotas should occur only in the context of a broader package agreement covering arrangements for gradually phasing gold out of the monetary system and amendments to the Articles of Agreement providing for floating exchange rates as a permitted option for member nations of the IMF. In this context, the Interim Committee in January 1975 approved an increase in IMF quotas to SDR 39 billion (about $47 billion), an increase of about one-third in Fund resources. This increase would double the quota shares of the major oil exporters, while maintaining the collective shares of all other developing countries. The Committee also agreed to review the quotas again in 3 years, instead of waiting the normal 5-year period. Since January, further discussions have been held on the distribution of quotas among individual members, and some problems remain to be resolved. Despite the economic justification for a larger quota, the United States in these discussions agreed to accept some decrease in its quota share, thus reducing its voting share fractionally, on condition that the Articles be amended to increase from 80 percent to 85 percent the vote required to approve amendment of the Articles and certain other basic decisions.

Considerable progress has been made toward agreement on phasing gold out of its monetary role over time. The Interim Committee has agreed on some principles such as abolition of the official gold price in the IMF and elimination of the obligation to use gold in payments between the IMF and its members. The Committee also agreed that a portion of the IMF's gold should be used for the benefit of the developing countries, particularly the low-income developing countries. There remain, however, several issues, including the question of transitional arrangements outside the IMF designed to avoid reappearance of a de facto official price of gold and to limit a rise in aggregate official holdings.

More difficulty has been encountered in reaching accord on amendments to the Articles of Agreement concerning exchange rate policies.

The United States believes that the IMF Articles should offer nations wide latitude for choice among exchange rate systems, including full acceptance of floating rates as an option, and should impose neither a moral nor a legal obligation to establish par values, now or in the future. While there is wide support for this objective, some countries would like to see all nations accept an obligation to return to par values. The United States has indicated that it will not agree to this.

International Investment and Capital Flows

The accumulation of financial assets by oil-producing countries, amounting to about $60 billion in calendar year 1974 and about $25 billion in the first half of 1975, aroused public interest in foreign investment in the United States. Under the Foreign Investment Study Act of October 1974, the Treasury is carrying out a special study to improve data on foreign portfolio investment in the United States. The Commerce Department is examining data on foreign direct investment in this country. The Treasury study will also analyze the methods and determinants of foreign investment here and the purposes and effects of U.S. laws and regulations bearing on such investment.

Following a report to the Economic Policy Board and the National Security Council by an interagency committee chaired by the Under Secretary of the Treasury for Monetary Affairs, several decisions were taken regarding inflows of foreign investment. It was decided that the United States should maintain its traditional open economy and investment policies and that no new legislation was needed to supplement existing safeguards. A high-level Committee on Foreign Investment in the United States was established to monitor the impact of foreign investment by Executive Order 11858 in May 1975. The Under Secretary for Monetary Affairs was designated as Chairman of that Committee.

During fiscal 1975, Congress appropriated $619.1 million for the operations of various international development banks. Although the United States is the largest single contributor, other donor countries together contribute more than twice as much as the United States. Total lending from the international development banks was equal to more than 40 percent of total new commitments of official development assistance from OECD countries in calendar 1974.

The World Bank group committed over $6 billion for development projects in fiscal 1975, an increase of 35 percent over fiscal 1974, and 72 percent higher than the lending level in fiscal 1973. The Inter-American Development Bank committed $1.1 billion and the Asian Development Bank $570 million. In the Inter-American Development Bank, an important event was the progress made toward broadening the base of the Bank to bring in 12 nonregional members: Austria, Belgium, Denmark, Germany, Israel, Italy, Japan, the Netherlands, Spain, Switzerland, the United Kingdom, and Yugoslavia. These new members will bring additional resources, both in capital subscriptions and in contributions to the Fund for Special Operations, which supplies financing on concessional terms.

At the annual meeting of the World Bank, the U.S. Governor stressed the need for effective utilization both of the private capital and of the modern technology available on a commercial basis. He pointed out that within the World Bank group the International Finance Corporation has a particularly important role in stimulating investment, and the Secretary of the Treasury emphasized the vital importance to developing countries of effective mobilization and use of domestic resources. The scarce resources of the international lending agencies should be concentrated on the countries with the greatest need and on high-priority projects such as promotion of food production.

Unfortunately, the increase in oil prices has fundamentally changed the growth outlook for the developing countries. In the 1960's and early 1970's, growth was proceeding at a considerably faster rate in those countries than in the industrialized nations. The impact of higher oil prices placed an immediate burden on the balance of payments of developing countries and also contributed to the subsequent recession which so adversely affected the exports of the developing countries. The economic growth rate of the most seriously affected countries has fallen below their rate of population growth. In the middle- and high-income developing countries, the problem of financing current account deficits has led to very heavy borrowing demands on the world's capital markets, and a slowing down of growth to avoid too rapid a rise in external debt.

To alleviate these undesirable pressures, the United States has proposed that a temporary trust fund be created under the management of the IMF to help meet the balance of payments needs of the poorest countries. The amount suggested is \$1.5–\$2 billion, to be financed by contributions derived from the sale of a portion of the IMF's gold reserves, as well as by contributions from oil producers and other countries. Resources provided by the trust fund would be on concessional terms.

The Development Committee has urged the Executive Directors to consider all aspects of such a trust fund, including possible sources of financing. It has also agreed to establish a working group to review regulatory and other constraints affecting access to capital markets and to study further proposals to support access, including the possible use of multilateral guarantees. The Committee also supported a 1-year intermediate lending facility in the World Bank (known as the "third window") to lend on terms intermediate between those of the International Development Association and the World Bank. The interest rate on such loans is to be subsidized with contributions from member countries. Pledged contributions will permit about $500 million in third window lending during fiscal 1976 with criteria for these limited funds favoring countries with an annual per capita income below $375.

On other matters concerning relations with developing countries, the Treasury submitted papers to the Economic Policy Board and the Council on International Economic Policy outlining measures to broaden and strengthen U.S. policy on expropriation. The Overseas Private Investment Corporation, which insures investments against the political risks of expropriation, inconvertibility, and war, revolution, and insurrection, issued $1,211.9 million in investment insurance in fiscal 1975, up over 20 percent from the amount issued in fiscal 1974.

In February 1975, the Secretary submitted the first comprehensive annual report on debt relief granted by the United States to developing countries, as required by legislation approved in 1974. Discussions on debt relief were held with Pakistan and Bangladesh to conclude bilateral debt rescheduling agreements, and a bilateral agreement was signed with India covering service due during the Indian fiscal year ending March 31, 1975. A multilateral understanding was reached with Chile under which debt due from the Government of Chile in 1975 would be rescheduled.

The Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries (Development Committee) was established in October 1974, during the IMF–IBRD annual meetings. The U.S. member is the Secretary of the Treasury.

CONCLUSION

An unprecedented combination of recession and inflation developed, both domestically and internationally, during the course of fiscal 1975. By the close of the fiscal year, the U.S. economy was in the early stages of an economic recovery. Unemployment was high but falling, and the rate of inflation had been reduced significantly during the year. An unprecedented amount of Federal financing was accomplished during the year while private credit demands were relatively slack, but interest rates remained high by historical standards and there was some difficulty in obtaining access to funds for some private borrowers. Despite considerable effort to devise programs to deal with the energy problem and to encourage a higher rate of capital formation, much remains to be done in each of these areas.

On the international side, significant progress occurred during the fiscal year in restoring the strength of the international economy although the rate of recovery in many nations is still slow and much remains to be accomplished. Inflation remains a major problem in many nations.

The international monetary system continued to evolve along three lines, comprising individually floating rates for the dollar and some other major trading currencies, a group of European currencies floating together against the dollar with limited intervention, and a number of other currencies pegged to the dollar or to some other currency or basket of currencies. During the year, progress was made toward international agreement on phasing down the international monetary role of gold, enlarging resources of the International Monetary Fund, and liberalizing access by developing countries to financing from both the Fund and the World Bank group. The massive accumulations of liquid international resources by oil-producing countries slowed down, but continued to contribute heavily to the worldwide situation of recession combined with receding, though still abnormally high, rates of inflation.

REVIEW OF TREASURY OPERATIONS

FINANCIAL OPERATIONS

Summary

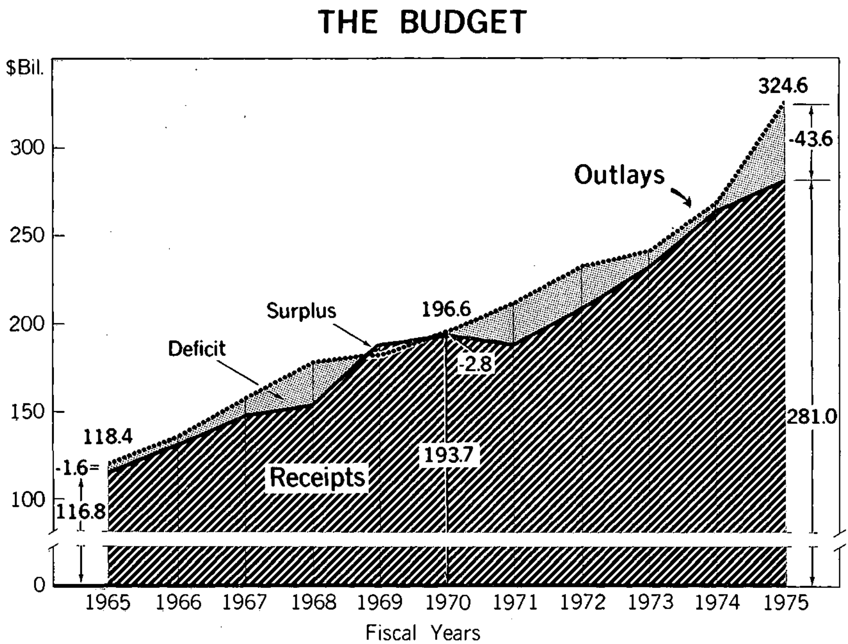
On the unified budget basis the deficit for fiscal 1975 was $43.6 billion. Net receipts for fiscal 1975 amounted to $281.0 billion ($16.1 billion over 1974) and outlays totaled $324.6 billion ($56.2 billion over 1974).

Borrowing from the public amounted to $50.9 billion as a result of (1) the $43.6 billion deficit, (2) a $0.3 billion increase in cash and monetary assets, and (3) a $6.9 billion decrease in other means of financing.

As of June 30, 1975, Federal securities outstanding totaled $544.1 billion, comprised of $533.2 billion in public debt securities and $10.9 billion in agency securities. Of the $544.1 billion, $396.9 billion represented borrowing from the public. The Government's fiscal operations in fiscal years 1974–75 are summarized as follows:

[In billions of dollars]

	1974	1975
Budget receipts and outlays:		
Receipts	264. 9	281. 0
Outlays	268. 4	324. 6
Budget deficit (−)	−3. 5	−43. 6
Means of financing:		
Borrowing from the public	3. 0	50. 9
Decrease or increase (−) in cash and other monetary assets	2. 5	−. 3
Other means:		
Increment on gold and seigniorage	1. 5	. 6
Outlays of off-budget Federal agencies	−2. 7	−9. 5
Other	−. 9	2. 0
Total budget financing	3. 5	43. 6



Receipts

Total budget receipts amounted to $281.0 billion in fiscal 1975, an increase of $16.1 billion over fiscal 1974. A comparison of net budget receipts by major source for fiscal years 1974 and 1975 is shown below.

[In millions of dollars]

Source	1974	1975	Increase, or decrease (−)
Individual income taxes	118,952	122,386	3,434
Corporation income taxes	38,620	40,621	2,002
Employment taxes and contributions	65,892	75,204	9,312
Unemployment insurance	6,837	6,771	−66
Contributions for other insurance and retirement	4,051	4,466	415
Excise taxes	16,844	16,551	−293
Estate and gift taxes	5,035	4,611	−424
Customs duties	3,334	3,676	341
Miscellaneous receipts	5,369	6,711	1,343
Total budget receipts	264,932	280,997	16,064

Projected estimates of receipts to future years, required of the Secretary of the Treasury, are shown and explained in the President's budget.

Individual income taxes.—Individual income taxes reached $122.4 billion in fiscal 1975, an increase of $3.4 billion over fiscal 1974. In the absence of the Tax Reduction Act of 1975, which reduced individual tax receipts by $9.6 billion, the growth over fiscal 1974 would have been $13.1 billion.

Corporation income taxes.—Corporation income taxes increased by $2.0 billion over fiscal 1974 to reach $40.6 billion in fiscal 1975. The Tax Reduction Act of 1975 reduced corporate tax collections by $0.8 billion. Receipts in fiscal 1975 reflected in part high corporate earnings in 1974 and therefore did not decline with the 1975 decline in corporate earnings.

Employment taxes and contributions.—Approximately one-half of the $9.3 billion increase in this category resulted from the social security taxable earnings base increases effective January 1, 1974, and January 1, 1975. Employment taxes and contributions reached $75.2 billion in fiscal 1975.

Unemployment insurance.—Unemployment insurance receipts declined $0.1 billion in fiscal 1975, resulting largely from lower levels of employment experienced in the second half of the year.

Contributions for other insurance and retirement.—These receipts totaled $4.5 billion in fiscal 1975, an increase of $0.4 billion over fiscal 1974. Increases in medical premiums for the aged and disabled ($0.2 billion) and growth in Federal employees retirement contributions ($0.2 billion) accounted for the increase.

Excise taxes.—Excise taxes decreased by $0.3 billion to $16.6 billion in 1975. Totals for 1975 were affected by reductions in the telephone and interest equalization tax rates and by declines in receipts of taxes on tobacco, gasoline, lubricating oil, and tires.

Estate and gift taxes.—Estate and gift taxes totaled $4.6 billion, a decrease of $0.4 billion from fiscal 1974. The primary explanation for the decline appears to be the depressed level of stock prices.

Customs duties.—Customs duties increased by $0.3 billion, reaching $3.7 billion for the year.

Miscellaneous receipts.—Receipts in this category were $6.7 billion for fiscal 1975. This is $1.3 billion over fiscal 1974 and reflects the large deposits of earnings by the Federal Reserve System, which totaled $4.8 billion in fiscal 1974 and $5.8 billion in fiscal 1975.

Outlays

Total outlays in fiscal 1975 were $324.6 billion (compared with $268.4 billion for 1974). Outlays for fiscal 1975, by major agency, are compared to those of 1974 in the following table. For details see the Statistical Appendix.

[In millions of dollars]

	1974	1975	Increase, or decrease (−)
Funds appropriated to the President	3,329	3,572	243
Agriculture Department	9,767	9,725	−42
Defense Department	79,307	87,471	8,164
Health, Education, and Welfare Department	93,738	112,411	18,673
Housing and Urban Development Department	4,786	7,488	2,702
Labor Department	8,966	17,649	8,682
Transportation Department	8,104	9,247	1,143
Treasury Department	35,993	41,177	5,184
Energy Research and Development Administration [1]	2,362	3,198	836
National Aeronautics and Space Administration	3,252	3,267	14
Veterans Administration	13,337	16,575	3,238
Other	22,096	26,920	4,824
Undistributed intrabudgetary transactions	−16,646	−14,098	−2,548
Total outlays	268,392	324,601	56,209

[1] Effective Jan. 19, 1975, the functions of the Atomic Energy Commission were transferred to the Energy Research and Development Administration.

Cash and monetary assets

On June 30, 1975, cash and monetary assets amounted to $15.9 billion. The balance consisted of U.S. Treasury operating cash of $7.6 billion (this amount is $1.6 billion less than June 30, 1974); $1.9 billion held in special drawing rights ($0.1 billion more than fiscal 1974); a net $2.2 billion with the International Monetary Fund ($1.1 billion more than 1974); and $4.2 billion of other cash and monetary assets ($1.6 billion more than 1974). For a discussion of the assets and liabilities of the Treasury account, see page 166. The transactions affecting the account in fiscal 1975 follow:

Transactions affecting the account of the U.S. Treasury, fiscal 1975

[In millions of dollars]

Operating balance June 30, 1974			9,158
Excess of deposits or withdrawals (−), budget, trust, and other accounts:			
Deposits		327,895	
Withdrawals (−)		369,599	
			−41,704
Excess of deposits or withdrawals (−), public debt accounts:			
Increase in gross public debt		58,954	
Deduct:			
Net discounts on new issues	8,711		
Interest increment on savings and retirement plan securities	3,210		
Net public debt transactions included in budget, trust, and other Government accounts	6,899		
Net deductions		18,820	40,134
Operating balance June 30, 1975			7,589

Corporations and other business-type activities of the Federal Government

The business-type programs which Government corporations and agencies administer are financed by various means: Appropriations (made available directly or in exchange for capital stock), borrowings from either the U.S. Treasury or the public, or by revenues derived from their own operations. Various agencies have been borrowing from the Federal Financing Bank, which began operations in May 1974. The bank is authorized to purchase and sell securities issued, sold, or guaranteed by Federal agencies.

Corporations or agencies having legislative authority to borrow from the Treasury issue their formal securities to the Secretary of the Treasury. Amounts so borrowed and outstanding are reported as liabilities in the periodic financial statements of the Government corporations and agencies. In fiscal 1975, borrowings from the Treasury, exclusive of refinancing transactions, totaled $47.1 billion, repayments and cancellations were $37.8 billion, and outstanding loans on June 30, 1975, totaled $44.7 billion.

Those agencies having legislative authority to borrow from the public must either consult with the Secretary of the Treasury regarding the proposed offering, or have the terms of the securities to be offered approved by the Secretary.

The Federal Financing Bank makes funds available in accordance with program requirements to agencies having authority to borrow from the bank. Interest rates shall not be less than rates determined by the Secretary of the Treasury taking into consideration current average yields on outstanding Government or bank securities of comparable maturity. The bank may charge fees to provide for expenses and reserves.

During fiscal 1975, Congress granted new authority to borrow from the Treasury in the total amount of $23.1 billion and reduced existing authority by $2.1 billion, a net increase of $20.9 billion. The status of borrowings and borrowing authority and the amount of corporation and agency securities outstanding as of June 30, 1975, are shown in the Statistical Appendix.

Unless otherwise specifically fixed by law, the Treasury determines interest rates on its loans to agencies by considering the Government's cost for its borrowings in the current market, as reflected by prevailing market yields on Government securities which have maturities comparable with the Treasury loans to the agencies. A description of the Federal agency securities held by the Treasury on June 30, 1975, is shown in the Statistical Appendix.

During fiscal 1975, the Treasury received from agencies a total of $1.8 billion in interest, dividends, and similar payments. (See the Statistical Appendix.)

As required by Department Circular No. 966, Revised, semiannual statements of financial condition, and income and retained earnings are submitted to the Treasury by Government corporations and business-type agencies (all other activities report on an annual basis). Quarterly statements showing direct and guaranteed loans, and annual statements of commitments and contingencies are also submitted. These statements serve as the basis for the combined financial statements compiled by the Treasury which, together with individual statements, are published periodically in the Treasury Bulletin. Summary statements of the financial condition of Government corporations and other business-type activities, as of June 30, 1975, are shown in the Statistical Appendix.

Government-wide financial management

Legislative Reorganization Act of 1970.—The Congressional Budget and Impoundment Control Act of 1974 (Public Law 93–344) amended the Legislative Reorganization Act of 1970 to give the General Accounting Office an expanded role for coordinating the Government-wide efforts to respond to the information needs of the Congress for budget and fiscal data. Specifically, the Comptroller General, in addition to identifying these needs, is now required to prescribe basic classifications, standard terminology, definitions, and codes to be used in the information system. Under the new act, GAO is required to report to the Congress annually (the first report was due September 1, 1974) the results of its continuing program to identify and specify the needs of the Congress. OMB and Treasury are required to report annually in response to the GAO report their plans for addressing the congressional information needs.

Because of time constraints the first reports from the General Accounting Office and the executive branch could not be fully responsive to the act. Therefore, progress reports were made on the status of ongoing projects started as a result of needs already identified by the "Plan for Addressing Congressional Information Needs" prepared by an ad hoc team consisting of executive branch personnel and released on March 7, 1974.

During the year Treasury initiated several improvements in data and systems, the most significant being: (1) The inclusion of a special analysis in the budget document, prepared by the Office of Tax Analysis, which reflected the tax revenue losses attributable to special exclusions, exemptions, etc., (2) publication of the Daily Statement of the United States Treasury in a new format designed to disclose the U.S. Treasury's daily cash and debt operations in the manner most useful for analysis purposes, and (3) formation of a project team to redesign its Government-wide accounting system. A major objective of this project is to structure a system which can be more responsive to the information needs of the Congress and other users. It is hoped that direct access capability will be provided to interrogate selected current and historical data files.

Joint Financial Management Improvement Program.—By the end of the fiscal year, two projects were completed or near completion. The first was a project on money management in the Federal Government. The major objective of this project is to review cash management policies and practices and recommend improvements. The second project deals with the use of operating expense budgets for program management, an interagency study to review the existing use of operating budgets in agency program management and to develop recommendations for improvement.

International Monetary Fund.—The Commissioner of Government Financial Operations was appointed to serve as U.S. correspondent with the International Monetary Fund for matters related to the Fund's government finance statistics project. Selected statistics on Federal, State, and local government finance data are being collected to provide the Fund with a means of measuring the impact of government operations on the economy as a whole and on particular parts of the economy of Fund member countries.

The Fund is currently collecting fiscal 1973 statistical data. Relative data for which the Treasury is the source is being reviewed and passed on to the Fund. Other relative statistical data which are to be gathered through a network of information sources outside the Treasury sphere will be furnished the Fund through the U.S. correspondent.

FEDERAL DEBT MANAGEMENT

In fiscal 1975 Treasury debt management was again conducted in an extremely difficult economic atmosphere. Inflation continued to plague the economy and economic activity remained sluggish. Over the course of the fiscal year the Treasury had to issue an enormous amount of debt as total debt outstanding increased $59.0 billion. This was the largest increase since the $61.8 billion in fiscal 1944, a war year.

As in fiscal 1974, all coupon-bearing Treasury securities were sold by auction. However, in fiscal 1975 some auctions were conducted with bids stated in yields rather than in prices.

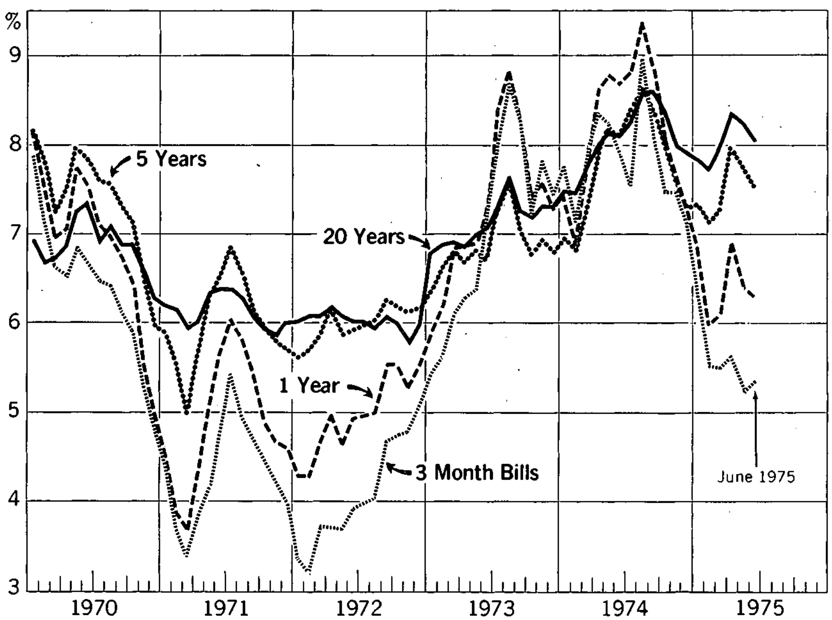
The cycle of 2-year note offerings was continued in fiscal 1975 as the Treasury sought to regularize the maturity structure of the debt. Nine notes were phased into the 2-year note cycle. In addition, three bills were issued in the 2-year cycle "slots," two of which matured and were replaced by 2-year notes. Gross offerings of coupon issues totaled $61.1 billion of which $26.8 billion was for new money. New money from bill offerings totaled nearly $33.6 billion—$22.0 in regular bills, $5.0 billion in tax anticipation bills, and $6.6 billion in other bills.

Because of the huge amount of debt issued by the Treasury, there was considerable concern that the Treasury would be "crowding out" less creditworthy private and public borrowers, particularly in the second half of the fiscal year when the Treasury did most of its borrowing. However, this "crowding out" did not materialize to any great extent and the Treasury, when possible, gave more advance notice than usual of its financing needs before entering the market.

Changes in Federal securities

Federal securities comprise the marketable and nonmarketable public debt securities issued by the Treasury and those obligations issued by Government agencies included in the unified budget. The principal agency issues are the participation certificates of the Government National Mortgage Association, the debt issues of the Export-Import Bank of the United States and the Tennessee Valley Authority, Postal Service bonds, Defense family housing mortgages, and the various guaranteed issues of the Federal Housing Administration.

MARKET YIELDS AT CONSTANT MATURITIES 1970-1975[1]



[1] Monthly averages of daily market yields of public debt securities. Bank discount rates of Treasury bills.

Federal debt and Government-sponsored agency debt

[In billions of dollars]

Class of debt	June 30, 1973	June 30, 1974	June 30, 1975	Increase, or decrease (−)
Public debt securities:				
Marketable public issues by maturity class:				
Within 1 year	122.8	139.9	163.9	24.0
1 to 5 years	88.2	77.2	101.9	24.7
5 to 20 years	45.6	44.4	41.3	−3.1
Over 20 years	6.4	5.1	8.4	3.3
Total marketable issues	263.0	266.6	315.6	49.0
Nonmarketable public issues:				
Series E and H savings bonds	59.4	61.9	65.5	3.6
U.S. savings notes [1]	.5	.5	.4	−.1
Investment series bonds	2.3	2.3	2.3	
Foreign government series:				
Dollar denominated	26.8	23.4	21.6	−1.8
Foreign currency denominated	1.7	1.6	1.6	
Other nonmarketable debt	.9	1.5	.3	−.6
Total nonmarketable public issues	91.6	91.3	92.3	1.1
Government account series (nonmarketable)	101.7	115.4	124.2	8.8
Non-interest-bearing debt	[2] 1.0	[2] 1.0	1.1	.1
Total gross public debt	[2] 457.3	[2] 474.2	533.2	59.0
Federal agency securities:				
Government National Mortgage Association	4.5	4.4	4.3	−.1
Export-Import Bank of the United States	2.2	2.9	2.6	−.3
Tennessee Valley Authority	2.3	2.7	2.1	−.6
Defense family housing	1.5	1.4	1.3	−.1
Other	.7	.6	.6	
Total Federal agency debt	11.1	12.0	10.9	−1.1
Total Federal debt	[2] 468.4	[2] 486.2	544.1	57.9
Government-sponsored agency securities:				
Federal home loan banks	12.1	18.6	21.2	2.6
Federal National Mortgage Association	20.4	25.2	28.2	3.0
Federal land banks	9.1	11.1	14.2	3.1
Federal intermediate credit banks	6.7	8.0	9.5	1.5
Banks for cooperatives	2.3	2.5	2.9	.4
Government-sponsored agency debt	50.6	65.4	76.1	10.7

[1] U.S. savings notes first offered in May 1967; sales discontinued after June 30, 1970.
[2] Non-interest-bearing debt for fiscal 1973 and 1974 was adjusted to reflect the reclassification in July 1974 of $825 million outstanding special notes issued to the International Monetary Fund.

At the end of fiscal 1975, outstanding Federal securities totaled $544.1 billion—$57.9 billion, or 12 percent, more than the $486.2 billion outstanding at the end of fiscal 1974. Treasury public debt securities amounted to $533.2 billion, an increase of nearly $59.0 billion during the fiscal year, while Federal agency issues fell $1.1 billion to a level of $10.9 billion. Treasury marketable securities outstanding at the end of fiscal 1975 amounted to $315.6 billion. This represented an increase of $49.0 billion compared with $3.6 billion in fiscal 1974. Treasury bills accounted for $23.6 billion of the increase in marketable debt, Treasury notes $21.8 billion, and Treasury bonds $3.6 billion.

Ownership

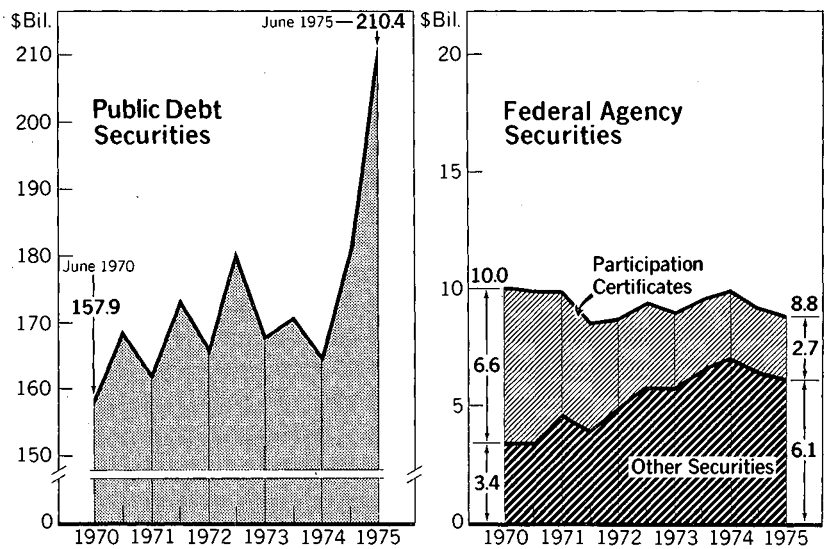
At the close of fiscal 1975 private investors held $311.9 billion of the $544.1 billion of Federal debt issues outstanding. The remaining

$232.2 billion was held by the Federal Reserve System and Government accounts. In addition, private investors increased their holdings of federally sponsored agency issues by $8.8 billion to a level of $71.5 billion. Federally sponsored agency issues held by the Federal Reserve System and Government accounts increased by $1.9 billion to a level of $4.5 billion. Total borrowing from the public, which includes the Federal Reserve System and foreign investors, amounted to $50.9 billion in fiscal 1975. This was considerably greater than the $3.0 billion in fiscal 1974 and is the largest amount since the $23.1 billion borrowed in fiscal 1968. Unlike fiscal 1974, when the Federal Reserve System aquired $5.5 billion of these securities and private investors showed a net disinvestment of $2.5 billion, in fiscal 1975 private investors acquired $47.6 billion, or 94 percent, of the securities while the Federal Reserve System picked up $4.3 billion.

In fiscal 1975 nonmarketable public debt increased $9.9 billion compared with a gain of $13.4 billion in fiscal 1974. Special nonmarketable securities issued only to Government accounts and trust funds such as the unemployment trust fund accounted for most of the increase in nonmarketable debt. These special securities increased $7.9 billion, while special nonmarketable issues to foreign investors declined $1.8 billion. Savings bonds outstanding grew by $3.6 billion and other nonmarketables by $0.2 billion.

The unified budget totals exclude the Government-sponsored agencies. Therefore, the obligations of these agencies are not part of the Federal debt; nevertheless, these privately owned and managed agen-

PRIVATE HOLDINGS OF MARKETABLE FEDERAL SECURITIES



cies are subject to some degree of Federal supervision. In fiscal 1975, the debt issues of Government-sponsored agencies grew by $10.7 billion to $76.1 billion.

Individuals.—Public debt securities held by individuals increased $6.3 billion in fiscal 1975 to a level of $87.1 billion. Around 57 percent, or $3.6 billion, of the increase was in savings bonds, while Treasury marketable issues accounted for $2.7 billion. On June 30, 1975, holdings of U.S. savings bonds and notes totaled $65.4 billion and holdings of marketable securities was $21.7 billion.

Insurance companies.—Insurance companies added $1.2 billion to their holdings of public debt securities in fiscal 1975 compared with a decline of $0.4 billion in fiscal 1974. Holdings of Federal agency securities also increased slightly during the year. At the end of the fiscal year, insurance companies held $7.1 billion of public debt securities and $0.4 billion of Federal agency issues.

Savings institutions.—Savings and loan associations' holdings of public debt securities increased $0.5 billion during fiscal 1975 compared with a decline in holdings of $1.1 billion in fiscal 1974. However, holdings of Federal agency securities were down slightly during the fiscal year. At the end of the year, savings and loan associations held $4.9 billion of public debt securities and $0.5 billion of Federal agency issues.

Mutual savings banks held $3.6 billion of public debt securities at the end of fiscal 1975, an increase of $1.0 billion for the year compared with a decline of $0.6 billion in fiscal 1974. Holdings of Federal agency securities changed only slightly and stood at a level of $0.4 billion at the end of the fiscal year.

State and local governments.—Around $29.6 billion of public debt securities was held by State and local governments at the end of fiscal 1975. This represented an increase of $1.3 billion for the year compared with a decline of $0.5 billion in fiscal 1974. Holdings of Federal agency issues, however, decreased $0.2 billion.

Foreign and international.—Foreign investors added $9.2 billion of public debt securities to their holdings in fiscal 1975 compared with a decline of $2.6 billion the previous year. Holdings of marketable issues, primarily bills, increased by $11.0 billion while special foreign nonmarketables declined $1.8 billion. Holdings of Federal agency securities declined by $0.2 billion. At the end of fiscal 1975, foreign investors held $66.0 billion of public debt securities and $0.4 billion of Federal agency issues.

Nonfinancial corporations.—Corporations acquired $2.4 billion of public debt securities in fiscal 1975 while holdings of Federal agency issues declined $0.1 billion. At the end of the fiscal year, their holdings of public debt securities amounted to $13.2 billion and Federal agency securities to $0.4 billion.

Other private nonbank investors.—Public debt securities held by other private nonbank investors increased by $9.8 billion compared with an increase of $1.7 billion in fiscal 1974. Holdings of Federal agency issues increased only slightly. On June 30, 1975, these investors held $22.5 billion of public debt issues and $0.1 billion of Federal agency securities.

Commercial banks.—Commercial banks were particularly heavy purchasers of Treasury public debt securities in fiscal 1975 after posting declines in holdings for 3 successive years. Banks acquired $16.0 billion of public debt securities during the fiscal year, most of which, $13.6 billion, was absorbed in the second half of fiscal 1975. However, holdings of Federal agency securities fell $0.5 billion. At the end of the fiscal year, banks held $69.2 billion of public debt securities and $1.9 billion of Federal agency issues.

Estimated ownership of public debt securities on selected dates 1965–75

[Dollar amounts in billions]

	June 30, 1965	June 30, 1973	June 30, 1974	June 30, 1975	Change during fiscal 1975
Estimated ownership by:					
Private nonbank investors:					
Individuals: [1]					
Series E and H savings bonds	$48.3	$58.9	$61.4	$65.0	$3.6
U.S. savings notes [2]		.5	.5	.4	(*)
Other securities	22.3	16.4	18.8	21.7	2.7
Total individuals	70.7	75.9	80.7	87.1	6.3
Insurance companies	10.7	6.3	5.9	7.1	1.2
Mutual savings banks	5.6	3.2	2.6	3.6	1.0
Savings and loan associations	7.1	5.7	r 4.5	4.9	.5
State and local governments	24.1	28.8	28.3	29.6	1.3
Foreign and international	[3] 12.3	[3] 59.4	[3] 56.8	66.0	9.2
Corporations	15.3	9.8	10.8	13.2	2.4
Miscellaneous investors [4]	9.7	10.9	12.7	22.6	9.8
Total private nonbank investors	[3] 155.5	[3] 200.1	[3] 202.4	234.0	31.6
Commercial banks	58.2	58.8	53.2	69.2	16.0
Federal Reserve banks	39.1	75.0	80.5	84.7	4.3
Government accounts	61.1	123.4	138.2	145.3	7.1
Total gross debt outstanding	[3] 313.8	[3] 457.3	[3] 474.2	533.2	59.0
			Percent		
Percent owned by:					
Individuals	23	17	17	16	
Other private nonbank investors	27	27	26	28	
Commercial banks	19	13	11	13	
Federal Reserve banks	12	16	17	16	
Government accounts	19	27	29	27	
Total gross debt outstanding	100	100	100	100	

r Revised.
*Less than $50 million.

[1] Including partnerships and personal trust accounts.
[2] U.S. savings notes first offered in May 1967; sales discontinued after June 30, 1970.
[3] Adjusted to reflect the reclassification in July 1974 of outstanding non-interest-bearing special notes issued to the International Monetary Fund and other international lending institutions. The adjusted amounts were $3,455 million at the end of fiscal 1965 and $825 million at the end of fiscal 1973 and 1974.
[4] Includes nonprofit institutions, corporate pension trust funds, nonbank Government security dealers, certain Government deposit accounts, and Government-sponsored agencies.

Federal Reserve System.—The Federal Reserve System added $4.3 billion of public debt securities to their holdings in fiscal 1975 compared with an increase of $5.5 billion a year earlier. Holdings of Federal agency securities increased slightly. At the close of fiscal 1975, the System held $84.7 billion of public debt securities and $0.2 billion of Federal agency issues.

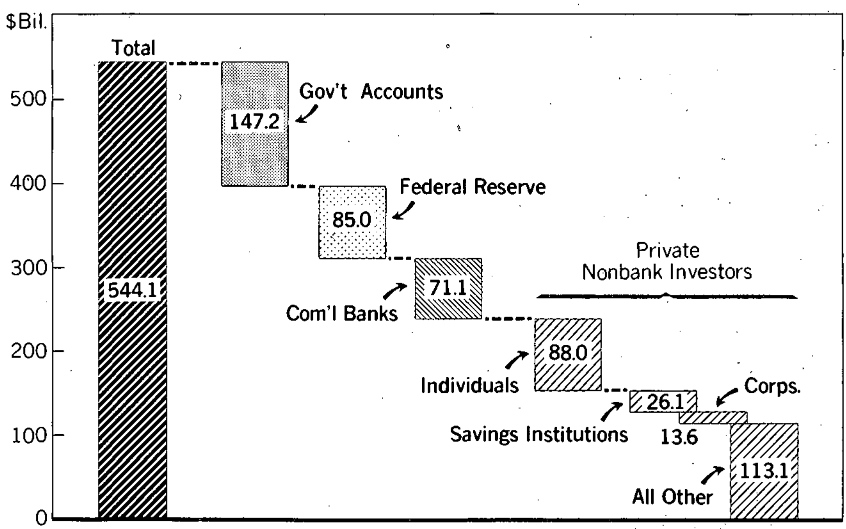
Government accounts.—Public debt securities held by Government accounts increased $7.1 billion compared with $14.8 billion in fiscal 1974. Holdings of special nonmarketable securities increased $7.9 billion. However, marketable holdings declined $0.8 billion compared with an increase of $1.1 billion in fiscal 1974. Holdings of Federal agency issues were down slightly. At the end of the fiscal year, Government accounts held $145.3 billion of public debt securities and $1.9 billion of agency issues.

Financing operations

In the quarter ending June 30, 1974, interest rate movements had been largely dominated by a combination of inflationary expectations, restrictive monetary policy, and continued strong demand for business loans. Interest rates on all forms of private debt had moved substantially higher, and by the end of the quarter many rates had reached record levels. Yields on short-term Government securities, however, had declined while rates on intermediate- and long-term Government securities had changed very little.

When fiscal 1975 began there was considerable concern over the

OWNERSHIP OF FEDERAL SECURITIES, JUNE 30, 1975



sluggish economy, inflation, and the rise in interest rates. At this time, the Treasury was meeting some of its new cash needs through additions to weekly bill auctions. Except for paydowns in two weekly auctions in September, the additions ranging from $100 million to $800 million were continued through the end of the fiscal year. About $22.0 billion of new money was raised through additions to regular weekly and monthly bill offerings.

To help meet seasonal cash needs, the Treasury announced on July 18 that it would auction $1.5 billion of 44-day tax anticipation bills on August 1 for payment on August 7. The bills were due September 20 and commercial banks were allowed to pay for their own and their accepted tenders by crediting Treasury tax and loan accounts. Bidding for the tax bills was aggressive. Total tenders amounted to $4.3 billion and $1.5 billion was accepted at an average rate of 9.66 percent.

Meanwhile, just prior to the tax anticipation bill auction, the Federal Financing Bank held its first auction on July 23 and sold $1.5 billion of 8-month bills priced to yield 8.05 percent. The bills, which had the same characteristics as Treasury bills, were auctioned with full commercial bank tax and loan account privileges. The proceeds of the offering were used to pay back the $1.4 billion borrowed by the Financing Bank from the Treasury to make loans to several agencies whose borrowing activities are coordinated by the Federal Financing Bank.

About 3 weeks prior to the August financing, Treasury bills and intermediate coupon issues were trading at rates substantially below the general pattern of the market, in part due to a shortage of tradeable issues and in part due to rumors of investment in Treasury securities by the oil-producing countries and Federal Reserve purchases of agency issues on July 17. As the end of July approached, expectations of increased foreign activity declined, and after testimony by Chairman Stein of the Council of Economic Advisers and Chairman Burns of the Federal Reserve Board, pessimism increased, resulting in increased Treasury yields at the time of the August announcement of refunding $4.3 billion in notes held by the public maturing on August 15.

The refunding called for the auction of $2.25 billion of 9 percent 33-month notes, $1.75 billion of 9 percent 6-year notes, and $400 million of 8½ percent bonds due in 1994–1999. In addition, the Treasury indicated that it would raise new cash by increasing the amount of weekly bill offerings or by issuing other obligations having a maturity of 1 year or less to help raise $3.5 billion to cover Treasury needs through early September.

The announcement of the offering of the short- and intermediate-term 9 percent notes, the reopening of the 8½ percent 1994–1999 bonds

Offerings of marketable Treasury securities excluding refunding of regular bills, fiscal 1975

[In millions of dollars]

Date	Description	Cash offerings: For new money	Cash offerings: For refunding	Allotted to Federal Reserve and Gov't accounts	Total	Average auction yield (percent)
1974	NOTES AND BONDS					
Apr. 1	1½ percent note, Apr. 1, 1979[1]		1		1	
Aug. 15	9 percent note, May 15, 1977	116	2,277	2,936	5,329	8.59
Aug. 15	9 percent note, Aug. 15, 1980	92	1,743	2,461	4,296	8.75
Aug. 15	8½ percent bond, May 15, 1994–99	19	381	486	886	8.63
Sept. 30	8¼ percent note, Sept. 30, 1976		1,818	205	2,023	8.34
Oct. 1	1½ percent note, Oct. 1, 1979[1]		1		1	
Nov. 6	7⅞ percent note, May 15, 1979	1,016			1,016	7.89
Nov. 15	7¾ percent note, Nov. 15, 1977	316	2,255	1,059	3,630	7.85
Nov. 15	7¾ percent note, Nov. 15, 1981	234	1,532	949	2,715	7.82
Nov. 15	8½ percent bond, May 15, 1994–99	81	522	338	941	8.21
Dec. 31	7¼ percent note, Dec. 31, 1976	180	2,025	77	2,282	7.32
1975						
Jan. 7	7⅞ percent note, May 15, 1979	1,253			1,253	7.33
Jan. 9	8 percent note, Mar. 31, 1976	756			756	7.24
Feb. 18	7⅛ percent note, May 15, 1978	1,269	1,994	697	3,960	7.21
Feb. 18	7⅜ percent note, Feb. 15, 1981	688	1,080	400	2,167	7.49
Feb. 18	7⅞ percent bond, Feb. 15, 1995–2000	292	460	150	902	7.95
Mar. 3	5⅞ percent note, Aug. 31, 1976	1,662			1,662	5.94
Mar. 3	6 percent note, Feb. 28, 1977	1,665			1,665	6.09
Mar. 19	7¾ percent note, Nov. 15, 1981	1,762			1,762	7.51
Mar. 25	6 percent note, May 31, 1976	1,580			1,580	5.98
Mar. 31	6½ percent note, Mar. 31, 1977	2,576			2,576	6.51
Apr. 1	1½ percent note, Apr. 1, 1980[1]		2		2	
Apr. 7	8¼ percent bond, May 15, 1990	1,247			1,247	8.31
Apr. 8	7⅛ percent note, Nov. 30, 1976	1,507			1,507	7.15
Apr. 30	7⅜ percent note, Apr. 30, 1977	1,579			1,579	7.43
May 15	7⅝ percent note, Aug. 15, 1978	801	2,054	2,300	5,155	7.70
May 15	8 percent note, May 15, 1982	428	1,086	1,233	2,747	8.00
May 15	8¼ percent bond, May 15, 2000–05	213	541	850	1,604	8.30
May 27	6¾ percent note, May 31, 1977	2,137			2,137	6.86
June 6	6½ percent note, Oct. 31, 1976	1,579			1,579	6.54
June 30	6½ percent note, June 30, 1977	2,007		162	2,169	6.61
	Total notes and bonds	26,786	19,768	14,572	61,130	
	BILLS (MATURITY VALUE)					
	Change in offerings of regular bills:					
1974	July–September	2,576			2,576	
	October–December	3,639			3,639	
1975	January–March	5,727			5,727	
	April–June	10,023			10,023	
	Total change in regular bills	21,965			21,965	
	Tax anticipation bill offerings:					
1974						
Aug. 7	9.655 percent, 44-day, maturing Sept. 20, 1974	1,526			1,526	
Dec. 3	7.426 percent, 134-day, maturing Apr. 16, 1975	2,251			2,251	
Dec. 5	7.521 percent, 194-day, maturing June 17, 1975	1,256			1,256	
	Total tax anticipation offerings	5,033			5,033	
	Other bill offerings:					
July 30	8.049 percent, 244-day, maturing Mar. 30, 1975 (FFB)	1,501			1,501	
Sept. 4	9.767 percent, 299-day, maturing June 30, 1975	2,003			2,003	
Nov. 4	7.933 percent, 227-day, maturing June 19, 1975	1,501			1,501	
1975						
Apr. 14	6.560 percent, 292-day, maturing Jan. 31, 1976	1,585			1,585	
	Total other bill offerings	6,590			6,590	
	Total offerings	60,374	19,768	14,572	94,718	

[1] Issued in exchange for 2¾ percent Treasury bonds, investment series B–1975–80.

to be sold in a regular auction, and the probable raising of additional September cash by means of bill issues elicited further price declines, although the auctions of the securities the following week were fairly successful.

In particular, small investor demand for the 9 percent notes was substantial; over 50 percent of the 33-month notes and almost 50 percent of the 6-year notes were sold noncompetitively for a total of $2.2 billion. This was the largest subscription by small investors to note auctions since the Treasury began using the auction technique regularly. Moreover, the availability of the notes in $1,000 minimum accepted denominations as well as the 9 percent coupon helped attract small investors and was mainly responsible for the 8.59 percent and 8.75 percent average yields, respectively, on the 33-month and 6-year notes. The bond sold at an average yield of 8.63 percent, reflecting relatively less small investor participation.

Profit-taking on the issues was not significant during the week of the auctions and prices actually moved higher shortly afterwards.

Following the August financing the Treasury prepared to meet its needs for early September. On August 20, a $2 billion offering of 299-day bills was announced, the auction to be held on the 28th. Market reception of the announcement was dull, since the bills added to a heavy calendar of bill financing. Bill rates rose steadily to the end of the week, and the weekly bill auction on Monday, August 26 averaged 9.91 and 9.93 percent on a bank discount basis for the 3-month and 6-month issues, respectively.

However, following that the market began to turn around, partly based on a belief that Federal Reserve policy was beginning to ease. As a result the 299-day bills, even without tax and loan credit, sold fairly well, averaging 9.77 percent on a bank discount basis.

A slight easing of Federal Reserve monetary policy and expectations of further easing resulted in a strong market for Government securities during the week prior to the Treasury's September 16 financing announcement. Demand, largely from dealers, was especially strong for shorter issues.

On September 16, the Treasury announced a refunding of the 2-year notes maturing September 30, 1974, consisting of $2.0 billion in new 2-year notes to be sold by cash auction. An innovation to the usual procedure was introduced by requiring all bids to be stated in yields rather than prices. Bids were then arranged and notes awarded in ascending order of yield, with the coupon later set close to the average so as to avoid difficulties arising from the tax treatment of capital gains. The minimum denomination was set at $10,000 to discourage disintermediation from thrift institutions.

The auction on September 24 was successful, as over $3.2 billion was bid. The average yield of 8.39 percent was consistent with the trading yields on outstanding issues of similar maturity and as a result of the bidding, a coupon of 8¼ percent was set. About 20 percent of the issue was awarded to private investors on a noncompetitive basis.

After a summer of record high interest rates, pressures in the financial markets eased in September and rates declined, especially in the short-term sectors. The effective rate on Federal funds averaged 11.34 percent, 67 basis points below the August level and substantially below the record high of 12.92 percent reached in July. Rates on 3-month certificates of deposit in the secondary market fell about 1 percentage point to the 10¾–11 percent range. Likewise rates on 90–119 day commercial paper declined from 12 percent at the end of August to 10⅝ percent at the end of September. However, the most dramatic fall in short rates was in the Treasury securities market, where rates on Treasury bills declined about 135 to 325 basis points over the month. Yields on Treasury coupon securities also declined with long-term interest rates edging down only slightly. In October, however, interest rates on Government securities were mixed with yields on notes and bonds falling while some Treasury bill rates increased. However, virtually all other interest rates fell in October.

During the week preceding the Treasury's October 16 announcement of a new cash financing, the market for Treasury coupon securities had remained fairly stable, while bill rates moved higher, as continued prospects for monetary ease by the Federal Reserve were partly offset by an expectation of heavy Treasury financing needs in the near future.

The financing consisted of a double offering, $1.0 billion of 4½-year notes to be sold using the new yield auction technique and $1.5 billion of 227-day bills. No tax and loan account privileges were allowed in purchasing the securities, and the June 19 bills were cash management bills rather than tax anticipation bills.

The note was auctioned on October 23, 1974. The average yield was 7.89 percent; as a result of this the coupon was set at 7⅞ percent. Dealers took about 32 percent of the issue, while another 20 percent was accounted for by noncompetitive bids. Despite the lack of tax and loan account privileges, bank demand was fairly strong.

In the week following the auction, dealers distributed about $185 million of their allotments, and the bid price for the 4½-year note fell by about 7/32.

Bill rates moved higher during the week as investors prepared to absorb the new issue of 227-day bills on top of the regular bill issues, and an additional $200 million of 52-week bills. The higher rates brought out new investors and, as a result, the October 29 auction of the 227-day bills went well.

The average yield was 7.93 percent. Dealers were awarded $862 million. After some initial hesitancy occasioned by the announced size of the November financing, the market moved to absorb the bills.

For the November financing the Treasury announced its plans to refund $4.3 billion of privately held notes and bonds maturing November 15 as well as to raise $550 million in new cash. The yield-auction method was to be used to sell $2.5 billion of 3-year notes and $1.75 billion of 7-year notes, while $600 million of 8½ percent bonds due in 1999 was to be auctioned on a price basis. The minimum denomination on the 3-year notes was set at $5,000 in order to reduce pressures on the thrift institutions, while the minimum denomination was $1,000 for the other securities. The Treasury also indicated that it would need to raise an additional $4.5 billion of new cash by mid-December.

The firm tone in securities markets evoked an eager response to the Treasury's refunding, which took place November 6, 7, and 8. All three securities were well covered, with the response to the reopened 8½ percent bonds of 1999 being particularly strong. Despite the larger issue size of $600 million, more than $1,800 million of bids were received, underscoring the fact that favorable market conditions make good coverage possible for even a relatively large amount of a long-term issue. The $2.5 billion of 7¾ percent notes of 1977 attracted $4.3 billion of tenders, while the $1.75 billion of 7¾ percent notes of 1981 drew $3.3 billion in tenders. Average issuing rates for the 3-year notes was 7.85 percent, for the 7-year note 7.82 percent, and for the bond at maturity 8.21 percent.

To raise the $4.5 billion in new cash to meet Treasury needs through mid-December, the Treasury relied on tax anticipation bills and a bill strip. Prior to the November 14, 1974, announcement, the tone of the bill market was firm. Expectations of interest rate declines and seasonal increases in reserve outweighed the impact of increased supply, although yields increased moderately in the short-end of the market subsequent to the announcement.

On November 20, the Treasury auctioned $2.25 billion in April tax anticipation bills. Bidding was brisk and the average rate of 7.43 percent was slightly below levels on outstanding April maturities. Dealers took $1.5 billion of the issue; noncompetitive bidders, $22.7 million.

Subsequently, the mood of the market changed and dealers began to reduce their inventories. Bidding for the $1 billion strip bill ($200 million additional for each weekly series maturing December 12 through January 9) was weaker. The average yield was 7.527 percent and dealers accounted for most of the issue, some $874 million. Noncompetitive awards accounted for only $1.3 million.

The $1.25 billion of June tax anticipation bills auctioned on November 26, 1974, yielded an average of 7.521 percent, slightly above rates on outstanding June issues. Dealers accounted for about $638 million of the issue, with noncompetitive tenders accounting for another $25 million.

The terms of both the April and June tax anticipation bill sales were unusual in that banks were not permitted to pay for bill purchases by crediting their Treasury tax and loan accounts.

In December most short rates fell, although this trend was interrupted at times. The Federal funds rate fell to its lowest level since early in the year, and Treasury bill rates declined. In its third weekly bill auction in December, the Treasury did not raise any new cash for the first time in 10 weeks. Coupon financing during the month consisted of two auctions, one for $2.0 billion in 2-year notes and the other on December 30 of $1.25 billion in additional 7⅞ percent notes maturing in May 1979. Proceeds from the sales were to be used to redeem $1.9 billion of publicly held 2-year notes maturing December 31 and to provide additional cash.

The December 13 announcement for the refunding of the 2-year notes placed the auction on December 23. The auction was on a yield basis and resulted in an average yield of 7.32 percent with a coupon of 7¼ percent. The amount sold was $2.3 billion which raised $0.2 billion in new cash.

During the week preceding the Treasury's December 20 announcement of a new cash financing, yields had been declining, in response to the gloomy reports about the economy and the belief that a further relaxation of monetary policy was a possibility. However, the market weakened on the announcement since participants had not expected the financing to be through the issue of coupon securities. The financing was to raise cash to meet the Treasury's needs prior to the January tax payments. The total amount raised was $2.0 billion through an additional $1.25 billion of the 7⅞ percent notes of May 15, 1979, and an additional $0.75 billion of the 8 percent notes of March 31, 1976. The auctions were held on December 30, 1974, and January 2, 1975, respectively. Bidding was on the conventional price basis, and in neither case could credit to tax and loan accounts be used.

The Treasury accepted $1.25 billion of the $1.8 billion in tenders for the 4-year 4-month 7⅞ percent note at an average yield of 7.33 percent. The auction on January 2 for the 15-month notes resulted in $0.75 billion of accepted tenders at an average yield of 7.24 percent.

Excluding the $1.25 billion of new cash raised through the auction of additional amounts of the 7⅞ percent notes of May 1979, the Treasury raised $16.8 billion of new money in the first half of fiscal 1975. Just over $2.1 billion was in coupon issues and $14.7 in bills, including tax anticipation bills issued and redeemed in the first quarter of the fiscal year.

The Treasury securities markets had continued their improvement from the low point in the summer of 1974 through the end of the year. However, with unemployment rising sharply and production falling, the administration introduced proposals for a cut in income taxes. The proposal was for rebates on individual income tax, based on 1974 taxes, and increases in the investment tax credit for business. This led to projections of increased budget deficits and Treasury marketing of new securities, and some unsettling of these markets. Fears were expressed that the Treasury would "crowd out" from the credit markets other borrowers and stall any economic recovery.

Through the first 6 months of 1975 the Treasury raised $33.5 billion in net new money in marketable securities, of which $25.5 billion, or 76.2 percent, was in issues of 2 years or less.

The Federal Reserve Board contributed to a less stringent monetary policy by lowering the discount rate on January 10, to 7¼ percent, and again on February 5, to 7 percent for the third successive lowering since December 9 when it was at an 8-percent level. Bank reserve requirements on demand deposits of over $400 million were lowered to 16½ percent from 17½ percent on February 13, 1975.

The initial details of the Treasury's February financing were announced January 22, 1975. Three securities were offered that would raise $5.5 billion from the public, to retire $3.55 billion of issues maturing on February 15, 1975. The refunding consisted of $3.0 billion of a 3-year 3-month note maturing May 15, 1978, $1.75 billion of a 6-year note due February 15, 1981, and $0.75 billion of a bond due in 30 years on February 15, 2000, with call privileges after 25 years.

The 3-year 3-month notes were auctioned on January 28 at an average yield of 7.21 percent with a 7⅛ percent coupon. Tenders for the $3.0 billion issue amounted to $6.4 billion of which $0.6 billion were noncompetitive. The 6-year notes were auctioned January 29 with an average yield of 7.49 percent with a coupon of 7⅜ percent. Tenders for the $1.75 billion issue amounted to $4.2 billion of which $0.2 billion were noncompetitive. The 25-year Treasury bonds were auctioned January 30 with an average yield of 7.95 percent with a 7⅞ percent coupon.

Immediately prior to the announcement of the terms of the February refunding, the market had been cautious in view of worries over the potential size of the Treasury financing. However, immediately prior to the announcement the Federal Reserve Board reduced the reserve requirements for commercial banks, which led to bill rates falling substantially, and coupon issues taking on a firm undertone.

Immediately after the announcement, prices of Treasury bills improved, short-term coupon issues were steady, and there were modestly lower prices on longer term bonds. Generally, the refunding package was thought to be manageable.

On February 11, the Treasury announced the auction of $3 billion in notes to the public to be held February 19, $1.5 billion in 18-month notes due August 31, 1976, and $1.5 billion in 2-year notes due February 28, 1977. The auction for the 18-month notes resulted in $2.8 billion of tenders for the $1.5 billion offered. The average yield was 5.94 percent with a 5⅞ percent coupon. The 2-year notes had $3 billion in tenders for the $1.5 billion offered. The issue had a 6 percent coupon and an average issue yield of 6.09 percent.

The market prior to the auction had been more constructive, as economic statistics continued to validate expectations of a downtrend in interest rates, and an accommodative posture from the Federal Reserve, to revive the growth in the monetary aggregates. The auction drew a good response from professionals, and investor demand came particularly from bank investors. Dealers took $657 million and $578 million of the issues, respectively.

After the auction, Treasury bill rates continued to decline and the price of intermediate and longer term issues edged higher.

On March 4, the Treasury announced the sale of up to $3.5 billion in notes to the public, in two issues, one of which was a reopening of an existing issue. An additional amount of $1.75 billion of the 7¾ percent notes due November 1981 was announced, along with the issue of $1.5 billion in a new issue due May 31, 1976. Payment for the notes was not allowed to be made through tax and loan accounts. The minimum denomination of issue for the 6-year 8-month notes was $1,000, and for the 14-month notes $5,000.

The sale of the 6-year 8-month notes was made March 11, when they sold for an average yield of 7.51 percent, and a 7.5 percent coupon. Bidding for the issue was active, and $3.4 billion of tenders were received. On March 31, the 14-month notes were sold with a coupon of 6 percent, and an average yield of 5.98 percent, with tenders received of $2.9 billion.

Prior to the announcement of the auction, prices of short and intermediate issues had shown modest gains. Sentiment was cautious due to large supplies, but the continuing fall in the prime rate helped steady the market. The Federal Reserve lowering of the discount rate prior to the auction was largely anticipated by participants and although there was concern that monetary policy was not easy enough, good demand was received for both notes. After the auction, trading subsided since the investor demand was largely satisfied by the auction, and fears of new supplies caused prices to drift lower.

On March 12, a further announcement was made to auction $3.45 billion in notes and bonds to the public. The offering consisted of $2.2 billion in 2-year notes due March 31, 1977, and $1.25 billion in 15-year bonds due May 15, 1990. The auctions occurred on March 18 and 20, respectively.

The results of the 2-year notes was a disappointing $2.6 million in tenders, reflecting investor concern at the volume of new issues coming to market. The coupon on the bond was set at 6½ percent with an average yield of 6.51 percent. The market remained cautious in front of the auction of the 15-year bonds, but the lower prices drew better bidding interest than had been expected. Tenders amounted to $2.9 billion, and the issue sold at an 8¼ percent coupon and an average yield of 8.37 percent.

After the auction, sentiment remained discouraged by the large supplies of new Treasury issues that would have to be sold in the market and coupon securities resumed their downward price bias. However, the 8¼ percent was fairly priced so that during the first week of when-issued trading, the issue was able to rise in price by 11/64 over the average price at the auction. At the same time, dealers were able to reduce their holdings of the issue from $591 million to $161 million.

On March 25, the Treasury announced the auction to the public on April 1 of up to $1.5 billion in 20-month notes maturing November 30, 1976.

The market for Treasury issues continued to deteriorate prior to the auction, in the face of continuing large-scale financing needs in both the government and the corporate bond markets. Dealers already had large inventories, and in the face of the evidence that the recessionary forces were weakening there was increased reluctance to add to these stocks. Investors tended to concentrate their demands on shorter maturities, but the large buildup of supply in this range led to the greatest weakness in this maturity range.

The Treasury received $3.8 billion in tenders for the $1.5 billion offered. The issue was sold with a 7⅛ percent coupon and an average yield of 7.15 percent.

On March 31, the Treasury announced its intention to raise $1.5 billion in new cash with the sale of 292-day bills to mature January 31, 1976. The bills were placed in a 2-year note cycle slot, and they will be refunded eventually with such a note.

The bills were auctioned April 8, 1975, at an average yield of 6.95 percent with $1.5 billion being sold to the public, and $85 million additional to Federal Reserve banks, acting both for themselves and as agents for foreign official institutions, and Government accounts.

On April 9, the Treasury announced the sale on April 15 of $1.5 billion in 2-year notes to the public, due on April 30, 1977.

Prior to the announcement the securities market had been steadying as investor demand increased, brought about by the higher yields. But confidence remained fragile since investors worried that the possible turnaround in the economy would drive yields even higher. However, the respite in new coupon financing over the last half of April helped distribute recent offerings. The threat of "crowding out" caused by the large Federal budget deficits remained a problem, though.

Immediately prior to the auction, however, the coupon markets took on a firm undertone as investors were attracted to the higher yields prevailing. An excellent demand was evident for the 2-year notes which attracted $4.1 billion in tenders. The average yield was 7.43 percent on a 7⅜ percent coupon.

The auction had a favorable impact on sentiment and good demand was evident in the secondary market, and the issue traded 5/32 above the average issue price the first day of when-issued trading.

The prices of Treasury coupon securities fluctuated sideways, before the announcement of the May refunding package, as market participants attempted to weigh the various options open to the Treasury. As more corporations feared that they would be crowded out of the market by the large Federal deficits if they waited, they announced their own new financings. Consequently, prices in both corporate and Treasury coupon securities retreated in the face of prospective large new supplies.

The refunding package was announced May 1. The Treasury stated its intention to sell $5.0 billion of new issues to the public, which would retire $3.8 billion of maturing issues and raise $1.2 billion in new money. The money would be raised by selling $2.75 billion in 3-year 3-month notes due August 15, 1978, $1.50 billion in 7-year notes due May 15, 1982, and $0.75 billion in 30-year bonds due May 15, 2005, callable at the option of the United States on or after May 15, 2000. The 3¼-year note was sold with a minimum size of $5,000, and the other two issues had a minimum size of $1,000. Payment could not be made through tax and loan accounts.

The 3¼-year note resulted in $5.3 billion in tenders for an average yield of 7.70 percent with a 7⅝ percent coupon. Competitive tenders of $3.9 billion were received for the 7-year note, which was sold at par with an 8 percent coupon. The 30-year bonds received $1.8 billion in tenders, and were sold with an 8¼ percent coupon at an average yield of 8.30 percent.

The response to the refunding package was heartening to the markets, as investors took note of further accommodation from the Federal Reserve. Dealers took $378 million of the $750 million of the 30-year bond sold to the public, as they sought to rebuild their long maturity inventories. By the end of the first week of when-issued trading, the long bond had moved 7/64 above its average issue price. Dealers reduced their holdings during this time by $180 million to $199 million.

On May 8, the Treasury announced the sale of $1.5 billion of 2-year notes, to the public, due May 31, 1977. The auction occurred on May 14 and $3.4 billion of tenders were received. The coupon was set at 6¾ percent to sell the bonds at an average yield of 6.86 percent.

On May 15, the sale of $1.5 billion of 17-month notes, due October 31, 1976, to the public was announced. The auction occurred on May 22, for issue on June 6, and the issue was sold with a 6½ percent coupon, at an average yield of 6.54 percent. Total tenders received amounted to $2.6 billion.

Immediately after the auction announcement the Federal Reserve lowered the discount rate, and the market for Treasurys improved. This was bolstered by a falling prime rate, and evidence that the inflation rate was continuing to wane. The 6½ percent notes went to a premium almost immediately in when-issued trading. Other coupon securities were firm, on the evidence that Treasury borrowing requirements in June and July would be slightly lower than originally projected.

On June 11, the sale of $2.0 billion in 2-year notes to the public, due June 30, 1977, was announced for June 17. This note was part of the Treasury's policy of selling a 2-year note to mature at the end of each month. The new note replaces a 299-day bill issued for the same amount in September 1974.

Prior to the auction announcement the prices of coupon securities had been rising steadily, on a continued improvement in wholesale prices, and other data that suggested the rebound in the economy was going more slowly than had been expected. Additionally, evidence that Treasury's borrowing requirements were less than expected led to increased demand from banks for short and intermediate securities.

The auction resulted in only $2.6 billion in tenders, accepted at the average yield of 6.61 percent, with a 6½ percent coupon.

The relatively poor response to the offering caused some nervousness in the market, and a cautious atmosphere prevailed. Prices of all maturity ranges were lower, including the new 2-year note down 17/64 on its first day's trading.

On June 18, the Treasury announced that $9.4 billion of new cash would have to be raised through mid-August, and on June 25, it would auction $1.75 billion of new 4-year notes due June 30, 1979.

Disposition of marketable Treasury securities excluding regular bills, fiscal 1975

[In millions of dollars]

Date of retirement	Securities: Description and maturing date	Securities: Issue date	Redeemed for cash or carried to matured debt	Exchanged for new issue at maturity	Total
	NOTES AND BONDS				
1974					
Aug. 15	5⅝ percent note, Aug. 15, 1974	Aug. 15, 1968	4,401	5,883	10,284
Sept. 30	6 percent note, Sept. 30, 1974	Oct. 19, 1972	1,855	205	2,060
Oct. 1	1½ percent note, Oct. 1, 1974	Oct. 1, 1969	42		42
Nov. 15	5¾ percent note, Nov. 15, 1974	Nov. 15, 1967	3,238	2,204	5,442
Nov. 15	3⅞ percent bond, Nov. 15, 1974	Dec. 2, 1957	1,071	142	1,213
Dec. 31	5⅞ percent note, Dec. 31, 1974	Dec. 28, 1972	2,025	77	2,102
1975					
Feb. 15	5¾ percent note, Feb. 15, 1975	Feb. 15, 1968	2,886	1,129	4,015
Feb. 15	5⅞ percent note, Feb. 15, 1975	Oct. 22, 1971	1,104	118	1,222
Apr. 1	1½ percent note, Apr. 1, 1975	Apr. 1, 1970	8		8
May 15	6 percent note, May 15, 1975	May 15, 1968	2,597	4,163	6,760
May 15	5⅞ percent note, May 15, 1975	Apr. 3, 1972	1,556	220	1,776
	Total coupon securities		20,783	14,141	34,924
	BILLS				
1974	Tax anticipation:				
Sept. 20	9.655 percent	Aug. 7, 1974	1,526		1,526
1975					
Apr. 16	7.426 percent	Dec. 3, 1974	2,251		2,251
June 17	7.520 percent	Dec. 5, 1974	1,256		1,256
	Total tax anticipation bills		5,033		5,033
	Other:				
Mar. 31	8.049 percent (Federal Financing Bank).	July 30, 1974	1,501		1,501
June 19	7.933 percent (227-day)	Nov. 4, 1974	1,501		1,501
June 30	9.767 percent (299-day)	Sept. 4, 1974	2,003		2,003
	Total other bills		5,005		5,005
	Total securities		30,821	14,141	44,962

The market was nervous in front of the auction in the face of action by the Federal Reserve to reduce the growth of the monetary aggregates within their previously specified limits. Prices of securities retreated enough that the auction received $5.4 billion in tenders, and the notes were sold with a 7¾ percent coupon, at an average yield of 7.83 percent.

Federal Financing Bank

The Federal Financing Bank (FFB) was created December 29, 1973, to assure the coordination of Federal and federally assisted borrowings from the public and to assure that such borrowings are financed in a manner least disruptive of private financial markets and institutions.

The bank has become the vehicle through which most Federal agencies finance their programs involving the sale or placement of credit market instruments, including agency securities, guaranteed obligations, participation agreements, and the sale of assets. The major exceptions to date are the title XI ship mortgage bonds, the federally guaranteed tax-exempt housing and urban renewal notes and bonds, and the Government National Mortgage Association asset sales.

During fiscal 1975, the FFB made approximately 150 loans and advances totaling $15.8 billion to Federal agencies and federally guaranteed borrowers. In the absence of the bank, the majority of borrowers would have issued their obligations in the market at a cost significantly higher than that charged by the FFB.

At the first meeting of the Board of Directors of the bank on May 23, 1974, the Board approved a policy of borrowing from the Treasury Department on an interim basis. These borrowings were to be periodically repaid by the sale of FFB securities in the market. On July 23, 1974, the bank auctioned $1.5 billion of 244-day Federal Financing Bank bills dated July 30, which matured on March 31, 1975. The cost of this borrowing by the FFB was somewhat greater than the cost to the Treasury of similar borrowings. Therefore, it was decided by the Board of Directors on June 5, 1975, that rather than using the Treasury as an interim lender and the market as a permanent source of funds, the bank would borrow all funds from the Treasury Department matching the terms and conditions of its borrowings from the Treasury with the terms and conditions of its loans. The bank is currently lending funds at a rate 1/8 of one percent above the new issue rate of marketable U.S. Treasury securities of similar terms and conditions.

Federal Financing Bank loans outstanding

[In millions of dollars]

Borrower	Loans outstanding
Farmers Home Administration	5,000.0
General Services Administration	45.2
Department of Defense—foreign military sales	111.6
Department of Health, Education, and Welfare (medical facilities loan program)	62.1
Department of Housing and Urban Development (New Communities Administration)	21.0
Export-Import Bank of the United States	4,049.4
National Railroad Passenger Corporation (Amtrak)	317.5
Overseas Private Investment Corporation	5.5
Postal Service	1,500.0
Rural Electrification Administration	254.7
Small business investment companies	47.5
Student Loan Marketing Association	240.0
Tennessee Valley Authority	1,435.0
U.S. Railway Association	33.9
Washington Metropolitan Area Transit Authority (WMATA)	177.0
Total	13,300.4

OFFICE OF THE GENERAL COUNSEL

The General Counsel, the chief law officer of the Department, is appointed by the President, by and with the advice and consent of the Senate, pursuant to an act of Congress approved May 10, 1934. The

General Counsel supervises the Legal Division and has responsibility for all legal work in the Department. The principal and most important role of the General Counsel is to serve as a senior legal and policy adviser to the Secretary and other senior Treasury officials. As legal adviser to the Secretary, the activities include consideration of legal problems relating to broad policy aspects of management of the public debt, administration of internal revenue and tariff laws, international cooperation in the monetary and financial fields, law enforcement affairs, and similar activities.

Activities related to legal matters arising in connection with duties and functions of Treasury operations include responsibility for: General legal advice wherever needed, Treasury litigation, preparing the Department's legislative program and comments to Congress on pending legislation, reviewing the Department's regulations for legal sufficiency, and counseling the Department on conflict of interest and ethical matters. The General Counsel also has the responsibility for hearing appeals to the Secretary from certain decisions of bureau heads or other officials.

All legal counsels of the Department and their staffs are part of the Legal Division. The Chief Counsel for the Internal Revenue Service, Tax Legislative Counsel, and the Chief Counsel for the Comptroller of the Currency report directly to the General Counsel. Chief Counsels and individual attorneys of other bureaus report to him through an Assistant General Counsel and the Deputy General Counsel. In addition, the General Counsel supervises the Office of the Director of Practice.

Reorganization

To improve service to client bureaus and offices, the General Counsel reorganized the Legal Division in January 1975. The General Counsel issued and published a series of orders delegating authority to the Deputy General Counsel, the Assistant General Counsels, and the Chief Counsels. In these orders the responsibilities of Assistant General Counsels were redefined and the reporting requirements for the Chief Counsels and Legal Counsels of operating bureaus were made definite. The responsibilities of Assistant General Counsels are defined so that each organizational unit within the Office of the Secretary has a specific Assistant General Counsel assigned to provide the unit with legal services. The Tax Legislative Counsel was designated an Assistant General Counsel.

Legislation

During fiscal 1975, the Legal Division participated in the drafting of a number of legislative proposals. Among the more significant were:

The Office of the General Counsel in collaboration with other interested Federal agencies prepared the proposed Financial Institutions Act of 1975, which is designed to reform and strengthen the financial system to provide more competitive and efficient service to the public.[1] The proposal was introduced in the 94th Congress as S. 1267, H.R. 5291, H.R. 5618, and H.R. 5619.

The Office of Chief Counsel of the Office of Revenue Sharing and attorneys in the immediate office of the General Counsel drafted proposed legislation to extend the State and Local Fiscal Assistance Act of 1972, which was submitted to the Congress by the President and introduced in the 94th Congress as S. 1625, H.R. 6558, H.R. 8244, H.R. 8245, and H.R. 8246.

The Office of Chief Counsel of Customs participated in drafting the proposed Customs Modernization Act of 1975, which was transmitted to the Senate and the House in May 1975.

The Office of the Assistant General Counsel for International Affairs participated in drafting a number of bills affecting international financial relations. They include the Financial Support Fund Act, introduced as S. 1907 and H.R. 8175; a bill to provide for the participation of the United States in the African Development Fund, introduced as S. 1512, H.R. 6241, H.R. 6937, and H.R. 8033; and a bill to provide for the entry of nonregional countries, and the Bahamas and Guyana, into the Inter-American Development Bank.

Opinions

In addition to the many routine legal opinions given by the General Counsel and other Legal Division officials in the day-to-day transactions of the Department's business, the General Counsel, from time to time, issues formal opinions on significant legal issues.

In one such opinion the General Counsel took the position that payments under the revenue sharing law to recipient State and local governments do not provide a basis for application of the Hatch Act because such payments should not be considered grants. This view was affirmed in an opinion by the Assistant Attorney General, Office of Legal Counsel, in a memorandum to the General Counsel dated April 28, 1975.

Another opinion involved preliminary procedures leading toward issuance of Presidential Proclamation 4341 in February 1975, which imposed a $1-per-barrel tax upon imported petroleum. The General Counsel concluded that the Secretary had discretion to dispense with public hearings before reporting to the President his determination of the effect on the national security of the importation of petroleum, if the Secretary decided such hearings were unnecessary.

[1] See exhibits 10 and 12.

Litigation

The Legal Division is responsible for formulating the Department's position on litigation involving Treasury activities and for working with the Department of Justice in the preparation of litigation reports, pleadings, trial and appellate briefs and assisting in trying all cases in which the Department is involved. There are many thousands of individual cases arising out of Treasury activities pending in the U.S. Customs Court, the U.S. Tax Court, and other Federal courts. Only a few of the more significant cases can be mentioned here.

In *Sparrow et al.* v. *Goodman et al.* the Director of the Secret Service and 10 agents, along with other defendants, were sued because of certain actions allegedly taken in connection with a Presidential visit to Charlotte, N.C. In May of 1975, after many months of pretrial activity and a trial lasting 2 weeks, the case against the Director and the Secret Service agents was dismissed with the plaintiffs' agreement.

In *Robinson* v. *Simon* the District Court for the District of Columbia issued an injunction in December 1974 prohibiting the payment of revenue sharing funds to the city of Chicago on the basis of a preliminary finding that the city's police department was not in compliance with the nondiscrimination provisions of the revenue sharing law. In January 1975, the case was transferred to the district court in Chicago for a trial on the substantive issues. The injunction against the Department remained in effect.

In *Yoshida* v. *United States* the U.S. Customs Court held that Presidential Proclamation 4074, which imposed a 10-percent additional duty on most imported articles, was invalid because it exceeded the authority delegated to the President. The Government's appeal was argued on June 2, 1975, before the U.S. Court of Customs and Patent Appeals.

In February 1975, the District Court for the District of Columbia denied a motion for preliminary injunction requested by several Northeastern States to prohibit the implementation of Proclamation 4341, which imposed certain additional taxes on imported petroleum and petroleum products. This decision permitted the President to go forward expeditiously with his energy conservation program.

What may be a significant trend in customs litigation developed during the year. Domestic manufacturing interests sought injunctive and other relief in several district courts in certain customs matters, principally in four cases involving the countervailing duty and antidumping fields. The Government took the position that the statute vesting "exclusive jurisdiction" in the U.S. Customs Court barred these actions in the district courts. That position was rejected in these cases and the Government has appealed the one case which was not mooted by passage of the Trade Act of 1974.

Regulations

In November 1974, amendments to the Freedom of Information Act (Public Law 93–502) were enacted which, among other things, required executive departments to provide a single set of general rules governing access to information in its constituent units. The Office of the General Counsel had the responsibility for preparing the Treasury-wide regulations. Treasury operating bureaus revised their disclosure regulations, supplementing the general departmental issuance. On February 18, 1975, the Treasury regulations became effective and included detailed procedures for submitting requests for information, appeal procedures if a request is denied in whole or in part, and standardized fees for records searches.

The Office has responsibility for preparing proposed regulations to implement the Privacy Act of 1974. The proposed regulations will identify systems of records on individuals and proposed procedures for access and correction of such records by the individuals.

The Office of the Chief Counsel, Alcohol, Tobacco and Firearms, assisted in drafting two notices of proposed rule making issued by ATF which would have broad impact and have received widespread publicity. One would require that alcoholic beverage labels include information on the ingredients of the beverage; the other would standardize beverage container sizes on the basis of metric measurements.

Privacy Committee

In July 1974, the Deputy General Counsel represented the Secretary at the first formal meeting of the Domestic Council Committee on the Right of Privacy. Of particular interest is the fact that the Deputy General Counsel was the only non-Presidential appointee to attend as a departmental representative at this Cabinet-level meeting. The Treasury's Privacy Committee, on which all constituent units of the Department are represented, worked during the year on several Committee projects dealing with the right of privacy of individuals and freedom of information.

ENFORCEMENT, OPERATIONS, AND TARIFF AFFAIRS

Six operating bureaus of the Department of the Treasury are supervised by the Assistant Secretary (Enforcement, Operations, and Tariff Affairs), who is assisted by three deputies and three staff offices (Offices of Law Enforcement, Operations, and Tariff Affairs). The bureaus are Customs Service, Engraving and Printing, Mint, Secret Service, Consolidated Federal Law Enforcement Training Center, and Alcohol, Tobacco and Firearms. The policies and operations of the Office of

Foreign Assets Control are also directed by the Assistant Secretary, and the enforcement aspects of the responsibilities of the Internal Revenue Service receive his review and coordination. In addition, the Assistant Secretary acts as the principal adviser to the Secretary on all law enforcement matters under the jurisdiction of the Treasury.

Law Enforcement and Operations

The Deputy Assistant Secretary (Operations), with the assistance of the Director, Office of Operations, exercised general line supervision, as delegated, over all bureau activities, with special attention to cost-effective design and execution of programs, assignment of appropriate resources, efficiency of management, coordination of programs within Treasury and with other departments, review of senior personnel appointments, and monitoring of management information reports.

The Deputy Assistant Secretary (Enforcement) continued the ongoing development and review of the policies and programs of Treasury law enforcement activities. Particular attention was directed to improved management; development of new strategic concepts; coordination among bureaus; coordination of Treasury's contributions to interdepartmental law enforcement efforts; and interaction of programs and strategy with other departments, agencies, and governments. Special concern was focused on the numerous legislative proposals related to gun control, privacy, information systems, and intelligence activities. The oversight by this office encompassed the enforcement activities of the Secret Service, the Bureau of Alcohol, Tobacco and Firearms, the Consolidated Federal Law Enforcement Training Center, and the Interpol National Central Bureau.

Antinarcotics program

Treasury continued a high level of antinarcotics activities. The Department participated in activities of the Cabinet Committee on International Narcotics Control, evaluating the cost-effectiveness of foreign assistance programs and stressing the leverage of customs-to-customs programs which trained over 1,300 foreign customs officials in 40 countries to enhance their own border control and revenue collection capabilities.

Customs Service seizures of narcotics at U.S. ports and borders exceeded those of all other Federal agencies, with over 21,000 seizures representing a "street value" of over $678 million. Customs mobile tactical interdiction units, located in strategic areas, continued to make heavy inroads on narcotics-smuggling activity from Mexico, the present major source of narcotics destined for the United States. A record seizure of 37,785 pounds of marijuana was made in Arizona in September 1974, with the arrest of four persons. Detector dog teams, increased to 105, compiled an impressive drug detection record.

The Internal Revenue Service continued the narcotics trafficker program, which has achieved significant results against narcotics traffickers known or suspected to be in violation of Federal income tax laws.

Cargo security program

In furtherance of Executive Order 11836 of January 29, 1975, Treasury continued its collaboration with the Department of Transportation, other departments and agencies, and the transportation industry in suppressing theft of cargo. The Customs Service, with its unique physical presence of Federal officers at all points where international cargo arrives and is stored awaiting clearance, extended and intensified its cargo security program. Customs surveys of terminal and transport deficiencies resulted in expenditures by industry for improvements in security measures of over $9 million.

Customs closed nearly 1,300 cargo theft cases, with 232 arrests and seizures valued at approximately $1 million.

Mint

In September 1974, an audit team formed from various bureaus and GAO examined the gold stored at the U.S. Bullion Depository, Fort Knox, Ky., and reported that their inventory agreed with the Depository's records. In the same month an extraordinary event took place at the Fort Knox Depository when a congressional delegation and over 100 news media representatives visited the gold vaults to view the U.S. gold reserves there.

The Mint deposited $668.2 million into the general fund of the Treasury, principally from seigniorage. Over 13 billion domestic coins were produced in fiscal 1975, exceeding the previous year by nearly 3 billion.

During the last half of the fiscal year the Mint produced over 250 million of the newly designed Bicentennial dollar, 50-cent, and 25-cent coins to be distributed after July 4, 1975.

Productivity was improved by acquisition of 12 four-strike coin presses and 4 improved upset mills, and implementation of a standard coinage die and coin press tooling program.

Engraving and printing

Through a unique lease-purchase financing arrangement, without contingent termination liability, the Bureau of Engraving and Printing let contracts for six high-speed intaglio printing presses and six currency overprinting and processing machines. Estimated annual savings in currency production costs from complete utilization of this equipment is $3 million.

The Bureau also began installation of two modern web presses and a sheet-fed offset press for printing multicolor postage stamps and acquired equipment for completely mechanizing the manufacture of stamps in book form.

The Bureau installed shredding and baling equipment for processing mutilated currency and recycling it to the paper manufacturer, eliminating an incinerator which caused unacceptable air pollution.

During fiscal 1975, 616,040 visitors took the tour of engraving and printing operations.

Customs services

The Customs Service collected a record $4.5 billion in duties and taxes, processed over $100 billion worth of imported goods, and cleared 246 million arriving persons, 75 million vehicles, 353,000 aircraft, and 123,000 vessels.

Customs placed special emphasis on an expanded program of fraud investigation, which produced a 42-percent increase in revenue recoveries and penalties, the detection of false manifesting of containerized cargo, the development of high-security seals for in-bound shipments, advancement of its automated merchandise processing system, and its major role in the international programs of the Customs Cooperation Council and in bringing into force on June 13, 1975, the American-German Mutual Customs Assistance Agreement.

Treasury transmitted to Congress in May 1975 a Customs modernization and simplification bill which would eliminate many archaic provisions of the customs laws and enable Customs to adopt modern business methods in processing persons and merchandise.

Customs completed the consolidation of all of its headquarters elements into one permanent Federal building at 1301 Constitution Avenue, NW. The Customs National Training Center was relocated from Hofstra University in New York to the Georgetown area of Washington, D.C., and renamed the "U.S. Customs Service Academy."

Protective responsibilities

During fiscal 1975, the Secret Service provided protection for President Ford, Mrs. Ford, and their four children; Vice President Rockefeller, Mrs. Rockefeller, and Nelson, Jr.; former President Nixon; John F. Kennedy, Jr.; and former First Ladies, Mrs. Truman, Mrs. Eisenhower, Mrs. Johnson, and Mrs. Nixon.

The Secret Service also had the responsibility of protecting Secretary of State Kissinger (on a reimbursable basis); Secretary Simon; and House Speaker Carl Albert during the period Vice President Rockefeller was being selected and confirmed. In addition, the Secret Service protected 132 visiting foreign dignitaries.

On December 27, 1974, President Ford signed Public Law 93–552, amending 18 U.S.C. 3056, to authorize protection by the Secret Service of members of the immediate family of the Vice President, unless declined. In addition, this bill designated the former residence of the Chief of Naval Operations, located on the grounds of the U.S. Naval Observatory, as the temporary residence of the Vice President.

The Executive Protective Service provided protection for the White House, buildings having Presidential offices, and 127 foreign diplomatic missions located at 300 locations in the metropolitan area of the District of Columbia. Protection was afforded at Presidential directive on a case-by-case basis for foreign diplomatic missions located in other areas of the United States.

Treasury enforcement communications system (TECS)

The Treasury enforcement communications system provided direct communication capability between the constituent Treasury law enforcement groups, which include the U.S. Customs Service, the Bureau of Alcohol, Tobacco and Firearms, and the Intelligence and Security Divisions of the Internal Revenue Service. In addition to having access to the commonly indexed Treasury law enforcement information, other necessary law enforcement information was available through the FBI National Crime Information Center and through interface with the national law enforcement teletype system.

Inquiries processed through TECS furnished 21,232 pieces of positive information, which resulted in 717 arrests.

The speed with which millions of TECS transactions were processed was enhanced during fiscal 1975 by the installation, testing, and acceptance of a new B7700 computer and other modern hardware components. The new equipment not only permitted the addition of more terminals consonant with the expanding workload, but also provided a response time approximately eight times faster. One hundred new terminals brought the total on line to over 500.

Counterfeiting

Counterfeiters in fiscal 1975 produced approximately $48 million in counterfeit U.S. currency, up 127 percent from fiscal 1974.

While fiscal 1975 losses to the public rose to $3.6 million, from $2.4 million in fiscal 1974 (up 49 percent), the Secret Service seized over $45 million of the counterfeiters' total output before it reached victims.

Organized crime

Treasury agencies continued their major role in the Federal Government's joint strike force program, which is coordinated by representatives of the Department of Justice, in 17 major cities throughout the United States. The IRS and other Treasury bureaus account for almost half of the manpower involved and a large number of the convictions obtained.

In addition, Treasury took action against organized crime through: The antinarcotics border interdiction activities of Customs; the IRS narcotics trafficker program; actions against major counterfeiting and bond forgery operations by the Secret Service; the cargo security program of Customs; and the attack on armed and dangerous offenders, Project Identification (to trace weapons used in crimes), and the suppression of illegal use of firearms and explosives by the Bureau of Alcohol, Tobacco and Firearms.

Anti-terrorism

As a member of the Cabinet Committee to Combat Terrorism, the Treasury, through the Office of the Secretary, participated in the President's continuing program to thwart international terrorism. Contributing to the development and review of emergency procedures for dealing with terrorist incidents were the U.S. Secret Service, the U.S. Customs Service, and the Bureau of Alcohol, Tobacco and Firearms.

Financial recordkeeping

The Assistant Secretary (Enforcement, Operations, and Tariff Affairs) administers Treasury's Financial Recordkeeping and Reporting Regulations, which were issued in 1972 as part 103, 31 CFR. The regulations require banks and other financial institutions to maintain basic records needed for the investigation of many tax, regulatory, and criminal matters. In addition to the recordkeeping, the regulations also require reports of the ownership of foreign bank accounts by all U.S. persons, reports of unusual domestic currency transactions, and reports of the international transportation of monetary instruments. The regulations implement Public Law 91–508.

Several Federal agencies have been delegated responsibility for assuring compliance with the regulations under the general oversight of the Assistant Secretary. In addition to the Federal bank supervisory agencies, the Securities and Exchange Commission, the Federal Home Loan Bank Board, the National Credit Union Administration, the Internal Revenue Service, and the U.S. Customs Service have enforcement responsibilities.

During fiscal 1975, 15,000 banks, 10,000 credit unions, and 3,500 savings and loans were examined for compliance with the regulations. Twenty thousand reports of large currency transactions were filed with the Internal Revenue Service and 30,000 reports of the international transportation of monetary instruments were filed with the U.S. Customs Service.

Firearms and explosives control programs

The Gun Control Act of 1968 provides the basis for programs of the Bureau of Alcohol, Tobacco and Firearms (ATF) aimed at preventing the illegal possession and use of firearms by criminals and would-be criminals. ATF special agents also provided assistance to State and local law enforcement groups in their fight against crime and violence.

In discharging its responsibilities under title XI of the Organized Crime Control Act of 1970, which regulates explosives, ATF concentrated on curbing the acquisition and misuse of explosives by criminals. Most criminal investigations within this program involved actual or attempted bombings followed by investigations of the thefts of explosives.

Under the provisions of the National Firearms Act, certain types of firearms, including machineguns, sawed-off shotguns, and silencers, have been subject to Federal registration since 1934. Certain other weapons, including destructive devices, are also subject to registration.

ATF maintained the National Firearms Registration and Transfer Record, which is the control file for these weapons. Persons found in possession of unregistered weapons were prosecuted.

The National Firearms Tracing Center traces firearms from the manufacturer or the importer through the wholesaler and the retailer to the purchaser at the first retail level sale. During fiscal 1975, 34,622 traces were requested, 53 percent (or 18,476 traces) by State or local agencies.

Project I (for "identification") was launched in 1973 to determine the sources of guns used in crimes in selected metropolitan areas and to develop nationwide flow patterns of types of handguns used in criminal activities. During fiscal 1975, the third phase of the project was completed. Statistical analysis showed that, of 2,452 weapons traced, 29 percent were in the cheaply made "Saturday Night Special" category. Approximately 30 percent of all crime guns were purchased in a State other than the one in which they were used.

The interstate firearms theft program, initiated during fiscal 1974, was designed to eliminate theft from firearm shipments as a source of weapons for criminal elements. During fiscal 1975, 687 reports of lost or stolen firearms were received, reflecting losses of an aggregate of approximately 3,500 weapons. Of this total, approximately 110 weapons were recovered by special agents and 13 criminal cases were developed against 27 individuals. Loss reports fell from an average of 75 per month to 57 per month.

The international traffic in arms program was initiated to cope with the continuing illegal international gunrunning activities which originate within the United States. Firearms, ammunition, and explosives illegally exported frequently are acquired within the United States in direct violation of the Gun Control Act of 1968 and title XI of the Organized Crime Control Act of 1970. Utilizing licensing and inspection authority, ATF sought to curtail this illegal acquisition and exportation.

Explosives investigations continued to receive high priority during fiscal 1975, due to the potential threat to public safety. During this year ATF prepared for prosecution 139 cases relating to explosives violations and arrested 182 individuals. Special agents seized 61,711 pounds of explosives and 516 destructive devices.

During fiscal 1975, ATF significantly increased compliance inspections of dealers in firearms and explosives.

On June 19, 1975, President Ford included in his message on crime to Congress an order for ATF to expand its investigative efforts in the 10 largest metropolitan areas. The President directed that ATF employ and train an additional 500 investigators for this priority effort.

Interpol

In fiscal 1975 assistance by the U.S. National Central Bureau of the International Criminal Police Organization (Interpol) to local, State, and Federal law enforcement agencies in the United States and to foreign law enforcement agencies in handling criminal investigations continued to increase. This was primarily the result of expanded efforts by the Bureau to publicize the assistance Interpol can provide. The increased workload necessitated assignment of an additional special agent and an additional clerical employee.

On January 1, 1975, the Bureau commenced full utilization of TECS. Since Interpol in the United States neither initiates investigations nor presents criminal cases for prosecutions, it is important that information received concerning international crime be disseminated to the appropriate U.S. law enforcement agencies as soon as possible. The use of TECS makes this information more readily and rapidly accessible.

During the fiscal year, the United States made a one-time, nonrecurring, voluntary contribution of $135,000 to Interpol from foreign assistance funds for international narcotics control administered by the Department of State. The funds are being used to establish and support one Interpol liaison officer in the Far East and one in South America. Their mission is to assist in international coordination of drug enforcement operations. This same program has operated in Europe for several years; because of its success, the number of Interpol liaison officers in Europe was increased from three to five.

In September 1974, Treasury led the U.S. delegation to the 43d Interpol General Assembly in Cannes, France. The General Assembly adopted substantive resolutions on privacy of information, safeguarding of international civil aviation, cooperation with immigration departments, traffic in heroin, cocaine, cannabis and its derivatives, and exchange of information internationally with regard to firearms, explosives, and ammunition purchased by aliens.

During the General Assembly, Director H. Stuart Knight, U.S. Secret Service, was elected to the Executive Committee of Interpol as a representative from the Americas.

Treasury also participated in Interpol symposiums on fraud, illicit traffic in stolen motor vehicles, taking of hostages, illegal narcotics, the Caribbean Conference, and the Manila Conference.

On May 30, 1975, the U.S. National Central Bureau was awarded the Presidential Management Improvement Certificate "For Excellence in Improvement of Government Operations."

Tariff Affairs

The Office of Tariff Affairs directs the administration of the Antidumping Act and countervailing duty law. These statutes serve as remedies for domestic industries against the unfair trade practices of their foreign competitors. The office sets policies and reviews the actions of the Customs Service under these statutes as well as under other tariff and customs laws in general.

In addition, the office has responsibility for conducting investigations and making recommendations with respect to the effects of imported articles on the national security, pursuant to section 232 of the Trade Expansion Act of 1962.

The activity of the office in administering the countervailing duty law has dramatically increased in the past year. While in previous years actions were taken in only a handful of cases, during the week of June 30, 1975, alone, Treasury issued 15 preliminary determinations. This increased activity is attributable principally to amendments to the statute made by the Trade Act of 1974 coupled with renewed efforts to administer the law in a manner consistent with the legislative intent.[1]

During fiscal 1975, Treasury issued five final countervailing duty decisions. In three, countervailing duties were imposed: Nonrubber footwear from Spain, nonrubber footwear from Brazil, and bottled olives from Spain. In the case of cut flowers from Colombia, there was a negative decision based on the elimination of the subsidy. In the

[1] See exhibit 26.

case of dairy products from European Community countries, there was an affirmative determination coupled with a temporary waiver of some duties and discontinuance of some subsidies. During the same period, a total of 32 investigations were initiated, of which 13 were subsequently terminated, principally because the petitioner withdrew the complaint. Preliminary determinations were reached on 18 cases, 10 affirmative and 8 negative.

Only 10 antidumping cases were begun in fiscal 1975. This compares with 27 initiations in fiscal 1973 and 10 in fiscal 1974. The Trade Act of 1974 made several significant changes to the Antidumping Act.[1]

In January 1975, an investigation of the effect of petroleum imports on the national security was conducted pursuant to section 232 of the Trade Expansion Act of 1962, as amended. This resulted in a report by Assistant Secretary David R. Macdonald that the national security was threatened by the magnitude and circumstances of the importations of crude oil and petroleum products, and a subsequent recommendation by Secretary Simon to the President that action be taken to reduce such importations.[2]

TAX POLICY

Legislation

During fiscal 1975, the administration's immediate efforts in the area of tax legislation were focused on the alleviation of inflation, recession, and unemployment; and on the shortage and rising costs of energy. Attention was also given to the problems associated with tax reform and the equity of the Federal tax system.

Tax reform.—By November 1974, the House Ways and Means Committee had completed a detailed examination of the Federal tax system and had reached tentative decisions about changes in various tax provisions with a view toward producing a comprehensive tax reform bill. This examination had begun with the presentation of the Treasury's tax reform proposals on April 30, 1973. The committee's tentative decisions covered a wide area including elimination of many itemized deductions for individuals and allowance of a simplification deduction; an increase in the standard deduction; substitution of a new minimum tax for the present minimum tax on income from items of tax preference; limitation of deductions for artificial accounting losses; changes in the taxation of capital gains including the reduction of tax on gains from property held over 5 years, the elimination of the alternative tax for individuals, an increase in the length of the holding period necessary to qualify for long-term capital gains treat-

[1] See exhibit 27.
[2] See exhibit 25.

ment, and an increase in the amount of capital losses that may be deducted against ordinary income; increasing the investment credit for public utilities; phasing out the percentage depletion allowance for domestic oil and gas products; tightening the tax treatment of foreign source income; imposing a windfall profits tax on domestic oil and gas production; and many other provisions.

Due to the lack of time remaining in the 93d Congress for consideration of a major tax bill, the Ways and Means Committee decided not to report the comprehensive bill. Instead, Ways and Means reported out a more limited bill, H.R. 17488, action on which it believed was still possible by the Congress. The main features of H.R. 17488 provided for a windfall profits tax on, and the phaseout of percentage depletion for, oil and gas production; extension of certain special 5-year amortization provisions; increases in the percentage standard deduction and in the minimum and maximum amounts of the standard deduction; an increase in the investment credit for public utilities; changes in the taxation of political organizations; and changes in the tax treatment of foreign source income, including a phaseout of the earned income exclusion and an end to the per country limitation for the foreign tax credit. The full House of Representatives, however, did not take any action on H.R. 17488 before the conclusion of the 93d Congress.

On April 1, 1975, the Treasury released a paper showing that the U.S. ranking in investment and in real economic growth is among the lowest of industrialized countries. On May 7, 1975,[1] Secretary Simon reiterated before the Senate Finance Committee the antisaving, anti-investment bias of our tax system, pointing out the definite tilt toward personal and corporate income taxes in the United States reflecting our preference for immediate consumption over savings and future investments. He stressed that the future requirements for capital investment, estimated at over $4 trillion through 1985, indicate that tax policies should be revamped. It was announced that in anticipation of a joint review with the Congress in the coming months of possible tax reform initiatives, the question of the two-tier system of corporate taxation, in which income is taxed once at the corporate level and again at the shareholder level, is under study. It was pointed out that our system of taxation bears more heavily on corporations than do the tax systems of almost every other major industrial nation. Through a variety of mechanisms, other major countries have largely eliminated the classical two-tiered system of corporate taxation by integrating the corporate and individual income taxes. It was announced that a Treasury-Joint Committee on Internal Revenue Taxation study of

[1] See exhibit 20.

integrating the corporate and personal income taxes will be ready for congressional consideration after August.

Early in 1975, the Ways and Means Committee was concerned with the immediate problems of a recession-related tax reduction and with the energy crisis. However, as fiscal 1975 drew to a close, the committee announced its intention to begin consideration of tax reform legislation.

Inflation, unemployment, recession measures.—In a message to the Congress on October 8, 1974, the President proposed a 5-percent surcharge on individual and corporate income taxes for 1975 in order to help control inflation and to pay for unemployment and other spending programs necessary to cushion the economic decline. While the surtax was to apply to all corporate income tax, it was only to apply to individual income taxes on incomes of over $15,000 for married couples and $7,500 for single taxpayers. The message also endorsed tax relief for lower income persons, mainly through the increase in the minimum amount of the standard deduction contained in the then-pending tax reform bill.

Included in the Presidential message was a proposal for an increase in, and a permanent restructuring of, the investment tax credit. The credit was to be increased permanently from 7 to 10 percent for all industries, and from 4 to 10 percent for utilities. The proposed changes called for elimination of the limitations based on useful life so that all property with a life in excess of 3 years would qualify for the full credit. The proposal also would have replaced the limit on the maximum credit which may be claimed with eventual full refundability for the excess of credits over tax liability. The purpose of making the credit refundable was to help growing companies with large current investments relative to their current incomes. It would also have helped companies in financial difficulties and small businesses which were more severely affected by the existing restrictions and limitations.[1] The changes also required the adjustment of the depreciation base to make the credit neutral with respect to long-lived and short-lived assets.

To encourage expansion of corporate equity capital and increase the effectiveness of capital markets, it was proposed that dividends paid on qualified preferred stock be allowed as a deduction to the payer corporation.

In the state of the Union message in January 1975, the President proposed a 1-year tax reduction to alleviate the effects of the recession, a temporary increase in the investment credit, the imposition of excise,

[1] See exhibit 30.

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import, and windfall profits taxes on oil and gas, and permanent tax reductions made possible by the revenue from energy-related taxes.[1]

The income tax reduction for individuals would have consisted of a temporary reduction based on 1974 tax liabilities, and a permanent reduction in 1975 and later tax liabilities. The President proposed to make a cash refund of 12 percent of 1974 individual income tax liabilities but not over $1,000. The refund was to be paid in two equal installments in May and September of 1975. The proposed permanent changes in the individual income tax consisted of an increase in the minimum amount of the standard deduction and the alteration of the tax rate tables. The changes were designed to raise the tax-free level of income above the poverty line. Since the permanent tax changes were largely intended to compensate individuals for extra taxes on oil and gas which the President requested in his state of the Union message, a mechanism was needed to assure that nontaxpayers received equivalent relief. The President suggested that every person 18 years of age or older who did not pay any income tax or who did not under the proposal receive at least an $80 reduction in income tax would receive a cash payment from the Treasury of the lesser of $80 or the shortfall from $80 of his actual tax reduction.

Instead of the previously proposed permanent restructuring of the investment tax credit, the state of the Union message recommended a temporary increase in investment tax credit for 1975 only to 12 percent (instead of 10 percent) for all taxpayers including utilities. Utilities would continue to receive a 12-percent credit for 2 additional years for qualified investment in electrical powerplants other than oil- or gas-fired facilities. Also, for utilities, the proposal included a temporary increase in the amount of credit which may be used to offset income in excess of $25,000. Since many utilities have credits they have been unable to use because of this net income limitation, it was proposed to allow utilities to use the credit to offset up to 75 percent of their tax liability for 1975, 70 percent for 1976, 65 percent for 1977 and so on, until 1980 when they would in five annual steps have returned to the 50-percent limitation applicable to industry generally.

The administration also proposed a 1-year reduction in the corporate tax rate from 48 percent to 42 percent. This reduction would have applied only to corporate income in excess of $25,000. Additionally, the October proposal, allowing a preferred stock dividend deduction to increase incentives for raising needed capital in the form of equity rather than debt, was resubmitted in the state of the Union message.

Modifications of the President's proposals for an antirecession tax package were embodied in Public Law 94–12, the Tax Reduction Act

[1] See exhibit 29.

of 1975, approved March 29, 1975. The major provisions of the act include:

A rebate based on 1974 individual income tax liabilities. The rebate was generally 10 percent of tax liability, but the minimum rebate was the lesser of $100 or actual tax liability. The maximum amount of the rebate was $200.

An increase in percentage standard deduction. For 1975 only, the standard deduction was increased from 15 percent to 16 percent of adjusted gross income. The minimum amount of the standard deduction was raised from $1,300 to $1,600 for single taxpayers and $1,900 for married couples. The maximum was raised from $2,000 to $2,300 for single taxpayers and $2,600 for married couples.

A tax credit, for 1975 only, of $30 per exemption (except exemptions for age and blindness).

A new refundable earned income credit, again for 1975 only, of 10 percent of the earned income of an eligible individual up to a maximum of $400. The credit phases down to zero at $8,000 of income. To be eligible, an earner must maintain a household in the United States for a dependent child.

A tax credit for the purchase of a new principal residence during 1975 of 5 percent of the purchase price, with a maximum credit of $2,000. (These provisions were liberalized in Public Law 94-45, approved June 30, 1975.)

New income tax withholding tables, implemented May 1, 1975, reducing withholding in conformity with the Tax Reduction Act of 1975 and increasing take-home pay.

An increase in the investment tax credit to 10 percent for 2 years (instead of 12 percent for 1 year as proposed by the administration).

An increase in the corporate surtax exemption from $25,000 to $50,000 of taxable income for 1975, and a reduction in the tax rate applicable to the first $25,000 from 22 to 20 percent.

A permanent increase in the accumulated earnings tax credit from $100,000 to $150,000.

Extension of the WIN program tax credit, to stimulate employment, to welfare recipients hired off welfare rolls (previously limited to participants in WIN training programs) if employment lasts at least 1 month, and to nonbusiness employees such as domestics.

Elimination generally of percentage depletion for oil and gas production for majors. A small production exemption was provided royalty owners and independents.

Certain changes in the taxation of foreign source income. Various provisions concerning foreign tax haven incomes were strengthened.

The per country limitation for the foreign tax credit for oil and gas income was repealed. A loss recapture rule was adopted which provides that after 1975, foreign oil income will be treated as U.S. source income to the extent of any post-1975 oil-related losses.

Energy tax program.—The state of the Union message reintroduced the windfall profits tax, which has been proposed and supported since 1973, to recover windfall profits resulting from crude oil price decontrol. This was part of a comprehensive energy conservation tax program which the administration asked the Congress to pass, along with an excise tax on all domestic crude oil and on natural gas and an import fee on imported crude oil and products.[1]

Under the proposed windfall profits tax, the base for the depletion allowance would be reduced by the windfall profits tax. The administration, however, recommended against the elimination of percentage depletion on oil because it felt that the best way to capture the windfall profits from domestic oil producers was not through the elimination of percentage depletion but through a windfall profits tax.

The administration's energy tax program also contained a 15-percent tax credit for residential conservation to provide incentives to homeowners for making thermal efficiency improvements such as storm windows and insulation in existing homes, to be applicable to the first $1,000 of expenditures before 1979.

As stated above, the repeal of the percentage depletion allowance for oil and gas producers was enacted into law in the Tax Reduction Act of 1975. The Congress version of the energy tax proposals are contained in H.R. 6860 which at the end of fiscal 1975 had been approved by the House of Representatives and was awaiting Senate action. The major provisions of the bill include:

Import restrictions on oil are embodied in import quotas and in a tariff.

Automobile efficiency standards for the use of gasoline are imposed. These standards are to be enforced by civil penalties.

Excise taxes on radial tires and on buses used in intercity public transportation are repealed.

Tax credits for home insulation and for the installation of solar energy equipment are provided.

Excise taxes on business use of natural gas and oil are to be phased in between 1977 and 1982.

The investment tax credit is denied for new electrical generating equipment burning oil and gas.

[1] See exhibit 31.

On June 13, 1975, the White House released the Labor-Management Committee's recommendations for tax and other measures to increase electric utility construction and output. The proposed measures included an increase in the investment tax credit permanently to 12 percent on all electric utility property except generating facilities fueled by petroleum products; full and immediate credit on progress payments for construction of property that takes 2 years or more to build, except generating facilities fueled by petroleum products; tax deferral for dividends which are reinvested in new issue common stock of electric utility companies; extension of the fast writeoff of pollution control facilities; and other incentive measures.

Pension reform.—Public Law 93–406, the Employee Retirement Income Security Act of 1974, was approved on September 2, 1974. Both the House and the Senate had passed the pension reform bill, H.R. 2, in fiscal 1974, but conference committee action to resolve differences between the House and Senate versions was not completed until August 1974. The pension reform legislation incorporates in revised form the administration's major proposals, made on April 11, 1973, for strengthening the private pension system. The law includes: New standards for participation, vesting, and funding; a new deduction for contributions to individual retirement accounts; portability through rollover; contributions to plans for self-employed individuals; new fiduciary standards; and new reporting and disclosure requirements. It also establishes a Government system of insuring against loss of benefits upon termination of pension plans; establishes limits on contributions and benefits under qualified retirement plans; establishes a declaratory judgment procedure in the Tax Court relating to qualification of retirement plans; and provides for a new Assistant Commissioner of Internal Revenue for Employee Plans and Exempt Organizations.

Public Law 93–406 also contains provisions altering the income taxation of certain lump-sum distributions from qualified retirement and profit-sharing plans. Beginning in 1974, the portion of lump-sum distributions which represents contributions made after 1973 will be taxed as if it were ordinary income received over a 10-year period. However, it will be taxed separately from all other income under the income tax rate schedule for single taxpayers. All qualifying distributions, regardless of whether they are received by employees or by self-employed persons under Keogh Act plans, will be taxed in exactly the same manner.

Social security and railroad retirement.—In his tax message to the Congress on January 15, 1975, the President proposed as one measure to help control inflation that the automatic cost-of-living increases for social security benefits which are normally related to changes in the Consumer Price Index be limited by legislation to 5 percent for 1975. The Congress did not take action, and the cost-of-living adjustment effective in June 1975 provided an 8-percent increase in social security benefits.

Public Law 94–12, the Tax Reduction Act of 1975, provided for a one-time $50 payment to each person who was entitled to social security, railroad retirement, or supplemental security income benefits for March 1975. These payments were made in June 1975.

For 1975, the annual retirement earnings limitation increased from $2,400 to $2,520. For beneficiaries under 72 years of age, benefits are reduced by $1 for every $2 of earnings in excess of $2,520. There is no reduction in benefits for excess earnings for those over age 72.

Unemployment compensation.—The unemployment compensation program is a Federal-State system designed to provide wage loss compensation to workers who are temporarily unemployed. The basic State programs generally provide up to 26 weeks of benefits in a year for covered workers. In times of high unemployment as defined by State or National insured unemployment rates, the law provides for up to 13 additional weeks of "extended benefits."

Public Law 93–572, the Emergency Unemployment Compensation Act of 1974, approved December 31, 1974, provided for an extra 13 weeks of benefits (for a total of 52 weeks) during 1975 and 1976 for workers who had exhausted their eligibility for regular and extended benefits. The law also provided 13 weeks of benefits for persons who were not covered under the regular unemployment compensation program. The conditions under which States could pay extended benefits were also liberalized.

The Tax Reduction Act of 1975 increased the third tier of unemployment benefits provided by the Emergency Unemployment Compensation Act of 1974 from 13 weeks to 26 weeks for unemployment occurring through June 1975. Thus, the act increased the maximum period for which unemployment compensation benefits could be paid from 52 weeks to 65 weeks.

Public Law 94–45, the Emergency Compensation and Special Unemployment Assistance Extension Act of 1975, approved June 30, 1975, extends the 65-week benefit period through December 1975 on a National basis and through March 1977 on a State-by-State basis, if rates of insured unemployment within a State exceed certain levels.

Excise taxes.—Under the terms of previously enacted legislation, the tax on communications services was reduced from 8 percent to 7 percent as of January 1, 1975, the tax of 0.53 cents a pound on sugar manufactured in the United States terminated on July 1, 1975, and a tax of 11 percent on manufacturers' sales of bows and arrows became effective January 1, 1975.

Public Law 93-490, approved October 26, 1974, repealed as of October 27, 1974, the excise tax on filled cheese and the annual occupational tax on manufacturers and dealers. It also increased the amount of carbon dioxide that may be contained in still wines.

Public Law 93-499, approved October 29, 1974, reduced as of December 1, 1974, the excise tax on wagers from 10 percent to 2 percent and increased the annual occupational tax from $50 to $500.

In the President's message to the Congress of November 26, 1974, on budget restraint, he included proposals with respect to user charges for the airways and waterways. The airways proposal involved a tax of $5 or $10 to be paid by aircraft engaged in noncommercial aviation upon departure from an airport having a Federal Aviation Administration control tower. The waterways user charge system combined a $10 lockage fee for pleasure boats with a ton-mile charge for cargo units which would vary with operation and maintenance costs for designated segments of the inland waterways.

The March 17, 1975, message to the Congress of the President transmitting legislation to restructure the airport and airway development programs included a revised user charge proposal for noncommercial aviation. Instead of the previously recommended departure tax, the President proposed to raise the tax on fuel used in noncommercial aviation from 7 to 15 cents a gallon for the period July 1, 1975, through September 30, 1978, and then to reduce it to 10 cents a gallon.

Other legislation.—Public Law 93-499 provides that the decarbonation of trona is to be considered as an ordinary treatment process for purposes of computing the percentage depletion allowance for trona. The effect is to allow percentage depletion on trona based on the value of soda ash extracted from it.

Public Law 93-597, approved January 2, 1975, resolves certain income tax problems of military and civilian prisoners of war and the families of those individuals who were listed as missing in action and who it was subsequently determined had died at an earlier time, particularly with respect to their combat pay exclusion and eligibility to file joint income tax returns.

Public Law 93-625, approved January 3, 1975, contained a series of amendments to the Internal Revenue Code, including a 1-year extension of the 5-year amortization provisions for rehabilitation of low- and moderate-income housing, pollution control facilities, coal mine safety equipment, and railroad rolling stock; taxation of the investment income of political organizations; taxation of gifts of appreciated property to political organizations; increases in the tax deduction or credit for political contributions; and increases in the interest rate the Government collects or pays on tax deficiencies or overpayments.

There were several laws which altered or removed import tariffs from specific classes of merchandise.

Administration, interpretation, and clarification of tax laws

The Department of the Treasury, during fiscal 1975, issued 33 final regulations, 13 temporary regulations, and 31 notices of proposed rule making relating to matters other than alcohol, tobacco, and firearms taxes. In addition, there were 9 final regulations and 15 notices of proposed rule making relating to alcohol, tobacco, and firearms taxes. Seven of the temporary regulations and five of the notices of proposed rule making were issued under the Employee Retirement Income Security Act of 1974. Among the subjects dealt with in these regulations and proposed regulations were: Stock dividends, lump-sum distributions from pension plans, individual retirement accounts, H.R. 10 (Keogh Act) plans, social security taxes, industrial development bonds, alternative capital gains tax, estate and gift tax charitable deductions, charitable deductions of trusts and estates, child care deductions, disability pay, foreign tax credits, and domestic international sales corporations (DISC's).

DISC report

Pursuant to the Revenue Act of 1971, the Treasury submitted to the Congress its second annual report on the operation and effect of the DISC legislation. The report covered fiscal 1973.

Tax treaties

Bilateral income tax treaties with Poland and Iceland were signed on October 8, 1974, and May 7, 1975. Both treaties have been submitted to the Senate for approval. An income tax treaty with Israel was initialed on May 13, 1975, income tax treaties with Kenya, Indonesia, and the Republic of China (Taiwan) are approaching completion, and tax treaty discussions with India have been initiated. Negotiations and technical discussions on income tax treaties were conducted with Canada, the United Kingdom, Botswana, Egypt, Iran, Malaysia, Malta, the Philippines, and Singapore.

Participation in international organizations

Treasury representatives participated in the work of the Committee on Fiscal Affairs of the Organization for Economic Cooperation and Development (OECD). Treasury representatives were members of a number of working parties of the Committee, including the working party on the taxation of multinational corporations.

Treasury representatives attended the annual general assembly of the Inter-American Center of Tax Administrators (CIAT).

TRADE, ENERGY, AND FINANCIAL RESOURCES POLICY COORDINATION

Trade and Raw Materials Policy

Fiscal 1975 was a year of new and complex challenges in the area of international trade—a year marked by extensive consultations and efforts among developed and developing countries, market and nonmarket economies to cooperate in addressing the major issues confronting the international community. The continued strong impact of sharply increased energy prices on the economies of nations worldwide contributed to what appeared to be a sudden surge of new concerns: Balance of payments problems compounded by economic recession, consequent pressures to impose trade or current account restrictions, calls for a new economic order of greater benefit to the developing countries, efforts to form new producer cartels for individual commodities, and—of some concern to the United States in particular and not related to the energy situation—the failure of the U.S.-U.S.S.R. trade agreement to enter into effect due to congressional restraints on the normalization of relations.

The challenge of protectionism, the challenge of the developing countries and of commodity issues, and the challenge of potential setbacks to East-West trade all called for a positive, creative U.S. response consonant with the significance of these problems to national economic interests. During the year the Treasury played an active role in all of these areas, participating constructively in international consultations in an effort to maintain and improve a liberal international trading environment conducive to the more efficient use of natural resources, while recognizing the special needs of the developing countries and the special requirements of trading with nonmarket economy countries.

Response to protectionism

During fiscal 1975, countries with serious balance of payments problems due in large part to the increased price of oil and, increasingly, those with sharply rising domestic unemployment have been under strong pressure to impose trade or current account restrictions to improve their situation. Unfortunately, such actions have an adverse impact on others in the international economic community and run a serious risk of increasing worldwide economic difficulties for all.

The danger of a proliferation of import or other current account restrictions became more acute during the fiscal year as individual developed countries began to adopt restraints. This occurred in spite of the adherence of all OECD (Organization for Economic Cooperation and Development) member countries to a trade pledge, signed in May 1974, to refrain from such restrictions for balance of payments reasons. Several different types of measures became a matter of concern: Import deposit schemes; export inflation insurance programs with a clear subsidy element; tariff, quota, and tariff-quota restrictions on imports ostensibly taken to protect domestic industries from threatened unemployment; and import surcharges introduced for balance of payments or budgetary purposes.

All of these actions potentially violated the spirit if not the letter of the OECD trade pledge, and agreement to renew the pledge was considered vital to avoid a proliferation of restraints for balance of payments or other reasons as countries moved into deepening recession.

In response to these problems, the Treasury improved methods of consultation on restrictive trade or current account measures in the OECD, discussed these issues in the GATT (General Agreement on Tariffs and Trade) Council, and referred certain troublesome issues to specialized groups of the multilateral trade negotiations. In May 1975, the United States and other OECD countries (except Portugal) renewed the trade pledge for a second year, stressing the importance of combating inflation while maintaining a high level of employment and expansion of world trade.

The Trade Act of 1974

Of major significance to longer term efforts to prevent the international community from slipping backwards into protectionism, Treasury worked closely with Congress in developing and securing passage of the Trade Act of 1974, which will enable the United States to join others in the multilateral trade negotiations in negotiating positive improvements in the international trading system through reduced tariff and nontariff barriers and new understandings on other major trade problems.

Under the new legislation, the President has the authority to enter into negotiations to harmonize, reduce, and eliminate existing barriers to trade; he has been given a mandate to revise international trade rules, including the GATT, to assure supply access to raw materials and other products as well as to recognize the right of countries to impose import surcharges to correct balance of payments deficits; and he can impose import surcharges or quotas, if international agreements permit, or lower tariffs or loosen existing quotas to deal with fundamental international payments problems.

The act also recognizes specifically the need to expand trade with nonmarket countries as well as developing countries. In the case of nonmarket economy countries, certain preconditions must be met before most-favored-nation treatment, credits, and guarantees can be extended. As for developing countries, the United States is now in a position to improve trade relations with these countries by providing preferences to them by allowing duty-free treatment for certain of their products.

While recognizing the benefits of liberalized trade, Congress also noted that there will undoubtedly be a period of adjustment for certain U.S. industries and workers. As such, the act loosens the previous stiff requirements for industries which need temporary relief. In addition, a new concept of trade adjustment assistance for communities has been introduced.

Commodities and the developing countries

Through a variety of producer organizations in copper, bauxite, iron ore, rubber, mercury, and bananas, less developed countries (LDC's) have been trying to stabilize commodity prices, assert greater control over their natural resources, and increase their income at the expense of developed country consumers. Thus far, most of producer organizations outside of the Organization of Petroleum Exporting Countries (OPEC) have been ineffective either in increasing consumption of their commodities or in raising their prices. Four members of the International Bauxite Association (Jamaica, Surinam, Haiti, and the Dominican Republic) have increased their revenues by requiring foreign aluminum companies to pay a production tax ranging from 7½ to 10 percent. Two producer associations—the Union of Banana Exporting Countries and the Association of Natural Rubber Producing Countries—have been seriously considering forming international agreements with consumers as a means of achieving the commodity price stability which they have not accomplished by themselves.

Unable to emulate OPEC's success, most LDC's have sought to increase their trade revenues and their influence over the world economic system through diplomatic action in international fora where they have demanded preferential, nondiscriminatory, and nonreciprocal access to foreign markets for their exports; regulation of commodity markets through integrated commodity agreements; indexation of commodity prices to the prices of manufactured goods; and the right to nationalize foreign property without compensation or recourse to international law.

Third World countries have been presenting their demands with increased militancy since Algerian President Boumédiènne proposed and the U.N. General Assembly adopted the "Declaration and Program of Action for a New International Economic Order" in May 1974 at the Sixth U.N. Special Session despite U.S. objections.

Although the United States is investigating means of LDC's ameliorating some of the commodity problems, the United States has opposed the creation of the proposed new international economic order on the grounds that the indexation of commodity prices, the nationalization of property without fair compensation, and the maintenance of artificially high prices through cartel activity would diminish economic growth in both the developing and the developed world. The essentially open trading system, including free markets for commodity trade, has not failed. On the contrary, the efficient allocation of resources made possible by the market system has improved the living standards of all the world's people.

The policy of the United States toward commodity trade has been characterized for many years by a preference for noninterference in the market, combined with a willingness to entertain proposals for commodity arrangements on a case-by-case basis. Treasury officials are now coordinating and participating in an interagency task force review and reexamination of U.S. commodity policy that was called for by the Economic Policy Board on February 25, 1975.

Although the review of U.S. commodity policy has not yet been completed, a number of firm conclusions have already been reached. First, it is believed that cooperative efforts between producers and consumers, developing and developed nations, can yield constructive solutions in stabilizing excessive commodity price fluctuations, strengthening commodity markets, increasing investment in natural resources, and promoting the growth of the less developed world.

Second, while excessive price fluctuations are costly to both consumers and producers, price fluctuations per se are part of the realities of the marketplace, and the functioning of the market should not be distorted in the interest of shortrun price stability. Third, the solution to commodity problems does not lie in establishing high fixed prices and attempting to maintain their value through indexation to the prices of manufactured products. The appropriate solutions will vary depending on the commodity being considered. It is for this reason that the United States has rejected the concept of a broad-scale commodity agreement in favor of a case-by-case approach to the problems of specific commodities. Finally, the study concluded that joint efforts between consumers and producers are the appropriate means, in all cases, of coping with specific commodity problems. Such efforts should be aimed at improving the market-oriented system of commodity trade. Unilateral actions and any generalized system of commodity agreements aimed at fixing prices should be resisted.

On the basis of these conclusions, a number of general action proposals have been formulated. The United States has agreed to an overall review of existing mechanisms aimed at stabilizing the export earnings of developing countries that are exporters of raw materials.

However, since production, consumption, transport, and investment for each commodity differ, the United States has insisted that this review be conducted on a case-by-case basis. In addition, the United States has proposed a strengthening of the compensatory financing facility in the International Monetary Fund as an aid to LDC's experiencing an unexpected shortfall in export earnings, and has proposed an increase in the resources of the World Bank available for resource-related projects in conjunction with private management, skills, and capital. Finally, the United States has been working in the form of the multilateral trade negotiations in Geneva to reach agreement on market access and supply access.

Another area of international concern and discussion has been with the problem of world food security arising from the short supply situation in grains. In the past, world food supplies were assured by the excess grain stocks unilaterally held by the major grain exporters, particularly the United States. However, world stocks are now at unusually low levels. This concern about the precariousness of the basic food supply situation led the United States to propose that the major grain importing and exporting countries negotiate an internationally coordinated system of nationally held grain reserves. Such a system would be designed to offset serious global shortfalls in production. It would also encourage expanded and liberalized trade in grains. Discussions on this subject have taken place in London in the framework of the International Wheat Council and in Geneva in the Sub-Group on Grains of the multilateral trade negotiations.

East-West trade

Progress in the development of U.S. commercial relations with Communist states continued in fiscal 1975, despite the legislative restrictions on the normalization of East-West trade relations contained in title IV of the Trade Act of 1974 and the Export-Import Bank legislation of 1974. The total turnover on U.S. trade with Communist countries in 1974, at $3.3 billion, was over five times the 1971 level, yielding a substantial favorable contribution to U.S. exports, employment, and the balance of payments.

The United States-Romanian trade agreement, the first agreement negotiated under the provisions of the Trade Act of 1974, was signed on April 2, 1975, in Bucharest, and submitted to the Congress for approval.[1] The agreement includes provisions for the extension of most-favored-nation tariff treatment, for business facilitation, for procedures for dispute settlement, for the protection of industrial property rights, and for safeguards against disruption of U.S. markets.

Activities directed towards the further development of the insti-

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[1] See exhibit 35.

tutional framework for the normalization of East-West trade increased during fiscal 1975 and produced significant accomplishments. Secretary Simon, as honorary co-Director, led the U.S. delegation to Moscow for the second meeting of the Board of Directors of the U.S.-U.S.S.R. Trade and Economic Council in October 1974. Assistant Secretary Parsky headed the U.S. delegation to the first meeting of the Working Group of Experts of the Joint U.S.-U.S.S.R. Commercial Commission held in Moscow in February 1975. In April 1975, Secretary Simon, as U.S. Commission Chairman, traveled to Moscow for the fifth session of the Joint U.S.-U.S.S.R. Commercial Commission. Both Governments expressed regret that it had not been possible to bring the 1972 U.S.-U.S.S.R. trade agreement into force and reaffirmed their determination to remove the barriers which currently prevent the full development of trade. Trade legislation enacted during the fiscal year, which restricts the extension of U.S. Government credits and most-favored-nation tariff treatment to the Soviet Union, has impaired the competitive position of U.S. firms relative to foreign competitors during the period when the Soviet Union is negotiating major contracts for the 1976–80 plan.

On March 27, 1975, the President established the East-West Foreign Trade Board as required by title IV of the Trade Act of 1974. The Board, which subsumes the functions of the President's Committee on East-West Trade Policy, is responsible for ensuring that U.S. trade with nonmarket economy countries is conducted in the national interest, with particular regard to the export of vital technology and the extension of credits by Government agencies. Secretary Simon was appointed Chairman of the Board and Assistant Secretary Parsky was designated Executive Secretary.

Multilateral trade negotiations

The multilateral trade negotiations (MTN) provide the opportunity to governments to renew their commitments to a more open world trading system.

Participating in the trade talks are 90 countries accounting for nine-tenths of world trade.

The aims of the negotiations were defined in a meeting of ministers in Tokyo in September 1973 as (a) the expansion and liberalization of world trade and the improvement of the standard of living and welfare of people of the world, and (b) the securing of additional benefits for the international trade of developing countries. The Tokyo Round is more comprehensive and ambitious than previous trade negotiations in that it reaches beyond the traditional negotiating tasks of reducing tariff and nontariff barriers to encompass the institutional and procedural requirements for reform of the trading framework.

Substantive negotiations were initiated in February 1975, marked by a meeting of the intergovernmental Trade Negotiations Committee, which oversees the negotiations.

Negotiations have been structured according to major functional areas—tariffs, nontariff measures, safeguards, and sectors; in addition, groups were established for agriculture and for tropical products. Each of the six groups was charged with organizing a work program for the appropriate negotiating area.

In the tariffs area, a number of proposed tariff formulae have been tabled for discussion and various issues aired. U.S. commitment to a tariff-cutting formula will be possible after public hearings and consultations with the private sector have been completed, which is expected in fiscal 1976.

The nontariff measures group established subgroups on customs matters, quantitative restrictions, standards, and subsidies and countervailing duties.

The agriculture group focused initial attention on procedural matters. Subgroups for grains, dairy products, and meat—all areas of particular importance in world trade—have been established. A major task of U.S. negotiators in the field of agriculture will be to obtain improved market access for U.S. farm products.

Tropical products, an area of particular interest to the developing countries, has been designated as a special and priority area of the negotiations. Work in this area has progressed beyond that of any other group and has proceeded to the traditional item-by-item negotiating process. The developing countries would like to achieve concrete results in this area by the end of calendar 1975.

Work on the sectors approach to negotiations and on safeguards is at the exploratory stage.

A formal group was not established on supply access issues during fiscal 1975, but it is anticipated that these matters will be taken up within the existing structure in conjunction with work on related trade issues. In view of its importance to the United States, close attention will be given to the work being carried out in this area.

Law of the Sea

Treasury continued to participate in the interagency Law of the Sea Task Force and was represented in this year's U.N. Law of the Sea Conference, held from March 17 to May 10 in Geneva, Switzerland. Treasury seeks to assure that any treaty resulting from the conference will protect U.S. economic interests, guarantee U.S. right of access to the oceans' resources, and encourage their efficient development. These resources include fish and other protein sources, the hydrocarbon reserves on the continental shelves and margins, and the manganese nodules located on the deep seabed.

Over 100 developing countries participated in the conference and presented policy positions that clearly reflect their goal to create a new international order for the recovery of the deep seabed minerals. These developing countries called for a strong international organization that would be given broad powers to coordinate seabed production with land-based producers, and determine the conditions under which the deep seabed could be mined. A single negotiating text emerged from the session and reflected many of the objectives of the developing countries; however, it is not a final negotiated text. Another session is scheduled for early spring 1976. Meanwhile Congress is considering legislation that would change international ocean laws by a unilateral as opposed to a multilateral treaty initiative.

Energy Policy

The abrupt end of the era of cheap energy brought about serious problems for the United States and for other consuming nations. The energy crisis has had four separate dimensions: First, the threat to national security from a potential embargo; second, worldwide inflation from rapid escalation in energy prices; third, the threat to the stability of the international financial system from the payments imbalance between OPEC and the oil-consuming countries; and fourth, the threat of recession following from the readjustment required by the energy shortage and the first three factors.

To deal with such grave problems without either disruptive change or government coercion was a major U.S. concern. To reduce the Nation's dependence on oil imports required a reduction of energy demand growth and an increase of domestic supply. To import less, the administration determined that the United States commit more of its labor, capital, and technological resources to producing energy—develop a national program to solve our short- and long-term energy problems. Developing such a program became one of the top national priorities, calling forth the best talents and creative energies of government, private industry, the scientific community, and the public.

The challenge was to establish a program to encourage accelerated development of new supplies and to restrain domestic demand without adversely affecting the economy or causing disruptive social change.

In the analytical process of reaching these goals, the administration explored many alternatives. By a skillful integration of both the energy and economic factors, a national program for improving the diffused economy and developing a long-term energy plan for increased self-sufficiency was formulated.[1]

President's program

In order to wage a simultaneous, three-front campaign against recession, inflation, and energy dependence, the President presented a national energy policy in his January state of the Union message. To support that presentation, Treasury analyzed the "Project Independence Report" and helped select options for national energy policy.

Import tariffs.—To determine the extent and circumstances of our dependency on imported oil, the Treasury conducted an investigation under section 232 of the Trade Expansion Act of 1962, as amended, which determined that oil was being imported in such quantities and under such circumstances as to threaten to impair national security.[2] This finding was the legal basis for the President's decision to raise license fees on imported oil.

Decontrol and windfall profits.—Because a decontrol plan is a key element of the President's program, the Treasury worked closely with the Federal Energy Administration and with the Energy Resources Council to analyze and help develop the President's decontrol plan. Moreover, the Department helped coordinate development of a windfall profits tax schedule with the plan to decontrol "old" oil prices. (Old oil is that produced at pre-1972 production levels.)

Domestic refinery capacity.—Another key area of national energy policy is expanding domestic refinery capacity. Treasury worked on the development of the President's program for refinery expansion, working closely with the Federal Energy Administration to consider those policy elements of the refinery program which could be strengthened to encourage expansion of domestic refinery capacity.

Electric utilities.—The President has emphasized the need for legislation providing tax incentives to alleviate the capital formation problems of electric utilities. The Treasury helped analyze the need for such incentives and prepared supporting testimony which Secretary Simon presented to committees of the Congress.

International energy

International Energy Agency (IEA).—The energy crisis clearly showed the need for international cooperation. The Treasury worked with the Department of State and the Federal Energy Administration to bring about agreement on energy policy among consuming nations. Such agreement resulted in formation of the IEA. Participating countries agreed to a program which includes: (1) An alloca-

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[1] See exhibits 29 and 31.
[2] See exhibit 25.

tion scheme in times of emergency, including emergency reserve and demand restraint obligations; (2) an extensive information system on the international oil market; (3) consultation with oil companies; (4) long-term cooperation on energy; and (5) relations with producer countries and with other consumer nations. The Treasury participates in the followup meetings of the governing board and the standing groups of the IEA.

Financial safety net.—In connection with the international energy program, guidelines were developed for the operation of a $25 billion financial safety net.[1]

Minimum safeguard price.—Another important issue before the IEA is the proposed minimum safeguard price for oil imports. Treasury developed issue papers pertaining to the economic implications of such a plan.

Prepcon.—Senior Treasury officials actively participated in the French-sponsored Producer-Consumer Preparatory Conference Meeting in Paris last April. Although the results were inconclusive, this meeting was a milestone in forging new relations between the consuming nations (IEA) and the producing nations (OPEC).

Canada.—The Treasury staff prepared a briefing for Secretary Simon's visit to Canada, participated with the State Department in discussions on the pipeline treaty, and analyzed the effects of Canada's curtailments of crude oil and natural gas.

Middle East.—The Treasury gave technical assistance to Israel on solving oil storage problems and led an interagency oil discussion group which visited Saudi Arabia, Kuwait, Qatar, and Abu Dhabi.

Bilateral liaison.—To foster an exchange of technical information on such subjects as alternative energy development and national stockpiling, Treasury has maintained bilateral liaison with energy and economic officers representing foreign nations.

Interagency cooperation

Treasury staff has participated in various important interagency task forces and committees.

Synthetic fuels.—Treasury participated in an interagency Task Force on Synthetic Fuels, identifying and analyzing various options for commercial applications. Findings then go to the Energy Resources Council for further consideration and determination of priorities for the national effort.

Geothermal energy.—Treasury staff participated in the meetings of the geothermal coordination and management project.

Natural gas curtailment.—The Treasury serves on the Federal Power Commission Natural Gas Curtailment Task Force, which re-

[1] See exhibits 53, 57, 61, and 62.

views the natural gas supply outlook and develops priorities for supply and curtailments.

Uranium enrichment.—To resolve the question of whether private enterprise should be allowed to process and market enriched uranium, Treasury assisted in a National Security Council study reviewing uranium enrichment policy, which eventually lead to a determination that private industry should enter that area.

Contingency planning.—Emergency planning in the event of disruption of imports is another area where Treasury Staff are meeting with other agencies to develop contingency plans.

Energy Development Bank.—The Treasury worked with other Government agencies to prepare analyses on need for and implications of an Energy Development Bank.

Tankers.—Treasury provided staff support in reviewing issues for the interagency Task Force on Tankers.

Energy resource studies.—The National Science Foundation has received support liaison from Treasury for various resource energy studies, including western coal, oil shale, geothermal steam, and solar.

Transportation.—Treasury participated with other Government agencies on task forces to review and recommend policy on auto emission standards, auto efficiency goals, and auto excise taxes.

Clean Air Act.—To develop the administration's position on amendments to the Clean Air Act, including scrubber technology assessment, Treasury met with officials of various Government agencies.

Recycling.—Treasury met with other agencies to develop a position on waste recycling of energy and nonenergy materials.

Legislation and regulation

The President's legislative proposal for a national energy program created intense and detailed interest by the public and Congress in energy matters. Treasury officials were invited to speak at public hearings and present their views on a wide range of energy issues and energy-related legislation and regulatory policy. The need to respond to congressional inquiries and invitations to testify was particularly pronounced after the 94th Congress convened in January. Many of these issues are ongoing at this time, requiring continuing review by Treasury's staff, who identify and advise on the need for new or changed legislation and reform of regulatory policies dealing with energy-related matters.

Financial Resources Policy Coordination

Middle East financial and investment issues

Investment flows.—During fiscal 1975, it became apparent that the financial accumulations in the hands of the governments of the Middle

Eastern oil-exporting nations, while large, were not likely to reach the very high levels that had been widely predicted earlier. An important factor in this change in projected accumulations was the demonstrated ability of these countries to absorb imports at a much faster rate than had been expected. Import volume has increased by approximately 40 percent since the oil price increases.

During the first half of calendar 1975, the oil-producing countries have further diversified their placement of surplus funds. Investments in the United States by oil-producing countries amounted to $2.25 billion, approximately 9 percent of the total $24 billion accumulation. In 1974, the percentage allocated to investments in the United States was 20 percent, $11 billion of the $60 billion surplus.

Perhaps more important, the pattern of oil producer investments in the United States has also shifted. In 1974, the overwhelming portion of oil producer investments was in short-term Treasury obligations and bank deposits. In 1975, investments in longer term bank securities, Treasury and Federal agency bonds, and corporate stocks and bonds accounted for the major share of total reported OPEC inflows to the United States.

However, such long-term investments in the private sector of the United States remain small relative to the total OPEC surplus and almost negligible compared with the size of the U.S. economy. These investments were estimated to be less than $1 billion in 1974 and were not expected to exceed $3 billion in 1975. Moreover, such investments continue to be of a passive portfolio nature. These countries do not appear to be interested in buying control or participating in the management of U.S. corporations.

Policy review.—During 1975, Treasury led an interagency review of U.S. policy toward inward foreign investment. The review reaffirmed the existing open-door policy toward foreign investment. In addition, the group recommended establishment of a high-level interagency Committee on Foreign Investment in the United States, chaired by the Treasury representative, and the creation of an Office of Foreign Investment in the United States to be located in the Department of Commerce. By Executive order of May 7, 1975, the President adopted these recommendations and the committee and office are now in operation.[1]

Also as a result of the review, the Government is establishing procedures providing for consultation by foreign governmental investors with the U.S. Government on prospective major direct investments in the United States. Such advance consultation will safeguard our essential national interests and will facilitate foreign investment by eliminating uncertainty as to the Government's attitude concerning

[1] See exhibits 67 and 68.

specific proposals. The administration has initiated discussions relating to consultations with each of the potentially significant governmental investors in the Middle East.

IEA activities.—Early this year, the Governing Board of the International Energy Agency established an Ad Hoc Group on Financial and Investment Issues, chaired by Assistant Secretary Parsky, to deal with financial issues relating to the dialog between the oil-consuming and oil-producing nations. This group is drawing upon the work of other international organizations (in which Treasury also participates) in developing common consumer nation positions on the financial and investment issues that may arise in the consumer-producer dialog. Among the issues the group is addressing are (1) the policies of OECD member countries toward oil producer country investments; (2) the indexation of oil prices; and (3) development cooperation between the industrialized and the producer countries.

Governmental involvement in capital markets [1]

Fiscal 1975 saw U.S. capital markets buffeted by the twin problems of inflation and recession. The high rate of inflation has weakened the financial condition of U.S. firms and, as measured in real terms, has reduced the profitability of U.S. industry. As a consequence, some U.S. firms are facing great difficulties in raising new capital. Moreover, new capital needs in the energy sector and elsewhere will call for substantially greater rates of investment over the next decade.

Tax reform is at the top of the list of necessary measures. In addition, however, other Federal actions and policies substantially influence the health of our capital markets and the financial intermediaries which participate therein. As part of the administration's effort to meet the challenge presented by the state of the U.S. capital markets, Treasury has organized an interagency Capital Markets Working Group. Treasury chairs the group, and the other members are drawn from the executive branch and independent regulatory agencies concerned with the operation of the capital markets and the activities of financial intermediaries.

The Capital Markets Working Group has placed major emphasis on the study of legislative and regulatory barriers in the capital markets. It has devoted substantial resources to the restrictions, imposed by the Glass-Steagall Act, on the securities activities of commercial banks. By direction of the Economic Policy Board, the group has taken action on other capital market-related issues.

U.S. activities of foreign banks

A Federal Reserve Board proposal to regulate the U.S. operations of foreign banks precipitated a review of such activities. Presently,

[1] See exhibits 20 and 41.

foreign banks may engage in banking in the United States in two forms: either as a separate subsidiary banking entity chartered by a State or as an undifferentiated branch or agency of a foreign-chartered bank. State-chartered subsidiaries of a foreign bank or nonbank company require approval of the Federal Reserve Board under the Bank Holding Company Act. However, many of the most important foreign bank operations here are now conducted through branches or agencies and are, therefore, not subject to Federal regulation but still may be subject to State banking laws.

The Federal Reserve Board bill would significantly increase the extent of Federal regulation over all foreign banking activities in the United States. With the exception of certain "grandfathered" activities, all foreign operations would be subject to the same regulation and the same restrictions on multistate and nonbanking activities as are now imposed on domestic banks. Through the Capital Markets Working Group, the Treasury undertook a review of the proposed legislation and submitted recommendations to the Economic Policy Board.

Securities reform

The Treasury's interest in securities market reform was reflected in the enactment of the Securities Acts Amendments of 1975 in June 1975 and by the deregulation of brokerage commission rates on May 1, 1975. These measures contributed substantially to the Treasury's objective of more efficient securities markets, consistent with the principle of full investor protection which underlies the 1933 and 1934 Securities Acts.

The legislation directs the establishment of the national market system for securities trading, as well as a centralized system for the clearance and settlement of transactions. This central market system (1) will ensure that all investors receive the best possible execution of orders, (2) will maximize market-making capacity by encouraging competition among market makers, and (3) will increase the depth and liquidity of our securities markets. The legislation also creates a board of securities industry professionals to advise the Securities and Exchange Commission in the development of the market system.

Treasury supported deregulation of brokerage commission rates because of the conviction that free price competition would promote efficiency and improve services provided to investors. At the same time, Treasury is monitoring the short-term impact of deregulation on the structure of the securities industry to assure that the transition from fixed to competitive rates is accomplished in a way which protects all of the vital market interests concerned.

Middle East Policy

During fiscal 1975, the Treasury Department assumed a significantly greater role in promoting closer economic and financial relations with Middle East countries. The area had risen to new prominence in U.S. economic relations during the previous year because of its greatly increased importance in the energy and financial resources fields and because of U.S. efforts to encourage progress toward peaceful settlement of the Arab-Israeli dispute. In fiscal 1975, intensified efforts were undertaken to establish a framework of economic cooperation with countries in the Middle East to provide a better climate for peace and stability in the region and to establish a balanced relationship in key areas of economic interest.

Accordingly, in July 1974 Secretary Simon visited several Middle East countries to explore in detail a range of cooperative programs which had been discussed in general terms during President Nixon's earlier visit to the area. During the visit a number of specific agreements were reached which set the stage for the development of programs which would be responsive to the diverse needs of those countries as well as of mutual benefit to them and to the United States.[1]

The closer relationship with six Middle East and North African countries (Saudi Arabia, Iran, Israel, Egypt, Jordan, and Tunisia) and with India was symbolized by the creation of joint cooperation commissions in fiscal 1975 (joint committee in the case of Israel). With other countries, particularly the oil-producing states of Kuwait, Qatar, and the United Arab Emirates, senior Treasury officers expanded bilateral contacts and engaged in intensive discussions on a broad range of economic and financial problems.

Among the issues taken up with the Middle East countries were the inflationary and financial consequences of increased crude oil prices and questions relating to investment of surplus oil revenues. U.S. policy on inward foreign investment was discussed in detail, including the U.S. Government's request for advance consultations on major proposed governmental investments in the United States.

The possibility of triangular projects combining capital from the oil-producing countries with American management, technical expertise, and equipment for projects in Third World countries was also discussed both with potential host countries for such investment and with potential capital suppliers. Efforts were made to develop broad guidelines and procedures under which American firms could pursue ventures offering prospective benefit to all three parties.

The individual joint commissions with the Mid-Eastern and South

[1] See exhibit 44.

Asian states have served as a forum for reaching agreed policies and programs and as a joint agency to supervise implementation of programs in the fields of trade and investment, financial cooperation, and technical assistance. The commissions with Saudi Arabia and Iran have provided the framework and administrative machinery for extensive technical assistance on a reimbursable basis.

The Joint Commission on Economic Cooperation with Saudi Arabia, which is chaired on the U.S. side by the Secretary of the Treasury, effected early this year a technical cooperation agreement formalizing arrangements under which the United States supplies Saudi Arabia with technical advisers in diverse fields. The costs are being paid by the Saudi Arabian Government through a trust fund established in the U.S. Treasury. At the Commission's first formal meeting in late February, it was agreed that a Joint Economic Cooperation Commission office would be established in Riyadh.[1] The U.S. representation to the Joint Commission office, now fully staffed with 12 Americans and 23 Saudis, will increase the opportunity for the development and maintenance of closer economic cooperation between the two Governments.

Participation of the U.S. private sector in the economic development of the Middle East countries is another important area for joint commission activity. The commissions have been seeking to develop closer relations between the U.S. private business, scientific, and cultural communities and those of the partner country. Joint business councils have been created with several of the countries offering a means of direct contact for promotion of trade, investment, and other business activity.

INTERNATIONAL AFFAIRS

International Monetary and Investment Affairs

World economic and financial developments

The world economy.—By the beginning of the period under review, deflationary policies had generally been in place in the oil-importing countries for roughly 6 months, in response to excess domestic demand conditions and increasing inflation rates. The contractionary effects of these policies began to be felt in the major economies in early 1974. By mid-1974, business investment in the major economies had started to fall off. Uncertainties caused by the oil crisis and rapid inflation rates eroded consumer confidence. As the weakness in demand throughout the world became increasingly evident, businesses undertook sharp production cutbacks. Declines in demand outpaced production reductions and inventory levels rose dramatically. The industrial world experienced negative real growth on the order of 1 percent between July and De-

[1] See exhibit 45.

cember 1974 as the economic downturn accelerated. By early 1975, the world was in the worst recession of the postwar era.

The major industrial countries led the industrial world into recession in early 1975, and during the first half of 1975 the smaller countries joined the economic downturn. Although real gross national product in the industrial countries declined some 4 percent in the first half of 1975, early signs of recovery in the major countries were becoming evident late in the first half of 1975.

Recessionary pressures between July 1974 and June 1975 clearly affected rates of inflation in the majority of the industrial world, and exerted downward pressures on world commodity prices. With a few notable exceptions, inflation rates reached their peaks in the last half of 1974 and were substantially lower during the first half of 1975—but still well above historical averages. Wholesale prices actually declined in the United States and a few other major industrial countries during the first half of 1975, leading to expectations of reduced increases in cost-of-living indices in the near term.

The downturn in business activity reflects initial reactions to changes in demands and in the availability and costs of resources used in the productive process. What the final adjustments will be will not be evident for some time. But it may be possible to foresee some of the major changes that will be required. These could include a shift in the more advanced countries toward economic growth rates more compatible with less abundant and more expensive supplies of productive resources. A reduction may be required in the share of production for consumption as opposed to investment in order to broaden bottlenecks in the production process, to meet the need for upkeep and replacement which has been underestimated during the period of rapidly rising prices, and to facilitate the changes in the existing stock of capital equipment and other parts of the economic structure made necessary by the change in the energy balance.

Impact of oil price increases.—The world economy witnessed the first full year's effects of the oil crisis during the fiscal year. By July 1974, the full force of the massive oil price increases of January had been reflected in oil import prices as the lags in payments between oil importers and exporters had been worked out. The sudden jump in oil import costs led to an estimated total oil import bill of about $110 billion in fiscal 1974 in contrast to about $25 billion in fiscal 1973, and the increase in oil import bills caused a sharp deterioration in trade and current account positions throughout the oil-importing world. The OPEC (Organization of Petroleum Exporting Countries) nations' combined payments position, reflecting these deficits, recorded an investable surplus of approximately $58 billion during the fiscal year, the counterpart of a $25 billion combined current account deficit in the OECD (Organization for Economic Cooperation and Development) member countries and a $33 billion current account deficit in the non-oil-exporting developing countries. The size of these deficits, and the prospect of their continuation for a number of years, have seriously adverse implications for the world economy.

The primary economic costs to oil-importing nations arising from the oil price increases are not financial but real. Most obviously, they are measured in terms of the additional real resources transferred to OPEC nations. This potential transfer cannot be regarded as insignificant—last year alone, increased oil payments were on the order of 15 percent of world trade. In addition, however, there are heavy adjustment costs for oil-consuming countries arising out of major acceleration of inflation, frictional unemployment, and accelerated capital obsolescence as countries adjust their industrial structures to a very major change in the relative prices of inputs. The real losses incurred in the process of an abrupt, forced structural adjustment of the entire world should not be underestimated.

Even when shortrun effects are dissipated and accommodated, levels of real income in the oil-importing nations at any point in the future will be substantially lower than they would have been in the absence of the oil price increases, not only because of the continuing costs of high oil prices, but also because of the once-for-all reduction in efficiency of existing capital stock caused by the transitional adjustment to higher oil prices. There will probably also be some continuing impetus to inflationary pressures, insofar as cheap energy in the past helped to offset other cost pressures.

Quite apart from the question of the magnitude of the real resources to be transferred, there is a question whether distinctions should not be made among the types of resource transfers. For the next several years, it seems more likely than not that demand will be concentrated on industries producing goods most in demand in industrial countries. Demand for capital goods promises to be strong, as the adjustments in the energy field are undertaken. The burden of transferring real resources in the form of automobiles, a sector which threatens to see excess capacity for some time, is far different from the burden of supplying real resources in the form of oil drilling rigs, a sector operating at high levels of capacity to produce equipment of critical importance in the present circumstances. In sum, the costs of transferring real resources to OPEC are apt to be greater than implied by the magnitude alone because they will be wanting goods in short supply.

Higher costs of energy will also mean: (a) A reduced supply of funds available throughout the world for nonenergy uses, because of the enhanced demands for capital to produce energy from non-OPEC sources, and (b) some changes in the location of the world's industry, increasing the share of the world's manufacturing capacity in the OPEC countries relative to the shares of such capacity in the most high cost competing areas.

In contrast to the real effects of the oil price increases, which are serious and will persist, it became increasingly apparent during the fiscal year that world financing requirements and problems arising from the oil price increases could be substantially smaller and of shorter duration than had been widely thought immediately after the dramatic oil price increases. First, the OPEC nations have demonstrated an ability to absorb imports at much faster rates than had first been expected. OPEC import volumes, estimated to have increased by 37 percent in 1974, are expected to rise by another 30 to 35 percent in 1975. Second, the oil price increase has had a strong deflationary impact on the oil-importing economies, and worldwide recession has further reduced demand for OPEC oil. Finally, the oil-importing nations are pursuing a variety of measures to conserve energy and develop alternative energy sources which will reinforce a reduction in demand for energy in general and OPEC-sourced supplies in particular.

The combination of these factors has already resulted in a substantial increase in excess oil production capacity in the OPEC countries (current production is roughly 33 percent below capacity); a reduction in the volume and value of OPEC oil exports (export volume is estimated to be 12–14 percent below 1974 levels); and a substantial increase in both volume and value of OPEC imports. In addition, the OPEC members experiencing the largest production cutbacks are "low absorbers" which would have invested their oil revenues rather than purchase import goods: this pattern of production cutbacks has further reduced the potential investable surplus.

Thus, in contrast to some of the earliest projections, more recent analyses—published by private forecasters as well as internal projections by the OECD, World Bank, and U.S. Government—suggest that the net accumulation of OPEC financial assets will be substantially slowed and perhaps even halted entirely by the late 1970's or early 1980's. Most estimates of peak accumulations, expressed in 1974 dollars, center in the range of $175 to $250 billion. Even these projections represent an unprecedented transfer of financial resources, and the rate of accumulation will remain high for several years. One set of U.S. projections suggests the accumulation of OPEC financial claims could reach $250 billion in current prices ($200 billion in 1974 prices) by the end of 1977.

The private financial markets have displayed substantial flexibility and adaptability in meeting the massive financing demands resulting from the oil price increases, and in channeling funds to places they were needed. The international bond markets revived from low levels of activity in 1974—in part as a result of a lower interest rate structure and in part as borrowers become more "known"—and are now providing substantial amounts of long-term funds to both industrialized and developing countries. Perhaps $15 to $20 billion of long-term lending, including both private and public placements, can be expected of the bond markets in 1975. Commercial bank activity in the international area is expected to continue to grow—although banks are choosing their customers carefully.

OPEC countries' investments are being diversified extensively in terms of both country of placement and length of investment maturities. An increasing percentage of OPEC funds is going into long-term instruments. It also appears that the OPEC countries are now placing funds in a considerably broader list of industrial countries than was true earlier, including some of the developed countries facing the largest current account deficits and some of the developing nations, as a means of further diversification of their asset portfolios. Detailed statistical information regarding the currency distribution of OPEC investments is not available, although there are indications that producer countries are diversifying the currency distribution of their holdings to some extent. The following table provides some indication of the type of assets in which producer countries are investing, as well as their maturity and liquidity. Perhaps 25 to 35 percent of OPEC placements in calendar 1974 was in nonliquid assets such as direct loans to developed and developing countries, lending to the international financial institutions, and a residual category which includes securities and real estate; and the data so far available in 1975 suggest that such investments may be rising significantly as a proportion of the total.

Estimated OPEC investments

	1974		January-June 1975 p	
	Dollars (billions)	Percent of total	Dollars (billions)	Percent of total
In United States	11¼	19	2¼	9
In Eurobanking market (including United Kingdom banks, other European banks, and offshore banks)	22½	37½	10¼	43
Other to United Kingdom	7½	12½	¾	3
Other to developed countries	5½	9	2½	10
International financial institutions bonds and International Monetary Fund oil facility	3½	6	1¾	7
Other to developing countries (including grants)	4	6½	3½	15
All other	5¾	9½	3	13
Total	60	100	24	100

p Preliminary.

Wider diversification of the investments of the oil-exporting nations—as to maturity, geographic location, and currency—in comparison with the heavy concentration widely expected and to some extent experienced immediately following the oil price increases is a natural and healthy development. It can facilitate resolution of the world's oil-related financing problems by enhancing the ability of nations to obtain needed financing directly and reducing the need for international banking centers to play an intermediary role. However, financing requirements remain very large as a consequence of the oil price increases, and the pattern and nature of OPEC investments remain uncertain. Proposals to meet immediate financing needs are discussed below.

Foreign exchange developments and operations.[1]—The system of generalized floating of currencies initiated in March 1973, which places reliance on market forces for the determination of exchange rates, has facilitated adjustment during a period of great stress and uncertainty in the world economy. While exchange market behavior early in the fiscal year was adversely affected by several highly visible bank closures, resulting primarily from losses on foreign exchange transactions, banks and business generally adapted well to the flexible exchange system over the course of the year and the markets broadened and became more efficient. The flexible system has helped to avoid the exchange market crises, trade and capital controls, and more severe world inflation which undoubtedly would have accompanied attempts to preserve a fixed-rate system in the face of the changes imposed on the world economy in the past 2 years. The financial effects of the major oil crisis have been absorbed reasonably well. Widely divergent inflation rates among countries have been accommodated, and flexible exchange rates have made an important contribution to the prevention of new payments problems by permitting adjustments on a current basis to changes in underlying economic conditions. And, by helping the world to avoid a general resort to restrictions and controls on trade and payments, the flexible exchange rate system has contributed directly to the maintenance of high levels of world trade.

While fluctuations in exchange rates between individual currencies have at times been large during the period of floating, substantial rate changes could have been avoided under any exchange rate system, given the large volumes of mobile capital and wide variation in inflation rates. The large, abrupt changes of the par value system have been avoided and rate movements have served to stem speculative flows and prevent the disorderly consequences of attempts to maintain rates at variance with market judgments.

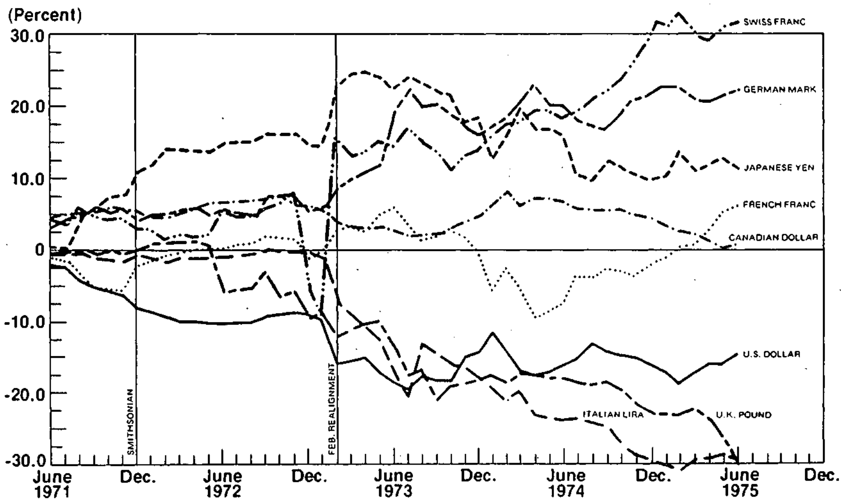
Moreover, any assessment of the position of a currency in the ex-

[1] See exhibit 59.

change markets must be based on its position relative to other currencies in general. For example, a focus on exchange rates of individual currencies vis-a-vis the dollar ignores the fact that during the floating period the dollar has fallen in value in terms of some currencies and risen in value in terms of others. Concentration on a single currency rate for the dollar is an inadequate approach to assessment of the dollar's general "strength" or "weakness" in the exchange markets. On the basis of a trade-weighted average—an admittedly imperfect measure but one which does encompass more than a single exchange rate—the dollar rose slightly higher during the fiscal year and was at about the same level as at the beginning of generalized floating.

Similarly, for many currencies, movements in rates vis-a-vis the dollar are of far less significance than are movements vis-a-vis the currencies of closer trading partners and competitors, and exclusive focus on movements in rates vis-a-vis the dollar distorts and exaggerates the extent of overall change. Trade-weighted exchange rate changes for several major currencies are presented in the accompanying chart. This chart indicates not only that the dollar appreciated slightly between March 1973 and June 1975 in terms of other OECD currencies, but that the dollar was more stable during the period than were most other currencies. The dollar varied within about plus or minus 4½ percent of the midpoint of its range in this period, compared with 5½ percent for the German mark, 8½ percent for the French franc, and 12 percent for sterling.

Trade-Weighted Exchange Rate Change vis-a-vis Other OECD Currencies Since May 1970



Trade-weighted exchange rate based on 1972 bilateral trade shares. May 28, 1970 base rates represent par values just prior to floating the Canadian dollar on June 1, 1970.

Both the unparalleled changes taking place in the world economy and the adoption of new and more flexible monetary arrangements have heightened the need for close consultation and cooperation among world financial authorities. The United States and other nations have arrangements for official intervention to prevent disorderly conditions in the exchange markets. These arrangements have been used and will also be used in the future when needed to prevent disorderly market conditions. But U.S. policy will continue to be to let underlying market forces determine the exchange value of the dollar. Such a policy serves the world, as well as the United States, far better than any attempt to fix a par value.

The beginning of the fiscal year saw the continuation of a modest uptrend in the exchange value of the dollar, based on substantial improvement in U.S. trade figures at midyear and inflows of funds responding to high U.S. interest rates, including short-term funds being accumulated by oil-exporting countries. The exchange market during this period was adversely affected by the Herstatt Bank insolvency in June, which focused attention on some of the risks of taking speculative positions in the exchange markets. In this environment, with markets thin and sensitive, the Federal Reserve was nevertheless able to acquire enough German marks and other currencies to liquidate fully swap indebtedness accumulated to finance earlier exchange market operations.

In September, the dollar began a gradual depreciation in terms of most major foreign currencies that continued until early March 1975. This trend coincided with an easing of U.S. monetary policy and a reduction of U.S. interest rates relative to those abroad, and with a natural and healthy correction of earlier expectations that the United States would receive a greatly disproportionate share of the investments made by oil-producing countries. In October, Switzerland and Germany lifted some restraints on short-term capital inflows, facilitating these movements. Also, there was some concern that expansionary policies in the United States might lead to a resumption of strong inflationary measures, and that U.S. price performance would not be as good as that of other major countries, particularly Germany and Switzerland, whose currencies appreciated most strongly during this period. Mounting evidence of a quickening slide of the U.S. economy into recession appeared to reinforce the downward trend of the dollar.

The Federal Reserve entered the foreign exchange market periodically during October and November, primarily selling German marks drawn on the swap line with the Bundesbank. During this period the Bundesbank also intervened to curb the rise in the mark, which by the latter part of November had risen to its upper limits within the European common margins (snake) agreement.[1] The Swiss authorities, on the other hand, placed major reliance on the reimposition and strengthening of various controls and disincentives to limit short-term capital inflows which put pressure on the franc, seeking to limit the appreciation of the franc as well as the expansionary effects on the money supply which would result from exchange market intervention to slow the appreciation.

While the dollar continued to depreciate in terms of most major foreign currencies in December, selling pressure abated somewhat and the Federal Reserve was able at times to acquire marks, guilders, and Belgian francs to reduce swap indebtedness. Continuing unfavorable developments in the U.S. economy and more rapid declines in U.S. interest rates than in some foreign rates stimulated further capital outflows from the United States, and oil-producing countries continued to diversify some of their receipts. Movements out of sterling were particularly large, especially following the announcement that the guarantee arrangement for certain holders of sterling reserves would lapse at yearend. By flowing through dollars into Continental European currencies, these movements tended to add downward pressures on the dollar relative to these currencies.

During January–March 1975, the Federal Reserve sold nearly $900 million equivalent of foreign currencies, and by late March its outstanding swap indebtedness accumulated since October had reached $1,066 million equivalent, of which over $800 million equivalent was in German marks. Most of these operations followed consultations early in February with the German and Swiss authorities to undertake more concerted intervention judged to be needed to maintain orderly market conditions in the face of growing uncertainties.

In March, dollar exchange rates began to stabilize, and by the close of the fiscal year the dollar had appreciated in terms of nearly all major foreign currencies. There were indications in March that the downward trend in U.S. interest rates was ending and that rates might turn up ahead of European rates. Thereafter, fluctuations in the dollar were generally relatively modest, as U.S. and foreign interest rate declines slowed and evidence grew of an impending economic upturn, especially in the United States. An important exception was sterling, which depreciated rather sharply at times, largely reflecting uncertain prospects for bringing inflation under control. The improving U.S. trade and price performance, which the market had seemed to ignore during earlier months, became more pronounced and capital inflows were attracted. The Federal Reserve was able to acquire marks and

[1] Under this agreement participating monetary authorities, which during the fiscal year included Germany, Belgium, the Netherlands, Sweden, Denmark, and Norway, intervene in the exchange market in member currencies or in dollars to maintain their exchange rates within 2¼ percent of "central" rates in terms of other participating currencies.

other currencies needed to reduce the substantial swap indebtedness built up since October. By the end of the fiscal year this indebtedness had been reduced to $396 million equivalent.

There were no drawings initiated by foreign central banks on Federal Reserve swap lines. Intervention undertaken by foreign monetary authorities to support their currencies, including that by the United Kingdom, Italy, Japan, and Canada, was financed in part by the use of reserves or by borrowing from other sources, and in many cases the conversion of government-encouraged borrowings by private and semipublic entities diminished the need for official intervention in the exchange market.

The dollar depreciated by about 9 percent during the fiscal year in terms of the group of currencies participating in the snake agreement, and by about 16 percent in terms of the French and Swiss francs. France had withdrawn from the snake arrangement in January 1974 as the franc depreciated sharply in terms of other members' currencies, but by mid-May 1975 the franc had appreciated sufficiently to place it within the band in terms of its former central rate, and the French authorities announced they would formally rejoin the arrangement in July. The dollar depreciated during the year in terms of the Italian lira by about 3 percent, but appreciated in terms of certain other major currencies—by 4 percent in terms of the Japanese yen, 7 percent in terms of the Canadian dollar, and 9 percent in terms of sterling.

The U.S. reserve position in the International Monetary Fund increased during the fiscal year as a result of drawings of dollars by other IMF members. At the end of the period the United States had a creditor position of $0.1 billion in the General Account of the International Monetary Fund, compared with a gold tranche utilization of $1 billion as of June 30, 1974, remaining from past U.S. drawings on IMF resources.

Gold market prices, at the London fixings, reached a low of $129 per fine ounce on July 4, rose again and then fluctuated broadly around $155 from late July to late October. Prices then increased to a high of $190.50 in mid-November, stimulated by purchases anticipating that the demand for gold in the United States would rise sharply following the lifting of the restrictions on ownership on December 31 (Public Law 93–373). Treasury spokesmen indicated, however, that the Treasury might decide to sell some of its stock in the market to meet some of the additional demand. Prices fluctuated widely until yearend, reaching a low during this period of $170.50 on December 4 and peaking at $197.50 on December 30.

On December 3, the Treasury announced that it would offer 2 million ounces of gold to the market in an auction on January 6.[1] Prior to

[1] See exhibits 53 and 77.

the auction the Treasury consolidated its gold accounts, including the remaining gold held in the Exchange Stabilization Fund.[1] In the auction on January 6, tenders for 753,600 ounces were accepted, at an average price of $165.67 per ounce. It was evident that the additional demand immediately following the lifting of the restrictions had been far less than had been expected. In deciding what volume of the offers to accept, the Treasury was faced with the necessity of balancing, on the one hand, the desirability of not selling at prices far below market indications with, on the other hand, the desirability of following procedures which would not place the U.S. Government unnecessarily in the role of setting prices.

The market price fell to around $175 per ounce early in January and thereafter fluctuated, gradually declining. In late May, the Treasury announced that its second auction of gold, of 500,000 ounces, would be held on June 30.[2] The market price, after dipping briefly following the announcement, varied in a narrow range through the month and was $166.25 in London on June 30. At the Treasury gold auction on that date, bids were accepted for 499,500 ounces of gold at a price of $165.05 per ounce.

Meeting immediate financing needs in the wake of the oil price increases

The oil-importing nations have been faced with unprecedented shifts in their payments positions and major increases in financing requirements as a consequence of the massive increase in oil prices. As suggested in the preceding section, the surpluses of OPEC countries are likely to be more a medium- than a long-term concern. Thus potential financing problems arising from the oil price increases are likely to be temporary and transitional in nature.

The financial problem faced by the oil-importing countries in this transitional period is not the availability of financing the aggregate, for the oil-exporting countries have no alternative to investment in the oil-importing world as a whole. Existing financial arrangements, private and official, have worked and adapted well in meeting the new financial needs arising in the wake of the oil price increases. Countries have not sought to maintain rigidly fixed exchange rates for their currencies in the face of sharp disruption of their external positions, but—with major differences in degree among countries—have allowed rates to respond more fully to market forces. This has helped the system to avoid the huge and destabilizing reserve movements and exchange market crises of earlier years, and has helped to prevent the general resort to restrictive and self-defeating practices that appeared to be a major possibility in the immediate aftermath of the oil price increases.

[1] See exhibit 54.
[2] See exhibit 77.

While the private financial markets and other financial arrangements have operated well and should continue to do so, it is not possible to foresee the pattern of international payments, or to know precisely what official financing needs may arise for nations individually or collectively. Given the prospect of large surpluses on the part of the major oil-exporting countries in the aggregate, and uncertainty about the character and geographical distribution of the counterpart investment flows, the United States believes that the international community must have in place adequate facilities to deal with major financing problems should they develop.

Accordingly, in November 1974, the United States put forward a comprehensive, "three-track" approach to meeting official multilateral financing needs in the present situation—involving the International Monetary Fund, a proposed Financial Support Fund, or "safety net," associated with the OECD, and a proposed IMF-managed trust fund for the poorest of the developing nations.

International Monetary Fund.—Under the U.S. proposals, the IMF would continue to be the institution relied upon to provide the basic support, the first line of official multilateral balance of payments financing for the full range of its membership, developed and developing countries alike, following principles of uniform treatment for all members. To enable the IMF to continue to perform this role, the United States supports an expansion of IMF quotas as part of a general package of quotas and amendments to the IMF Articles of Agreement; has proposed measures to increase the usability of existing IMF balances of member currencies; and has proposed authority for the IMF to dispose of its large gold holdings as appropriate and necessary to augment its lending capacity. These proposals are discussed in more detail below.

Financial Support Fund.[1]—The Financial Support Fund is designed as a temporary mechanism—a "safety net"—to encourage cooperation in energy and economic policy by supplementing other sources of financing in the event participating OECD members cannot obtain elsewhere on reasonable terms the financing they need to avoid recourse to restrictive trade policies, capital controls, or undue restraint of domestic economic activity. The potential danger is that a country could be moved to adopt inappropriate policies by the unavailability of financing on reasonable terms—or even out of concern that financing would not be available in the future—and that other countries would respond in kind to protect their own positions. There is a risk that recourse to such policies could quickly spread. The result would be serious disruption of the world economy, reduction of eco-

[1] See exhibits 57, 60, 61, and 62.

nomic well-being worldwide, and less cooperation in energy policy. The risk is shared by all countries, as are the benefits to be gained through avoidance of such policies.

The Support Fund is designed to protect against this risk by providing a form of financing insurance to the industrial countries, whose policies will determine both whether the world economic order remains liberal and open and whether the oil-importing world succeeds in reducing its dependence on unstable and excessively costly energy sources. The existence of the Support Fund during the period of financial difficulty will strengthen the confidence of its participants in the basic integrity of their own positions, and in their ability to deal with their own problems without dependence on the actions or agreement of the oil-exporting countries, and without a need to rely on financing provided by those countries. This self-confidence is fundamental to international cooperation, in energy as well as general economic policy. Membership in the Support Fund requires a basic commitment to cooperation. And if the Fund is ever used, specific policy conditions on loans by the Fund will be prescribed to further assure cooperative solutions to mutual economic and energy problems.

The Financial Support Fund would consist of total quotas of SDR 20 billion (about $25 billion). The U.S. quota would amount to SDR 5,560 million (27.8 percent of the total), or about $7 billion at dollar/SDR rates of exchange prevailing in the latter part of the fiscal year. Participants' quotas will determine their share in financing loans made by the Fund; their share in risks on loans made by the Fund; their voting rights (each member has a number of votes proportional to its quota); their maximum financial liability to the Fund; and the amount they may borrow from the Fund.

The United States expects to meet its share of the financing of any loans made by the Support Fund through the issuance of guarantees covering market borrowings by the Support Fund. However, the United States could choose, for market considerations or other reasons, to extend a direct loan to the Fund. Such loans could be extended from the Exchange Stabilization Fund under existing authority.

Negotiations on the agreement establishing the Financial Support Fund were initiated in the Group of Ten and completed by a temporary working party of the OECD. The agreement was signed by most OECD member countries in Paris on April 9, 1975, subject to necessary legislative action, with Secretary Simon signing on behalf of the United States. The agreement has now been signed by all OECD members. Proposed legislation authorizing U.S. participation in the Financial Support Fund was submitted to the Congress on June 6, 1975.

A full description of the purposes and operations of the Financial Support Fund is contained in a special report issued in May 1975 by the National Advisory Council on International Monetary and Financial Policies.

Trust fund.—The Support Fund will not directly meet the financing needs of the developing countries. It will strengthen the confidence of private investors in the integrity of the system as a whole, and will provide its participants with incentives and the means to avoid policies disruptive to the world economy. The benefits to developing countries of sustained economic growth and open trade and capital markets in the industrial countries are of first importance. But potentially serious economic and financial problems do confront developing countries as a consequence of the oil price increases. The IMF itself will meet part of these needs, but the special problems of the poorest countries call for highly concessional balance of payments financing, better handled in a separate facility outside the regular resources of the IMF.

As the third element of its proposal, the United States proposed creation of a temporary trust fund, managed by but separate from the IMF, for concessional balance of payments assistance to the poorest of the developing countries. The United States proposed that the trust fund be funded initially at about $1.5–$2 billion, financed by concessional contributions from the major oil-exporting countries and others in a position to contribute, and by use of a portion of IMF gold. The U.S. proposal was circulated to the IMF Executive Board in December and raised for initial discussion at meetings of Interim and Development Committees in January.

The Ministers of the Interim and Development Committees are in agreement regarding the need for concessional balance of payments assistance to meet the emergency needs of the poorest countries. At its meeting on June 12, the Development Committee urged the Executive Directors of the IMF to consider all aspects of the establishment of such a trust fund as well as to continue their study of all possible sources of financing. This review was underway at the close of the fiscal year. The United States will continue to press for early establishment of a trust fund to meet the needs of the poorest developing countries, which may become increasingly urgent in the months ahead.

Negotiations on longer term aspects of the international monetary system

As indicated in last year's Annual Report, the IMF Committee of Twenty on reform of the international monetary system, in its final report, recommended action on a number of elements of reform, including (1) establishment of an "Interim Committee" of the IMF, to oversee the future operations and evolution of the monetary system, and (2) further consideration of a package consisting of an increase in IMF quotas and a series of important amendments to the IMF Articles of Agreement.

The Interim Committee was formally established in October 1974, during the annual meetings of the IMF and IBRD. Secretary Simon is the U.S. member of the Committee. At its first full business meeting, in January 1975, the Committee approved an enlargement of the IMF's oil facility for 1975 and endorsed a proposal put forward by the Managing Director of the IMF to establish a special account to reduce, for the most seriously affected developing countries, the burden of interest payable by them under the oil facility.

The Committee also agreed on a 33.6-percent increase in IMF quotas, to SDR 39 billion (approximately $47 billion), subject to agreement on a satisfactory distribution of individual countries' quotas and on a series of amendments to the IMF Articles of Agreement. The Committee also agreed that the collective quota share of the major oil-exporting nations should be doubled and that the collective quota share of the other developing countries should not fall below the present level. Consequently, the quota share of the developed IMF member nations as a group will have to be reduced by about 4½ percentage points in order to accommodate the increase in the oil exporters' quota share.

The Interim Committee requested the Executive Directors to continue their work on amendment of the IMF Articles of Agreement, concentrating on amendments in the following areas: Gold; the exchange rate regime; improvements in the IMF General Account, including elimination of gold subscription requirements in connection with quotas and establishment of arrangements to ensure that IMF holdings of all currencies will be usable in its operations; improvements in the special drawing right; and transformation of the Interim Committee into a permanent Council with decisionmaking powers.[1]

Substantial progress was made toward agreement on these issues at a further meeting of the Interim Committee in Paris on June 10 and 11, 1975,[2] although important differences of view still remain and it has not yet proved possible to reach a comprehensive settlement. U.S. views on the major issues, and the status of the negotiations at the close of the fiscal year, are outlined below.

Gold.—Considerable progress was made toward agreement on gold, both in terms of possible amendment of the IMF Articles of Agreement, and in terms of transitional arrangements outside the Fund to govern transactions among national monetary authorities. The Interim Committee agreed on a number of principles which would

[1] See exhibit 55.
[2] See exhibit 63.

form a basis for a settlement, including reduction of the role of gold in the monetary system, abolition of the official price, and elimination of the obligations to use gold in payments between the Fund and its members.

Of particular interest was the Committee's agreement that a not-yet-determined portion of the IMF's gold should be used for the benefit of the developing countries, particularly the low-income developing countries. One proposal frequently mentioned was to use one-sixth of the IMF's gold holdings, or about 25 million ounces, for the benefit of the developing nations, with another one-sixth to be distributed to the general IMF membership on the basis of quota shares. The technique for mobilizing the gold and the mechanisms that would be used to channel the proceeds to recipient countries also remain to be agreed. As noted above, the United States has proposed use of some IMF gold to finance a special trust fund, and discussions on this proposal are continuing.

In addition to questions concerning disposal of the Fund's gold, four other issues remain:

(1) Whether, in addition to transitional arrangements outside the Fund, already agreed, to prevent reestablishment of a de facto official price for gold and to limit global official gold holdings, there should be understandings governing transactions in gold among national governments. The United States and most other countries believe it would be desirable to have such understandings following lifting of the IMF's formal restrictions on official transactions, in order to ensure that the movement toward a reduction in gold's role is in practice maintained.

(2) Whether there should be established in the Articles an obligation that countries collaborate with the IMF on policies to reduce the role of gold in the monetary system. In the context of a satisfactory overall settlement, the United States would be prepared to accept such an obligation. Some countries resist any such provision.

(3) Whether the IMF should be permitted to accept gold payments from members under the amended Articles. While significant gold payments probably would not in fact be made to the Fund even if permitted, the United States opposes such a provision on grounds that it would be inconsistent with the general approach of reducing the monetary role of gold, and this view appears to be shared by most other countries.

(4) Whether an account should be established in the IMF to allow countries to exchange their gold for SDR's—a gold substitution account. The United States doubts the utility of such an account and the desirability of getting the IMF back into the business of buying gold,

whatever the objective. However, the proponents of this approach regard it as a technique for facilitating a reduction of the monetary role of gold, and the United States is examining the proposal in that light.

Exchange arrangements.—The present IMF Articles require that all members maintain exchange rates for their currencies within narrow margins around declared par values, but no member is now adhering to this fundamental provision. All members agree that this situation should be corrected by appropriately amending the Articles. The United States supports an amendment which, first, would establish that each member country has basic obligations to foster exchange stability, to maintain orderly exchange arrangements, and to pursue cooperative policies; and, second, would assure that each country, in meeting these basic obligations, has freedom to choose the exchange arrangements best suited to its own needs and circumstances. The United States believes the appropriate focus of IMF attention is on a country's policies, not on the mechanisms, such as par values or floating rates, which it uses in implementing those policies. The IMF should look at how a country is behaving, with each country expected to provide information that permits assessment of its policies and to consult on its economic situation and the international implications of its policies. The Articles should offer nations wide latitude for choice among exchange rate systems, and should impose neither a moral nor a legal obligation to establish par values, now or in the future.

The Interim Committee discussions indicated that there is wide support for this approach. But there are some countries that want all nations to accept an obligation to return to par values. The United States has indicated that it will not agree to this approach.

IMF quotas.—As noted above, the broad distribution of quotas among major country groups was agreed in principle by the Interim Committee in January. Negotiations on the distribution of quota shares among individual countries are well advanced but not fully completed. Despite the economic justification for a larger quota, the United States has agreed that it will accept some decrease in its quota share in an effort to resolve this issue. As a result, there will be a significant reduction in the U.S. voting share—to about 20.3 percent—which must be expected to diminish further as new members join the Fund in the years ahead. However, this reduction would occur only in the framework of an amendment increasing from 80 percent to 85 percent the vote required to approve amendment of the Articles and certain other basic decisions in the IMF. While problems remain, it is expected that the quota question can be resolved if other key issues are settled.

IMF General Account.—A number of amendments to streamline and improve the operations of the IMF's General Account are under consideration. Most of these changes are highly technical and are not particularly controversial. Of the various changes under consideration, the United States believes that one dealing with the usability of currencies held by the IMF is particularly important.

The United States believes that all member countries should permit the IMF to use its holdings of their currencies under uniform conditions and criteria. This is not now the case. Countries, regardless of the strength of their external positions, can effectively block use of their currencies for loans to other members. It is essential that each country agree that when it is in a strong external position, the IMF would be permitted to use its currency. Such agreement must be a prerequisite to an increase in the country's quota, in part because quota subscriptions will be paid in national currencies, and there is no reason for the IMF to accumulate more of a country's currency if the Fund is not permitted to use the balances it already holds. The IMF presently holds about $32 billion of members' currencies, perhaps about one-third of which is presently usable. Much of the remainder represents the currencies of countries that are not currently in a strong enough position to make credit available to the Fund, but this is not the case in all instances. Agreement on the use of these currencies could add substantially to the Fund's usable resources at present and in the future, and strengthen its position as the central institution for provision of official balance of payments assistance to its members. The validity of this point is widely recognized.

Changes in SDR rules.—The United States has supported changes in the rules governing the special drawing right to make it a more flexible and usable asset; for example, by easing existing restrictions for voluntary transactions in SDR's among countries. The United States does not believe this is the time for major alterations in the character of the SDR, however, and has opposed proposals that would change countries' basic obligations with respect to the SDR; for example, to eliminate the limits on countries' obligations to accept SDR's, to eliminate countries' rights to opt out of new SDR allocations, and to eliminate countries' obligations to rebuild their SDR holdings to the extent they fall below 30 percent of allocation on the basis of a 5-year moving average.

IMF Governors Council.—With U.S. support, the Interim Committee agreed that an amendment should be prepared which would permit the Council to come into being when a decision is taken by the Fund for that purpose. The Council would strengthen the Fund by providing it with an organ composed in the same manner as the Committee of Twenty and the Interim Committee but with authority not only to exercise advisory functions, but also to take decisions under specific powers. The Interim Committee agreed that, except for a few powers of a political or structural character that should be reserved to the Board of Governors, all powers of the Board of Governors should be delegable in principle to the Council, to the Executive Directors, or to both concurrently, by decisions of the Board of Governors.

While substantial progress had been made on the monetary negotiations at the close of the period under review, the differences which remain are important differences, particularly those relating to the exchange rate system and gold. Furthermore, understandings on specific issues are subject to agreement on the comprehensive package. The United States hopes to see agreement reached at the next Interim Committee session at the end of August. This session will be held just prior to the annual meetings of the IMF and World Bank, during which many other issues will be discussed. If it does not prove possible at that time to resolve the remaining issues in the areas outlined, a full meeting of the Interim Committee is scheduled in January 1976 which will be focused specifically on these issues.

International investment and capital flows

The accumulation of financial reserves during the past year by oil-producing countries has led to increased interest, on the part of the public and Congress, regarding the possible political and economic effects of foreign investment in the United States. During the year 1974, governmental and private investors from OPEC countries did appear in the U.S. capital market in larger volume than before, but their aggregate long-term investment was quite small. Of about $60 billion in total accumulations by OPEC countries in 1974, it is estimated that about $11¼ billion was invested in the United States, in both long- and short-term instruments. Investments in short-term assets accounted for perhaps 90 percent of their total investments in the United States. Long-term investments in the United States by the oil-exporting countries consisted almost entirely of U.S. Treasury notes and bonds and other Federal agency issues, with less than three-quarters of a billion dollars being placed in private long-term investments, including real estate, corporate securities, and direct investment in U.S. corporations. For the first half of calendar 1975, there is some indication that OPEC countries have shifted to longer term investments, and will increase their holdings of private U.S. long-term securities.

U.S. policy toward foreign investment in the United States.[1]—U.S. policy with respect to international investment has generally been based on the premise that one should rely on the private market as the most

[1] See exhibit 58.

efficient means to determine the allocation and use of capital in the international economy. Accordingly, the basic policy toward foreign investment in the United States has reflected an "open-door" approach; that is, foreigners are offered no special incentives to invest here and, with a few internationally recognized exceptions, no special barriers have been imposed. Furthermore, foreign investors are generally treated equally with domestic investors once they are established in this country.

This policy was reviewed by the executive branch late in 1973 in the face of the increase that year in investments from Europe and Japan. The basic conclusion of that review was that the traditional open-door policy should be maintained and that no new restrictions should be placed on foreign investment in the United States unless necessary to protect national security.

Foreign Investment Study Act.—The review did, however, underscore a need to improve U.S. data on foreign direct and portfolio investment in the United States. (The last comprehensive benchmark census of foreign portfolio investment in this country was conducted in 1941, and these data were only partially revised in 1949.) Therefore, the Treasury testified in support of legislation introduced in the 93d Congress to authorize a study to improve our data on foreign investment in the United States. This legislation, known as the Foreign Investment Study Act, was passed by Congress and signed by President Ford in October 1974.[1] Pursuant to the act, the Department of the Treasury has begun a special study of foreign portfolio investment in the United States and the Commerce Department is examining foreign direct investment here. Interim reports are due in October 1975 and final reports in April 1976.

The Treasury study consists basically of two parts: (1) Collection of data on portfolio investments by foreigners as of December 31, 1974; and (2) analysis of these data and research on certain questions specified in the act. For the purposes of the study, foreign portfolio investment is defined as all securities of a U.S. corporation, including stocks, bonds, and other evidences of ownership or long-term indebtedness, held by a foreign person owning less than 10 percent of the voting securities of the corporation. The Treasury survey also covers foreign portfolio investment of limited partnership interests, investment trust certificates, and other evidences of ownership or indebtedness of noncorporate enterprises. In addition to private obligations, the survey also covers foreign holdings of debt obligations of the Federal, State, and local governments or other instrumentalities thereof, which have an original maturity of more than 1 year.

The research portion of the study is to be analyzed at two levels: One involves a study of the methods and determinants of foreign portfolio

[1] See exhibit 52.

investments in the United States; another deals with the purposes and effects of U.S. laws and regulations on such investment.

Committee on Foreign Investment in the United States.—As was noted earlier, the executive branch undertook another review of our policy toward foreign investment in this country in 1975 and again reaffirmed our traditional "open door" approach. It was also concluded that our existing legal and regulatory safeguards against abuses of foreign investments are adequate and that no new legislation was needed in this area.

At the same time, it was concluded, as discussed above, that new administrative arrangements, including the creation of a new interagency Committee on Foreign Investment in the United States and an Office of Foreign Investment in the United States in the Commerce Department, were needed.[1] The Committee was established in May 1975 by Executive Order 11858, which gave it a mandate to monitor the impact of foreign investment in this country and to coordinate the formation of U.S. policy on such investment. An important task of the Committee is to assess general trends and significant developments in foreign investments in the United States and to review investments which, in the Committee's judgment, might have major implications for U.S. national interests.

The Department of Commerce is currently in the process of getting its new office into operation. The purpose of this unit is to bring together the data on foreign investment in the United States which are gathered by various U.S. Government agencies. Although considerable data on foreign investment are collected by these agencies, until now there has been no central point for synthesizing and analyzing it.

Foreign direct investment issues in international organizations.—During fiscal 1975, a number of official international organizations considered the establishment of a code of conduct for multinational enterprises. In light of this widespread interest in this issue, the U.S. Government agreed to consider whether a nonbinding code, or set of guidelines, might be developed, addressing the responsibilities of enterprises as well as those of the host governments, as part of a balanced approach to international investment issues. This work is consistent with our efforts to liberalize progressively world arrangements affecting investment flows by developing a consensus of principles on international investment.

At a U.S. initiative, the OECD has, since 1973, been considering international investment problems caused by governmental policies, as well as a number of issues relating to multinational enterprise oper-

[1] See exhibit 67 and 68.

ations. Work on these issues accelerated with the January 1975 decision of the OECD Council to establish a provisional Committee on International Investment and Multinational Enterprises, whose purpose is to strengthen cooperation in a generally balanced way in the fields of international investment and activities of multinational enterprises. The new Committee is to make its recommendations on these issues to the Council no later than the end of 1975.

At its meeting in April 1975, the Committee emphasized the determination of governments that the work on investment issues be brought to a conclusion concomitantly with the work on the code.

As of June 30, 1975, work on international investment issues was well advanced. This involved guidelines aimed at reducing incentives and disincentives to foreign investment and at extending the same national treatment to foreign-owned firms as is accorded domestic enterprises. However, the Investment Committee work on a code of conduct was only in the early stages of development.

International investment issues were also taken up in other official international organizations. In December 1974, the United Nations General Assembly accepted the so-called "Eminent Persons" report on the role of multinational enterprises on economic development and on international relations. This report inter alia called for the establishment of a Commission on Transnational Corporations to report to the Economic and Social Council. At its first session in March 1975, the Commission developed a preliminary work program which attaches first priority to the development of a U.N.-wide multinational enterprise code of conduct.

A code of conduct relating to the activities of multinational enterprises was also under consideration in the meetings held in furtherance of the so-called new dialogue established last year between the United States and the countries of the Caribbean and of Central and South America. These talks were interrupted, however, when the Western Hemisphere meeting of Foreign Ministers was canceled at Ecuadorian and Venezuelan insistence as a protest against the provision in the U.S. Trade Act of 1974 whereby OPEC member countries would not be eligible for generalized preferences on the export of their manufactured goods to the United States.

International Monetary Fund operations

As the principal official multilateral source of balance of payments financing, the IMF is playing a central role in meeting the world's financing needs arising from the sharp increase in oil prices, rampant inflation, and severe economic recession. This was reflected in a sharp increase in IMF lending during fiscal 1975 with purchases of currency (drawings) by IMF members reaching a record SDR 5.2 billion (about

$6.3 billion).[1] This increase reflected a marked rise in drawings under the Fund's regular resources, as well as the operations of the IMF's special oil facility established in June 1974.

Regular resources.—Use of the IMF's regular resources rose sharply during the fiscal year. Purchases amounted to SDR 2,555 million by 45 countries, roughly twice the previous year's level. Italy was the single largest borrower, with drawings of SDR 1,268 million, followed by Germany (SDR 154 million)[2] and Argentina (SDR 125 million). Principal currencies drawn were the dollar, German mark, and Japanese yen. The use of dollars in drawings increased substantially from levels of recent years. Special drawing rights were drawn in the amount of 44 million.

Repayments of previous drawings (repurchases) totaled SDR 574 million with about 27 percent being made in German marks. In the latter part of the fiscal year, repurchases with dollars occurred for the first time since fiscal 1972 and totaled SDR 105 million. Other currencies used in repurchase included Belgian francs (SDR 90 million), Japanese yen (SDR 62 million), and Dutch guilders (SDR 47 million). Repurchases with special drawing rights amounted to SDR 28 million.

As of June 30, 1975, cumulative drawings from the beginning of IMF operations amounted to SDR 32,242 million, of which SDR 9,110 million were in U.S. dollars; cumulative repurchases were SDR 17,660 million, of which SDR 4,725 million were in U.S. dollars.

The U.S. reserve position in the IMF increased to SDR 1,762 million during the fiscal year as a result of purchases of dollars by other countries (SDR 953 million).

Oil facility.—The oil facility is intended as a temporary response to the emergency needs arising from the oil price rise (see 1974 Annual Report, pp. 44, 619–20). Resources available to the 1974 oil facility amounted to SDR 3.04 billion (about $3.6 billion), obtained through IMF borrowing from nine member countries, principally major oil-exporting countries but also including two industrial countries. Drawings from the facility were made by 40 countries and totaled the equivalent of SDR 2,583 million. The only major industrial country to use the facility was Italy, which drew the largest amount of any country, SDR 675 million, or 26 percent of total drawings from the oil facility. Spain was the second largest user of the oil facility, drawing SDR 296 million, followed by India (SDR 200 million), Yugoslavia (SDR 155 million), and Pakistan (SDR 125 million).

[1] All conversions from SDR to dollars in this section are made at the rate of $1.20 equals SDR 1. With introduction of the SDR "currency basket" valuation technique at the beginning of the fiscal year (see 1974 Annual Report, pp. 45, 620–21), the SDR's value in terms of currencies fluctuates daily in response to changes in market exchange rates.

[2] Gold tranche drawings in connection with the settlement of liabilities under the European narrow margins arrangement.

In January 1975, the IMF's Ministerial Interim Committee agreed that the oil facility should be continued for 1975 on an enlarged basis.[1] The IMF was authorized to borrow up to SDR 5 billion and to use the remaining funds available from the 1974 facility to finance operations in 1975. By the close of the fiscal year, the IMF had reached agreement with 12 countries to provide additional resources amounting to SDR 2,870 million. Some of these countries have agreed to consider lending additional amounts in the event further resources are needed and the SDR 5 billion limit has not been reached.

The IMF Executive Directors have made certain modifications in the operational provisions of the oil facility to bring it into closer conformity with current requirements. The formula for determining access has been modified to reduce the heavy emphasis on oil import costs in determining financing need and to focus increasingly on the more appropriate consideration of a country's overall balance of payments position. Initially, individual country access to the facility is limited to 30 percent of the maximum allowed (pending review in July of available resources in relation to need). Policy conditionality has also been strengthened in order to foster needed domestic adjustments and to avoid inappropriate external measures. Charges on drawings have been raised to cover costs, with an increase in interest rates to 7¼ percent (from 7 percent in 1974) to reflect higher payments to lenders and the addition of a 0.5-percent annual service charge. As noted above, in recognition of the burden these charges placed on the developing countries most seriously affected by current economic conditions, the Interim Committee endorsed a proposal by the IMF Managing Director to establish a subsidy account to reduce the interest cost on borrowing from the facility by the poorest countries.

This account, projected to total about $380 million with a suggested U.S. contribution of $70 million, could be financed in part through use of a portion of the Fund's gold, and in part through voluntary contributions. The United States has indicated that, should use of gold not prove possible, it would consult with Congress on the feasibility of obtaining appropriated funds for a U.S. contribution but that such funds would not be requested without indications from Congress that in so doing the funding of established bilateral and multilateral programs such as the International Development Association would be unaffected.

It is anticipated that the oil facility will be phased out at the end of calendar 1975, and that greater reliance will be placed on use of regular IMF resources in loans to members. To place the IMF in a better position to meet current and future needs, a review of policies

[1] See exhibit 55.

and practices regarding the use of its currency holdings was initiated during the fiscal year with the aim of increasing the number of currencies available to be drawn. It is hoped that with termination of the oil facility at the end of 1975—and consequently the availability of the subsidy account—the trust fund proposed by the United States will be in place to meet the needs of the poorest member countries.

IMF commodity financing arrangements.—Recent developments in world commodity markets have heightened international interest in the IMF's special commodity financing arrangements as a means of assisting developing countries in meeting the difficulties arising from excessive fluctuations in the prices of their primary product exports. The Fund's compensatory financing facility was established in 1963, and liberalized in 1966, to provide developing countries with additional access to the IMF's resources to meet balance of payments difficulties arising from temporary shortfalls in their export earnings due to circumstances beyond their control. A country with an overall balance of payments need may draw up to 50 percent of quota under the facility to finance an export shortfall. Not more than 25 percent of quota may be drawn in any 12-month period.

In determining the amount a country may draw from the facility, the level of exports in the shortfall year is compared with the average level of export earnings in a 5-year period that includes the actual level in the 2 years preceding the shortfall year, the shortfall year, and projected levels of earnings in the 2 years after the shortfall year. Actual drawings from the facility are subject to the same interest rate and repayment provisions as regular IMF drawings (currently 4–6 percent interest and 3–5 years maturity) but carry easier policy conditionality requirements than regular drawings and do not reduce a country's access to regular Fund drawings.

In the 12 years since the compensatory financing facility was established, 32 countries have made 52 drawings totaling SDR 1 billion. Drawings outstanding at the close of the current fiscal year amounted to SDR 519 million.

The second arrangement, the buffer stock facility, was created in 1969 to assist members with a balance of payments need to finance their contributions to international buffer stocks that meet IMF criteria. Countries may draw up to 50 percent of quota under the facility provided that total outstanding drawings under the compensatory financing and buffer stock facilities do not exceed 75 percent of quota. Unlike the compensatory facility, there is no limit on the amount that may be drawn in any 12-month period. While buffer stock drawings are additional to regular IMF drawings, they automatically reduce any available gold tranche position a member may have and in effect reduce its unconditional access to IMF resources. Drawings carry the same interest rate and repayment provisions as regular drawings, although disbursement of funds from the international buffer stock to a member must be used to repay drawings from IMF's buffer stock facility.

Two international buffer stocks, tin and cocoa, have been declared eligible under the IMF's criteria for financial support, although funds have been drawn only for the tin buffer stock. Total drawings have amounted to SDR 30 million (or about $36 million) by five countries, with only SDR 7.5 million still outstanding.

The United States has proposed that there be a major liberalization of these facilities, and the Interim Committee has requested the IMF Executive Directors to consider specific changes. In working with the Executive Board on the development of specific modifications, the United States will take the view that changes in the facilities should be consistent with the basic purposes and concepts of the IMF as provider of temporary balance of payments assistance to members in need.

Organization for Economic Cooperation and Development

There was intensified consultation on and coordination of economic and financial issues among the industrialized countries of the OECD in response to the multiple challenges of the past year. In addition to serving as a forum for the customary periodic examination of a broad range of fiscal and monetary matters, the OECD provided the auspices for intensive work on specific oil-related problems, notably the establishment of the International Energy Agency and the Financial Support Fund. At their annual meeting held in Paris May 28–29, 1975, OECD Ministers expressed determination to overcome the twin problems of recession and inflation; renewed for 1 year the "pledge" to avoid introducing measures aimed at restricting exports or imports, or providing artificial subsidies to exports; endorsed increased cooperation between oil-producing and oil-consuming countries; agreed on the need for a more active and broadly based approach to commodity problems; and adopted a Declaration on Relations with Developing Countries. Secretary Simon attended this meeting, as did Secretary of State Kissinger.

The OECD also created an ad hoc high-level group to examine relations with developing countries and a high-level group to study specific steps which might be taken in the commodity area. The Treasury participates in the work of these groups, which is being carried out under auspices of the OECD's Executive Committee meeting in special session.

Subsequent to the Washington conference on energy questions in February 1974, the effort to intensify cooperation in this area led to the establishment of the International Energy Agency in November

1974. The United States and 17 other of the 24 OECD member countries joined this agency, whose work includes operational arrangements to deal with possible disruption of supplies. The Treasury participates actively in much of the work of the IEA.

The Economic Policy Branch of the OECD was concerned throughout fiscal 1975 with the appropriate policy reaction to continued inflation, the emergence of widespread decline in economic activity and accompanying increases in unemployment, and the sharp increase in the balance of payments deficits on current account of some member countries, particularly as these problems were occasioned or exacerbated by the sharp increase in oil prices. Working Party 3 of the Economic Policy Committee, to which the Treasury's Under Secretary for Monetary Affairs leads the U.S. delegation, followed the evolution and financing of payments deficits of OECD countries throughout the year, and found that the situation had progressed much more smoothly than had been anticipated by some observers. A temporary working party of the Economic Policy Committee was established to study closely the economic and financial implications posed by higher oil prices in preparation for a possible dialog with oil producers.

The Treasury continued to participate actively in other activities of the OECD, many of which were also concerned directly or indirectly with the consequences of higher oil prices. These included the newly established Committee on International Investment and Multinational Enterprises; the Trade Committee and its subgroups on Export Credit and Credit Guarantees and on Government Procurement; the Development Assistance Committee; the Committee on Fiscal Affairs and its various working parties; the Committee on Financial Markets; and the Committee for Invisible Transactions.

U.S. balance of payments

Interpretation of balances.—The separation of international transactions into specific categories, and striking balances (e.g., current account, official reserve transactions) has an essentially analytical function. Depending on the construct of the balances, the results yield a variety of information such as developments in a country's competitive position, changes in the size and profitability of its foreign investments, the magnitude of various types of international capital movements, and so forth. In addition, several of the "overall" balances have been used during the period of fixed exchange rates as indicative of underlying trends in the strength of the dollar, or of the imbalance between supply of and demand for dollars in the exchange markets during any given period. This imbalance was measured by official purchases or sales of dollars which were assumed to have been made mainly to bridge that imbalance.

The analytical interpretation of any of these balances, or of changes in them, depends not only on the purpose for which the analysis is to be made, but also on the fundamental form of the international monetary system. The focus of the analysis of U.S. transactions has shifted several times over the past 30 years. For example, from the mid-1940's to the late 1950's, the emphasis tended to be on the impact of U.S. international transactions on the physical recovery and financial strengthening of other economies in the aftermath of World War II.

From the late 1950's to the advent of generalized floating in March 1973, the analysis was largely concerned with the strength of the dollar in its role as the principal reserve currency and the standard for measurement of the exchange rate parities of other currencies.

Under the current system, under which official agencies of foreign countries are not obliged to maintain the exchange rates of their respective currencies relative to the dollar within a specified margin around established par values, both a rise and a decline in foreign official holdings of U.S. debt obligations may be associated with either strength or weakness of the dollar in foreign exchange markets. Shifts in the exchange rates of foreign currencies relative to the dollar in opposite directions may not result in offsetting purchases and sales of U.S. debt obligations by foreign official agencies (leaving their aggregate holdings unchanged) but may result in either net sales or net purchases. If foreign official sales exceed foreign official purchases, U.S. liabilities to foreign official agencies would decline. Under such conditions, the exchange rate of the dollar may weaken but under the concepts underlying the official reserve transactions balance, the U.S. balance of payments would show a surplus. If foreign official purchases of U.S. debt obligations exceed foreign official sales, the exchange rate of the dollar may strengthen, but the official reserve transactions balance would show a deficit.

Furthermore, since the abrupt rise in oil prices at the end of 1973 official agencies of some of the major foreign countries have attempted to bolster their holdings of dollar assets by borrowing dollars directly, or through enterprises and banks under their control, from U.S. or foreign private sources. These official acquisitions appear as a deficit of the United States under the official reserve transactions concept although such acquisitions were deliberate and reflected confidence in the function of the dollar as a reserve asset rather than an intervention to absorb an excess supply of dollars in the foreign exchange markets. The usefulness of the official reserve transactions balance as a tool in interpreting the balance of payments of the United States has been invalidated further by the large investments by the official agencies of oil-exporting countries in U.S. Government and private securities. Such investments should be interpreted as an indication of strength of the U.S. economy and the U.S. balance of payments, not as a weakness.

In addition, the massive accumulations of OPEC funds has further obscured the already somewhat murky distinction between short- and long-term capital flows which underlie the so-called basic balance (current account plus long-term capital), sometimes used to evaluate the "underlying" balance of payments position. A large portion of these funds is invested in nominally short-term assets, although the intent often is to hold the investments over a longer term.

For all these reasons, analysis in terms of the so-called overall balances is extremely hazardous and potentially misleading under the present exchange rate regime, and the large acquisitions of dollar assets by official agencies of various countries as long-term investments and not merely for the purpose of evening out short-term imbalances in their foreign transactions.

Merchandise trade.—Merchandise exports rose from about $25 billion in the September quarter of 1974 to $27.2 billion in the March quarter of 1975 but declined to about $25.7 billion in the June quarter. About half of the rise and nearly all of the decline were in exports of agricultural products, largely due to changes in prices.

Exports of other commodities are more sensitive to business developments abroad. In value they expanded through the December 1974 quarter, but the rate of expansion slowed down considerably in the course of the calendar year. In value terms, exports reached a peak in January and declined in the following months. However, since prices of nonagricultural exports were rising throughout this period, although at a declining rate, export volume peaked in the June 1974 quarter, declined somewhat in the July–December 1974 half year, and more sharply in the following half year. This weakening in the volume of nonagricultural exports reflects the influence of foreign business developments, but only with a delay.

This delay is due to the normal lag between changes in foreign business activity and the receipt of orders of capital equipment, and the further lag until deliveries against these orders are made. During the declining phase of the business cycle, deliveries may for some time decline less than new orders as the order backlog is being reduced. The value of exports of capital goods, which comprise about 40 percent of all nonagricultural exports, has been maintained in part because of the lag in the deliveries and in part because of rising prices. Adjusted for prices, exports of capital goods leveled off in the second half of calendar 1974, and started to decline in the first half of calendar 1975.

The impact of the decline in foreign business activity on U.S. exports was mitigated in part, however, by the rise in import demands in the oil-producing countries (other than Canada).

Exports (excluding military equipment) to these countries rose from about $1 billion in the December 1973 quarter to $2.1 billion in the December 1974 quarter and to about $2.5 billion in the June 1975 quarter. For the year ended June 1975, exports to these countries totaled $8.8 billion, about double the amount in the preceding year.

The volume of imports peaked in the June 1974 quarter. Import volume in the following two quarters declined at an annual rate of 4 percent, but in the March and June quarters the decline was about the same as in the value of imports. Imports, adjusted for prices, thus started to decline about a half year later than domestic economic activity (measured by GNP adjusted for the prices changes) which had reached a peak in the December 1973 quarter and fell at an annual rate of about 4.4 percent in the first half of calendar 1974. In the following half-year period, the decline in imports was less than the decline in real GNP which had accelerated to about 5.5 percent. This relatively retarded and slower rate in the import decline was more than compensated for by the much more rapid decline in the March 1975 quarter, although the downward movement in domestic economic activity accelerated to about 11.4 percent, and in the following quarter when imports continued to decline while domestic economic activity started to turn up again.

One of the major reasons for the relatively slow reaction of imports to changes in domestic economic activity may have been the very large swings in inventories, which continued to rise throughout the calendar year 1974 but dropped sharply in the first and second quarters of calendar 1975.

The very sharp decline in imports in the winter and spring of fiscal 1975 may also reflect, however, an improvement in the ability of domestic producers to supply the domestic markets for the same reasons that domestic producers have been able to strengthen their competitive position in foreign markets. As in the case of exports, imports may not have reflected these changes until sales on domestic markets became more strongly influenced by competition among suppliers, and older contracts have expired.

The balance on merchandise trade, which reached a low point with a deficit of $2.3 billion in the September 1974 quarter, improved to a surplus of $1.8 billion in the March 1975 quarter and expanded further, to $3.3 billion in the June 1975 quarter.

Other current account transactions.—The balance on other current account transactions declined about $1.2 billion from a surplus of about $2,160 million in the second half of calendar 1974 to a surplus of $950 million in the first half of calendar 1975. The major reason for that change was a $2.1 billion decline in the excess of receipts over payments on investment incomes. About $1.7 billion of this decline was in incomes obtained by U.S. companies from direct foreign investments in the oil industry, net of the share in these earnings paid or payable to foreign governments of oil-exporting countries on their share in the oil production. In the first half of calendar 1975, incomes on investments in the oil industry were at an annual rate of about $2.8 billion, compared with $6.9 billion in calendar 1974 and about $4 billion in 1973.

The decline in incomes on direct investments abroad reflected in part the general decline in foreign economic activity. However, income receipts in the second half of 1974 also included dividend disbursements by foreign subsidiaries of U.S. corporations from surpluses which had been accumulated in earlier periods, so that the decline (about $600 million annual rate) from that period to the first half of 1975 was probably larger than the decline in earnings on the foreign investments.

The decline in the balance on investment incomes was partly offset by increases in the balances on various services transactions including transportation and travel. Net payments for transportation dropped as imports declined more than exports. Payments associated with travel by U.S. residents to foreign countries rose less than receipts associated with travel by foreign residents to the United States.

Other developments which have raised receipts and/or lowered expenses affected military transactions and Government grants. Expenditures through both of these transactions were reduced early in 1975 by the curtailment of activities in Southeast Asia. Receipts increased as a result of acceleration of deliveries of military equipment mainly to the Middle East—largely on orders which had been placed in earlier periods.

Capital transactions—July–December 1974.—The net outflow of U.S. private capital, which amounted to $10.1 billion in the June 1974 quarter, fell to $4.3 billion in the September quarter. This abrupt decline was due to a $5.3 billion contraction in net lending to foreign residents by U.S. banks, and to a $0.6 billion decline in the net outflow of corporate funds. These changes reflect the tightening in the availability of funds in the U.S. capital market which accelerated in the June quarter and reached a peak in the September quarter.

To some extent, the decline in the outflow of U.S. private capital was offset by a $740 million rise in dollar funds made available to foreign countries by the IMF, which increased the U.S. reserve position by an equivalent amount.

The decline in the net outflow of U.S. capital coincided with a $4.8 billion decline in the acquisition by foreigners of assets in the United States (or claims on U.S. corporations) from $10.6 billion in the June quarter to $5.8 billion in the September quarter. Official agencies and banks of oil-producing countries increased their investments in U.S. private and government debt obligations by about $3.6 billion, only slightly less than in the June quarter ($4 billion).

Investments in the United States by official agencies and banks of less developed countries other than the major oil producers were about stable in the September quarter, after having increased about $700 million in the previous quarter.

Assets held in the United States by private banks in other advanced countries (including banks organized in the Bahamas and certain other Caribbean islands) increased in the June and the September quarters by $2.7 and $2.6 billion, respectively.

During the December 1974 quarter, the tightness in domestic capital markets relaxed and interest rates, especially on short-term obligations, declined. These developments, which were associated with a considerable slackening in domestic activity (the GNP adjusted for price changes declined at an annual rate of about 9 percent), provided the basis for an acceleration in the net outflow of U.S. private capital by $4.6 billion to about $8.9 billion. About $1.9 billion of this increase consisted of bank loans, about $0.4 billion of purchases of foreign bonds, largely new issues placed with U.S. investors, and about $2.3 billion were provided by nonbank corporations, partly to their own affiliates abroad, and partly to other foreign residents.

The $4.6 billion rise in the net outflow of private U.S. capital plus an $0.8 billion increase in net lending by the U.S. Government, less a $0.6 billion decline in IMF lending of dollar funds, exceeded the $2.9 billion rise in inflows of foreign funds by $1.9 billion. The difference is largely accounted for by the $1.4 billion rise in the U.S. surplus on current account transactions and a $0.5 billion shift from net purchases to net sales of SDR's and convertible foreign currencies by U.S. official agencies.

The net inflows of foreign funds in the December quarter amounted to $8.7 billion; in the September quarter the net inflow was $5.9 billion. Included in the $8.7 billion rise in foreign assets in the United States was a $1.6 billion increase in U.S. official and private debt obligations held by official agencies and banks of OPEC countries (net of a reduction in claims by one of the oil-exporting countries on a U.S. corporation operating in its territory). This increase was about $2 billion less than in the preceding quarter. A slight offset to this decline was a $0.1 billion rise in investments by these countries in equity securities of U.S. corporations. Apparently a larger share of net dollar receipts by OPEC members was lent to other countries either directly or through intermediaries, including the oil facility of the IMF.

The U.S. debt obligations held by official agencies and banks of other less developed countries remained nearly stable, the same as in the preceding quarter. Holdings of U.S. assets by private banks in advanced foreign countries (including the banks organized in certain Caribbean islands) increased (after seasonal adjustment) $2.6 billion, down from $2.9 billion in the September quarter.

The decline in new investments in the United States by official agencies and banks of OPEC and other less developed countries, and banks in other advanced countries was more than made up, however, by a shift from a reduction by nearly $1 billion (after adjustment for seasonal variations) in U.S. debt obligations held by official agencies of other advanced countries in the September quarter to an increase of about $4.2 billion in the December quarter. This accumulation of dollar assets restored the amount of official reserve assets held in the United States by these countries to within less than $1 billion of the amounts held at the beginning of 1974, before the large payments for oil started.

Capital transactions—January–June 1975.—In the March and June quarters, capital transactions of the United States were affected by the decline in business activity both in the United States and abroad relative to the longer run trend.

Recorded outflows of U.S. private capital dropped from about $8.9 billion in the December 1974 quarter to about $6.3 billion in the March quarter and $6.6 billion in the June quarter. Net transfers of capital through U.S. Government lending programs, which had expanded to nearly $1 billion in the December quarter, remained at that level in the March quarter but declined slightly, to $0.8 billion, in the June quarter.

Recorded inflows of foreign capital declined from $8.7 billion in the December quarter to $3.7 billion in the March quarter and fell further, to $3 billion, in the June quarter.

The decline in the outflow of U.S. capital in the March and June quarters from the December quarter was largely due to a decline in the outflow of corporate capital to foreign affiliates as well as other foreigners. It is likely that this decline reflected the slowdown in foreign business activity and a contraction in their capital expenditures. Bank lending was also down from the December quarter rate, but the decline was smaller than that of corporate capital. In part, these reductions were offset by a considerable increase in U.S. purchases of foreign bonds. These purchases, which were particularly large in the March quarter, included primarily new securities issued by international organizations, foreign governmental organizations, and state enterprises. Capital requirements by these public organizations are not affected by cyclical developments in the same manner as capital requirements by private business, and often expand when private capital demand is relatively slack and contract in periods when private borrowing increases.

The decline in the foreign investments in the United States corresponded to the decline in net receipts of funds by foreigners from their other transactions with the United States. Most important in the March quarter was the $2.1 billion rise in their net payments to the United States for current account transactions and the $2.3 billion decline in their net receipts from the outflow of U.S. capital.

The further drop of $0.7 billion in foreign investments in the United States in the June quarter cannot be as closely related to these major categories of transactions. Net foreign payments for current account transactions rose another $2 billion, but net foreign receipts from the outflow of U.S. capital increased $0.4 billion. The difference of nearly $1 billion largely reflected an increase in net foreign receipts through other transactions, particularly some for which statistical data are not available.

The economic developments which influenced the changes in the overall size of capital inflows also influenced the composition of these inflows.

The major change in the inflow of foreign capital during the March quarter was a $2.7 billion liquidation of assets held in the United States by private banks of the advanced foreign countries. This liquidation nearly reversed a rise in their assets in the United States in the preceding quarter. (These figures are adjusted for seasonal movements.) At the same time, official agencies of the advanced countries increased their holdings of assets in the United States by $3.1 billion, which compares with an increase of $2.3 billion in the December quarter (after adjustment for seasonal movements). In fact, the inflow of funds from the official agencies of these countries equaled over four-fifths of the recorded inflow of foreign capital from all sources during that period.

Investments by official agencies and banks of OPEC countries, including investments in equity securities and advances to a U.S. corporation operating in the territory of one of these countries, amounted to about $300 million, compared with about $2.1 billion in the December quarter.

Official agencies and banks of other less developed countries increased their investments in the United States by nearly $700 million, slightly less than the rise in their indebtedness to U.S. banks in the same period.

The major reason for the liquidation of dollar assets by banks of other advanced countries and for the decline in investments in the United States by OPEC countries was perhaps the decline in domestic credit demand relative to the availability of capital and the lending facilities of banks, and the resulting decline in domestic interest rates.

An additional factor reducing the inflow of funds from OPEC countries was the decline in their revenues resulting from the decline in oil production, the postponement by Iran of collecting obligations of oil companies from the first to the second quarter.

In the June 1975 quarter, the petroleum-exporting countries accelerated again their investments in the United States to about $1.9 billion. Official agencies and banks of other less developed countries increased their assets in the United States by about $300 million, although their indebtedness to U.S. banks increased about $1 billion. Private banks in industrially advanced countries (including banks organized in the Bahamas and certain other Caribbean islands) stopped the liquidation of their assets in the United States and reversed the flow, but after adjustment for seasonal changes the rise of their assets was less than $200 million.

These changes account for approximately the total capital inflow in the June quarter except for about $0.5 billion in purchases of U.S. securities and direct investments by private foreign residents.

There were no significant acquisitions of assets in the United States by official agencies of advanced foreign countries. Monetary authorities of the United States were able to purchase foreign currencies in sufficient amounts to repay all but about $200 million of the loans obtained from foreign official agencies during the first 3 months of the calendar year.

Treasury foreign exchange reporting system

During fiscal 1975, by the introduction of 4 reports supplementary to the regular series, 19 countries, principally oil exporters, were added to the geographical list on which monthly data are collected under the Treasury foreign exchange reporting system. Notice of the amendment to the Treasury Regulations requiring the supplementary reports was published in the Federal Register on August 29, 1974.

The new reports were initiated primarily to provide comprehensive data on U.S. liabilities to and claims on the oil-producing countries in view of the current and potential magnitude of oil-related capital flows and their impact on the U.S. balance of payments. In addition to oil-producing countries, the supplementary forms include certain developing financial centers and certain countries in which U.S. banks conduct an important branch banking business. Limited data on these 19 countries have in the past been collected only semiannually.

A supplementary reporting instruction was issued in February 1975 to all reporting banks to obtain separate data on claims on foreigners held by the banks for their domestic customers.

U.S. balance of payments, fiscal years 1974–75

[In millions of dollars]

	Fiscal 1974 [1]	Fiscal 1975	Fiscal 1975*	
			1st half	2d half
Current account transactions:				
Merchandise trade, balance of payments basis,[2] net	956	1,333	−3,769	5,101
Exports	86,195	104,409	51,577	52,832
Imports	−85,239	−103,076	−55,346	−47,731
Military transactions excluding grants, net	−1,856	−1,768	−1,009	−759
Deliveries under sales contracts	2,883	3,365	1,605	1,760
Expenditures	−4,739	−5,133	−2,614	−2,519
Travel, excluding transocean fares, net	−1,966	−1,633	−930	−702
Receipts	3,720	4,432	2,082	2,351
Payments	−5,686	−6,065	−3,012	−3,053
Other services, net	2,950	3,470	1,514	1,957
Receipts	12,013	13,563	6,792	6,771
Payments	−9,063	−10,093	−5,278	−4,814
Income on investments, net	7,846	7,770	4,939	2,831
Receipts on U.S. assets abroad	20,095	22,292	13,518	8,775
Payments on foreign assets in the United States	−12,249	−14,522	−8,578	−5,943
Private remittances, Government transfers other than grants	−1,942	−1,819	−896	−923
Government economic grants	−2,744	−2,906	−1,456	−1,449
Balance on current account transactions	3,244	4,447	−1,608	6,055
Capital account transactions:				
U.S. acquisitions (−) and liquidations (+) of assets abroad, net	−27,764	−30,339	−15,226	−15,112
Private	−24,908	−26,069	−13,183	−12,885
Direct investments	−4,199	−8,181	−5,139	−3,043
Other assets reported by U.S. nonfinancial corporations [3]	−4,039	−9	−567	559
Securities	−1,637	−4,052	−1,030	−3,022
Assets reported by U.S. banks	−15,033	−13,827	−6,447	−7,379
Government	−2,856	−4,270	−2,043	−2,227
Credits, capital contributions, etc	−2,260	−3,027	−1,177	−1,850
Official reserve assets	−596	−1,243	−866	−377
Foreign acquisitions (+) and liquidations (−) of assets in the United States, net	21,939	20,837	14,341	6,496
Private [4]	21,875	9,025	8,573	452
Direct investments	4,578	309	−654	963
Other claims on U.S. nonfinancial corporations [3]	1,525	1,142	751	391
Securities other than U.S. Treasury issues	2,980	869	−459	1,328
Liabilities reported by U.S. banks	12,792	6,705	8,935	−2,230
Official [4]	64	11,812	5,768	6,044
Claims arising from prepayments on military and other sales contracts	743	1,414	401	1,012
Liquid assets	−84	8,263	4,386	3,876
Other U.S. debt obligations	−595	2,135	980	1,155
Balance on capital account transactions	−5,825	−9,502	−886	−8,617
Errors and omissions, net	2,583	5,054	2,493	2,561

[1] The figures for Government economic grants and for Government credits, capital contributions, etc. in 1974 have been adjusted to exclude certain grants to India and Vietnam provided in the form of cancellations of claims against those countries. In the balance of payments compilations published in the Survey of Current Business, these transactions appear as grants offset by capital inflows.

[2] The figures for merchandise trade included in balance of payments compilations are based on data collected by the Bureau of the Census, but are adjusted for coverage and timing. The balance of payments figures also exclude exports and imports by U.S. defense agencies which are included in military transactions. Details of the adjustments are shown in table 4 of the quarterly balance of payments compilations published in the Survey of Current Business.

[3] Includes claims and liabilities reported by U.S. brokerage concerns.

[4] Foreign private assets in the United States include (and foreign official assets in the United States exclude) all foreign investments in equity shares issued by U.S. corporations, and in claims, other than marketable debt obligations, of U.S. nonbank enterprises.

*Seasonally adjusted.

Source: Survey of Current Business, June and September 1975, published by U.S. Department of Commerce, Bureau of Economic Analysis.

Treasury foreign currency reporting system

The new Treasury foreign currency reporting system developed pursuant to title II of Public Law 93-110 of September 21, 1973, was established during fiscal 1975.[1] The first monthly reports provided data on banks' positions in major foreign currencies as of the end of November 1974; the first weekly reports covered banks' positions in those currencies as of December 4, 1974. Reports on the foreign currency positions of nonbanking corporations began as of March 31, 1975.

Although the bank report forms had been designed with considerable participation by banks and Federal banking authorities, because of the pioneering nature of the new reports on foreign currency positions unforeseen problems inevitably came to light when banks began to submit the reports. In addition, developments in the exchange markets and the difficulties experienced by a number of banks led to increasing concern in the executive branch and the Congress with problems arising from the exposure of individual banks in the exchange markets. Consequently, during the spring of 1975 significant revisions in the forms were undertaken to solve the reporting problems which had arisen, to increase the usefulness of the reports to the bank regulatory agencies, and to measure more precisely the foreign exchange market phenomena being studied. At the close of the fiscal year, revised bank report forms were in preparation for early submission to OMB for clearance under the Federal Reports Act.

Developing Nations Finance

International development banks[2]

The Congress appropriated $619.1 million for the resources of the international development banks in fiscal 1975, as shown in the table below:

Institution	U.S. participation [$ millions]		Comment
	Authorization	Appropriation	
International Development Association.		320.0	Final installment to third replenishment.
Do	1,500.0		U.S. contribution to fourth replenishment. Appropriation will be requested in four annual installments of $375 million each in 1976-1979.
Inter-American Development Bank—Fund for Special Operations.		225.0	$275 million remains to be appropriated from the amount authorized in fiscal 1972.
Asian Development Bank—Ordinary Capital:			
Paid-in	72.4	24.1	Authorization is U.S. share of first replenishment; appropriation is first installment of first replenishment.
Callable	289.5		
Subtotal	361.9	24.1	
ADB—Asian Development Fund.	50.0	50.0	Authorization is third U.S. contribution to ADB concessional facility; appropriation of second contribution authorized in fiscal 1974.
Total	1,911.9	619.1	

[1] See exhibits 65 and 66.
[2] See exhibit 74.

The international development banks committed $7,743 million to over 75 developing countries in fiscal 1975. The distribution of commitments by institution was as follows: World Bank group, $6,108 million; Inter-American Development Bank, $1,065 million; and Asian Development Bank, $570 million.

To put into perspective the importance of these banks to development assistance generally, total lending flows from the international development banks are equal to over 40 percent of the total official development assistance from OECD countries in calendar year 1974.

At the end of fiscal 1975, the United States was behind the schedules observed by other nations contributing to the international development banks. Although the United States is the largest single contributor to the international development banks, other donors together contribute more than twice as much. Contributions from other donors thus complement the U.S. subscriptions and increase the financial impact of these institutions which stress the role of market forces in the effective allocation of resources, the development of outward-looking trading economies, the critical role of private enterprise, and the importance of spreading development benefits to the poorer people.

The World Bank group

The International Bank for Reconstruction and Development (IBRD) and its affiliates, the International Development Association (IDA) and the International Finance Corporation (IFC), committed $6,108 million for development projects in their member countries in fiscal 1975. This volume represents a 35-percent increase over the fiscal 1974 level and 72 percent over the lending level in fiscal 1973. The IBRD made new loans of $4,320 million ($1,102 million more than in the preceding fiscal year) while new IDA credits were $1,576 million (compared with $1,095 million in fiscal 1974). New IFC investments in equity and loans to the private sector totaled $212 million in fiscal 1975 (compared with $203 million in fiscal 1974 and $147 million in fiscal 1973). As of June 30, 1975, total IBRD loans outstanding amounted to $22,322 million, total IDA credits outstanding were $8,795 million, and total IFC cumulative net commitments were $1,262 million.

IBRD and IDA lending is increasingly concentrated on agriculture with agricultural projects accounting for 32 percent of total lending in fiscal 1975 as compared with 22 percent in 1974. Other important sectors of IBRD/IDA lending in 1975 included development finance corporations and industry (22 percent), transportation (17 percent), and electric power (9 percent). IFC investments were concentrated in iron and steel (23 percent), chemicals (15 percent), development financing (13 percent), construction materials (10 percent), and textiles (10 percent).

The IBRD and IDA committed funds for development projects in 72 countries in fiscal 1975. The distribution of commitments by region was as follows: Africa, $1,081 million; Asia, $2,166 million; Latin America, $1,215 million; and Europe, the Middle East, and North Africa, $1,434 million. India was the largest individual borrower from the IBRD and IDA ($840 million), while Brazil was second ($427 million), and Mexico third ($360 million).

IFC commitments during fiscal 1975 went to 32 enterprises in 20 developing countries. By region, IFC commitments went to 12 projects in Latin America ($80 million), 7 projects in Europe ($63 million), 8 projects in Asia ($55 million), and 6 projects in the Middle East and Africa ($14 million). Turkey received the largest individual total ($62 million), with Korea second ($35 million), and Brazil third ($25 million).

At the annual meeting of the World Bank in Washington, D.C., September 30 to October 4, 1974, Secretary Simon indicated several challenges facing the Bank while strongly reiterating U.S. pride in its role in the development of the World Bank group since its establishment in 1945.[1] Among the challenges were: To strengthen the Bank's commitment to the principle that project financing makes sense only in a setting of appropriate national economic policies, of effective mobilization and use of domestic resources, and of effective utilization of the private capital and the modern technology that are available internationally on a commercial basis, and to continue and increase the Bank's annual transfer of a portion of its income to IDA.

The Secretary expressed concern about the Bank's capital position and encouraged the Bank to seek ways to mobilize funds by techniques which do not require the backing of its callable capital. He also noted that the Bank needs to renew its commitment to stimulation of the private sectors of developing countries, and pointed out that within the Bank group, the IFC is a key element in the total equation and one which should be even more important in the future.

The lending operations of the IBRD are financed by paid-in capital subscriptions, funds borrowed in capital markets and from governments and central banks, sales of participations, principal repayments on loans, and earnings on loans and investments. The IBRD's net outstanding funded debt increased by $2,637 million during the year to $12,287 million. This debt includes 143 separate bond issues, denominated chiefly in U.S. dollars ($5,693 million), deutsche marks ($2,859 million equivalent), and Japanese yen ($1,501 million equivalent).

During the year, IBRD gross borrowings reached a new peak of $3,510 million equivalent, up nearly 90 percent from $1,853 million

[1] See exhibit 50.

borrowed in fiscal 1974. The total borrowing of $3,510 million included $2,671 million equivalent in bond placements to raise new funds and $839 million in rollovers of past issues.

IBRD borrowings continued to shift toward placements with governments, governmental agencies, and central banks, with a sharp rise in bond purchases by petroleum-exporting countries. Of the total of $3,510 million raised in fiscal 1975, $856 million was raised on the private market and $2,654 million from governments. The percentage of IBRD issues purchased by central banks, governments, and governmental agencies has risen from 32 percent in 1972, to 59 percent in 1973, to 80 percent in 1974. There was a slight decrease to 76 percent this year, but the share of IBRD issues purchased by petroleum-exporting countries increased dramatically to 57 percent (up from 31 percent in fiscal 1974 and 13 percent in fiscal 1973).

The principal suppliers of borrowed capital in 1975 were Saudi Arabia ($891 million), Germany ($512 million), the United States ($500 million), and Venezuela ($500 million). The U.S. issues were the first borrowings in the U.S. market in 4 years.

Of total issues outstanding on June 30, 1975, about 24 percent were estimated to be held in Germany, 22 percent in the United States, 12 percent in Japan, 8 percent in Saudi Arabia, 6 percent in Switzerland, and 5 percent in Venezuela. The remaining 23 percent were held largely by investment institutions in about 70 countries.

During the year IDA operations reached a new record level with new credits totaling $1,576 million, an increase of 44 percent over fiscal 1974. IDA credits are funded primarily by member country subscriptions and contributions, grants from the net income of the IBRD, repayments of credits, and earnings. During the year, the United States contributed its fourth and final installment of $320 million to IDA's third replenishment plus an additional $66 million as a maintenance of value payment to IDA. Usable resources of IDA, cumulative to June 30, 1975, amounted to $11,613 million consisting of $10,505 million in member contributions, $908 million in transfers from IBRD net income, and the remainder from earnings, participations in credits, repayments on outstanding credits, and loans from the Swiss Confederation.

Resources available to IDA for future commitment increased substantially in January 1975 when the IDA fourth replenishment became effective on receipt of official notification from the United States of its intention to subscribe. This action was authorized by the Congress on July 2, 1974. The agreement was negotiated among 25 donor countries in September 1973 to cover a 3-year period through fiscal 1977, and calls for total contributions of the equivalent of $4,501 million in current dollars. (These contributions will not be subject to a maintenance of value provision.) The U.S. share of the replenishment under the negotiated agreement will be $1,500 million, subject to annual appropriation by the Congress. The United States has chosen to exercise its option to spread its contributions over 4 years and to delay payment of its initial installment for 1 year until fiscal 1976.

Inter-American Development Bank

During fiscal 1975, the IDB committed a total of $1,065 million from its two windows, for a 3-percent increase in lending over the previous fiscal year. Of this amount, $590 million was lent on conventional terms from Ordinary Capital resources and $475 million on concessionary terms from the Fund for Special Operations. In addition, the IDB committed $3 million in funds administered by the Bank for various donors. Cumulative lending by the IDB from its own resources totaled $7.1 billion as of June 30, 1975. Of this, $3.5 billion had been lent from Ordinary Capital and $3.6 billion from the Fund for Special Operations. In addition, the IDB had lent $600 million from funds it was administering. Local contributions in member countries to IDB-financed projects are almost two times greater than IDB funding.

The power and agriculture sectors received most of the funds committed during 1975. About 27 percent ($292 million) went to power and 24 percent ($257 million) to agriculture. The transportation sector received 19 percent ($203 million) of the loans. On a cumulative basis, agriculture has received the largest amount, 23 percent, or $1.8 billion; power has received the next largest amount, 21 percent, or $1.6 billion.

Lending operations of the IDB are financed mainly from capital subscriptions, borrowings in international capital markets, and member contributions to the Fund for Special Operations. At the end of fiscal 1975 the total subscribed capital of the IDB was $5,965 million, of which $983 million was paid-in and $4,982 million was callable. The resources of the IDB Fund for Special Operations amounted to $3,945 million. U.S. subscriptions to IDB capital shares were $2,409 million, or 40 percent of the total. The United States accounted for $2,715 million, or 69 percent, of total resources contributed to the Fund for Special Operations.

As of the end of June 1975, U.S. contributions to the Fund for Special Operations under the capital replenishment initiated in 1970 were behind the schedule observed by the other member nations. On March 26, 1975, the Congress appropriated $225 million, of which $50 million was designated for lending only to cooperatives, credit unions, and savings and loan institutions. Of the $1.0 billion authorized in fiscal 1972, there remained outstanding and still to be appropriated $275 million.

In fiscal 1975 the IDB placed long-term borrowings of $250 million equivalent in international capital markets. These borrowings consisted of $225 million in the United States, $12 million in Europe (Italy), and $10 million in Latin America (Trinidad and Tobago). In addition, the IDB sold $53 million of 2- and 5-year bonds to central banks in Latin America. The IDB's funded debt amounted to $1.6 billion equivalent on June 30, 1975.

In February 1975, the IDB and Venezuela reached agreement on a $500 million trust fund to be administered by the IDB. The resources will consist of $400 million and 430 million bolívares (approximately equivalent to $100 million), to be made available in 10 equal semiannual installments over a period of 5 years. The Venezuelan trust fund will make loans on Ordinary Capital terms and will make small equity investments in the lesser developed countries of Latin America to develop natural resources, finance working capital, finance agriculture and agro-industry, complement the IDB export promotion program, and promote economic integration.

In fiscal 1975, significant progress was made toward broadening the base of the IDB's resources by bringing nonregional industrialized nations into the Bank. A group of 12 nonregional countries (10 European, Israel, and Japan) issued in December 1974 a declaration of their intention to join the IDB. In February 1975 the IDB and the prospective nonregional members concluded negotiations and in March the Board of Directors approved the proposed financial package and the amendments to the Charter necessary to facilitate entry of the nonregional countries. The countries that were signatories to the Declaration of Madrid are Austria, Belgium, Denmark, Germany, Israel, Italy, Japan, the Netherlands, Spain, Switzerland, the United Kingdom, and Yugoslavia. The group as a whole will subscribe to $372.7 million in capital shares and contribute an equal amount to the Fund for Special Operations. Of the total of $745.4 million, $444 million will consist of cash payments and the remainder callable capital. The Board of Governors adopted a resolution in May 1975 calling for expeditious consideration and ratification of the proposals by both the current and prospective members. The target date for effective implementation of nonregional membership is late in fiscal 1976.

The 16th annual meeting of the IDB was held in Santo Domingo, Dominican Republic, May 19–21, 1975. Secretary Simon headed the U.S. delegation and in his address said that the United States was prepared to begin discussions of a capital replenishment for 1976–79. He urged the more developed Latin American members to make part of their contributions of soft funds in convertible currencies, and he stated U.S. support for further concentration of scarce Fund for Special Operations resources in lending to the least developed countries.

He called for greater IDB efforts to expand agricultural research and promote food production. He also urged reduction of the undisbursed loan pipeline and of cost overrun financing. He emphasized the importance of private investment in the development process and called on the IDB to expand its parallel and joint financing activities.[1]

The Board of Governors adopted several resolutions at the annual meeting, the most important of which called for the urgent consideration of replenishment of the Bank's resources. A working group established to pursue that objective met in Paris in early June 1975 and reached agreement on the basic outlines for an increase in the subscribed capital and Fund for Special Operations quotas. The Board of Executive Directors approved the proposals of the working group on June 26, 1975, and resolved to call a special meeting of the Board of Governors to consider the matter. The proposed replenishment package for the period 1976–79 totaled $6,348 million, of which $5,303 million would consist of subscriptions to capital shares ($348 million paid-in and $4,952 million callable including unassigned shares) and $1,045 million would be contributions to the Fund for Special Operations. The proposed U.S. share in the replenishment was $1,650 million in capital subscriptions ($120 million paid-in and $1,530 million callable) and $600 million in contributions to the Fund for Special Operations. The administration plans to submit the proposal to the Congress in early fiscal 1976.

Asian Development Bank

During fiscal 1975, the Asian Development Bank committed a total of $570 million, of which $376 million were Ordinary Capital loans, and $194 million from Special Funds/Asian Development Fund. (The Asian Development Fund (ADF) was set up in 1974 to replace the ad hoc Special Funds mechanism by a unitary, multilaterally negotiated concessional loan window.) As a result, the Bank's cumulative loans stood at $2,061 million at June 30, 1975, $1,538 million from Ordinary Capital and $523 million from Special Funds. The highest proportion of lending was to the agriculture sector (29 percent).

The Bank obtains its lending resources for Ordinary Capital from subscriptions to the Bank's Ordinary Capital stock. Cash for disbursements is provided by paid-in capital subscriptions, funds borrowed in private capital markets and from governments and central banks (backed by callable capital subscriptions), repayments of principal and interest on loans, and net earnings on investments. Special Funds/ADF loan resources come from member country contributions, set-asides from Ordinary Capital earnings, and repayments of loans.

[1] See exhibit 73.

At June 30, 1975, the Bank's subscribed Ordinary Capital stock totaled $3,201 million. The $431 million increase during the year reflected the special capital increases for three members of the Bank: Malaysia, Indonesia, and Korea, $210.6 million, and the U.S. subscription to the first installment of the 1972 capital increase of $120.6 million.

In fiscal 1975 the Bank entered the U.S. private capital market with a $75 million placement. This was the first time the Bank had borrowed in the United States since 1971. For the year as a whole, gross borrowings in international capital markets were $263 million, as compared with $54.2 million in 1974. At the end of fiscal 1975, the Bank's total funded debt stood at $432 million.

Congressional authorization for a $362 million U.S. participation in the Bank's 1972 Ordinary Capital increase was approved in December 1974, along with the authorization for a third U.S. $50 million contribution to the Special Funds/Asian Development Fund. Appropriation of the first of three annual installments of $120.6 million in Ordinary Capital ($24.1 million paid-in and $96.5 million callable) was sought in fiscal 1975. In March 1975, the Congress appropriated only the $24.1 million for the paid-in portion. On April 23, 1975, Secretary Simon subscribed, on behalf of the United States, to 10,000 additional shares of the Bank's Ordinary Capital stock; i.e., to 2,000 shares of paid-in capital amounting to $24.1 million, and to 8,000 shares of callable capital amounting to $96.5 million. Since subscription to the callable capital portion of the first U.S. installment of the capital increase represents a contingent liability of the United States, appropriations are not required at the time authorization legislation is obtained.

Congress authorized a $100 million U.S. contribution to the ADB's Special Funds in 1972. Of this amount, $50 million was appropriated in fiscal 1974 and $50 million in 1975. A request for a third $50 million, authorized in December 1974, has been included in the 1976 budget. This $50 million contribution would complete the U.S. $150 million share of the Asian Development Fund resource mobilization.

As of June 30, 1975, 14 donor countries had contributed $660.8 million to the Bank's Special Funds/Asian Development Fund. In addition, they had contributed $16.8 million for technical assistance. The ADF came into existence on June 28, 1974, with $236.9 million pledged by 10 donor member countries of the Bank. The second stage of contributions to the Fund came into effect on June 30, 1975, with additional contributions totaling $101 million. As of June 30, 1975, the United States had contributed $100 million to the Special Funds/Asian Development Fund.

The eighth annual meeting of the Board of Governors was held at the Bank's headquarters in Manila, April 24–26, 1975. Secretary Simon headed the U.S. delegation. In his address,[1] he emphasized the continuing American commitment to development efforts in Asia, exemplified by the U.S. subscription to the Bank's Ordinary Capital increase and the contribution of a second $50 million to the Bank's Special Funds. He congratulated the Bank for adopting a two-tier interest rate which will entail higher rates for borrowers with higher per capita incomes and thus encourage them to make greater use of private capital markets for their external financing requirements. In this context, he urged the Bank to avoid cost overrun financing and to pursue actively joint and parallel financing arrangements with the private sector. Since development comes from completed projects, he also encouraged the Bank to intensify its project supervision efforts to ensure the successful implementation and completion of approved projects.

At the annual meeting, the Board of Governors approved a resolution requesting the Board of Directors to report its findings on the need for future resource replenishment and its recommendations for future action. During the annual meeting, the Bank held an initial discussion with donor member countries on ADB management's proposal that a $1 billion replenishment take place early in 1976 to provide resources for the 1976–78 period. The United States and some other donors were not in a position to comment on the replenishment at that time.

African Development Fund

The African Development Fund (AFDF) was established in July 1973 through the cooperative efforts of 14 industrialized nations and the African Development Bank (AFDB). The Fund was created to channel non-African resources into the African development process and to provide concessional funds for social and infrastructure projects.

The United States was an active participant in the negotiation of the Agreement Establishing the African Development Fund and has sent observers to the annual meetings of the AFDB and AFDF. The 11th annual meeting of the Bank and the second annual meeting of the Fund took place in Dakar, Senegal, in early May 1975. At that meeting Saudi Arabia and Argentina announced their intention to join the Fund.

At the close of the fiscal year the capitalization of the Fund amounted to $142 million, all from participants' contributions. The Fund's lending terms are 50 years repayment period with 10 years grace and a 0.75 percent service charge.

[1] See exhibit 72.

Administration-sponsored legislation authorizing U.S. participation in the Fund with an initial $15 million subscription was introduced by Senator Sparkman on April 23, 1975. In June, Congressman Gonzalez introduced a similar bill. Authorization hearings were scheduled before the House Subcommittee on International Development Institutions and Finance for July 1975.

During fiscal 1975, the AFDF Board of Directors approved seven loans and one study totaling about $29 million, principally in agriculture and roadbuilding in drought-stricken West Africa.

Impact of oil prices[1]

The international economic and financial events of the last 2 years, particularly the increase in oil prices, fundamentally changed the growth outlook for the developing countries. Prior to the oil price increases, the external position of the developing countries and their growth prospects had been steadily improving. In the 1960's, the developing countries were growing at a considerably faster rate than the industrialized countries. This pattern continued into the 1970's, with real GNP growth in the non-oil-exporting developing countries exceeding 6 percent per annum. Export prices for the nonoil developing countries increased faster than import prices during the 1971–73 period, and the aggregate current account deficit of the developing countries was reduced. Capital inflows increased, and contributed significantly to an improved foreign exchange position by 1973. In 1973, the developing countries were enjoying an encouraging economic outlook; growth rates were at record highs and it appeared such rates could be sustained because basic development policies were being steadily improved, rates of domestic savings were rising, and external financing was increasing.

However, the development prospects for the non-oil-exporting developing countries were significantly impaired by events in late 1973. Not only did the increased price of oil place an immediate and extreme burden on the balance of payments of the developing countries, but the subsequent worldwide recession eroded both other commodity prices and the demand for less developed country exports. In 1974, increases in prices of food and fertilizer, occurring at the same time as oil prices quadrupled, also had serious effects on the economies of some of the developing countries. However, these effects appear to be transitory as prices of basic foodstuffs have already declined and fertilizer prices are falling. In 1974, the current account deficit of the non-oil-exporting countries is estimated at about $27 billion.

Of particular concern to the international community has been the problem of 33 countries designated by the United Nations as "most

[1] See exhibit 49.

seriously affected" (MSA's) by the oil and other import price rises. The magnitude of the current account and basic balance deficits for the MSA's is modest in absolute terms—about $6 billion and $1.6 billion, respectively. However, these countries generally require assistance on highly concessional terms as they are the countries with relatively weak long-term development prospects. In many of the MSA's, the growth rate of GNP has been reduced below the rate of population growth. As the scarce resources of the MSA's are used to pay for current consumption of oil, rather than longer term development projects, present and future growth potential is reduced. The response of international donors to the financing needs of the MSA's in 1974 was encouraging. Increased bilateral aid flows from both the DAC (Development Advisory Committee) and OPEC countries cushioned the immediate impact of increased oil prices, while the MSA's were able to finance the remainder of the deficit through regular IMF drawings and IMF oil facility borrowings.

Many middle- and high-income developing countries experienced a greater magnitude of disequilibrium in their external accounts than the MSA's, although the consequences have been less dramatic. In these somewhat more advanced countries, oil is more widely used in the production process than in the subsistence economies of the most seriously affected. However, middle- and high-income developing countries had access to private capital markets to cover much of the increased cost of oil, at least in 1974.

In 1974, despite forebodings to the contrary, capital flows to finance the greatly increased current account deficits of the developing countries were forthcoming mainly in the form of increased trade credits from the industrialized nations and expanded private capital borrowings. Supplementally, traditional and new sources of financing from the International Monetary Fund were largely adequate to finance the remaining 1974 balance of payments deficits.

In 1975, the impact of higher oil prices and recession in the industrialized countries shows up as a requirement to substantially slow down growth in the developing countries because large amounts of additional capital cannot continue to be borrowed year after year.

Less developed country adjustment to higher oil prices will be assisted over time by a strong recovery in economic activity in the developed countries. Also, as oil has become an expensive source of energy, the developing countries have begun to explore the possibility of exploiting heretofore undeveloped energy potential such as hydroelectric power and gas.

Development Committee

In June 1974, the Committee of Twenty recommended the establishment of a joint Ministerial committee of the Boards of Governors of the IMF and the IBRD to carry forward the C–20 Working Group study of the broad question of the transfer of real resources to developing countries and to recommend measures to be adopted in order to implement its conclusions. Prompt activation of such a group was urged by the United States during the summer.

The Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries (Development Committee) was established October 2, 1974, during the IMF/IBRD annual meetings. The members of the Committee are governors of the Bank, governors of the Fund, ministers, or others of comparable rank. The U.S. member of the Committee is the Secretary of the Treasury. The delegation includes representatives from the Federal Reserve Board, the Department of State, and the Agency for International Development. The Chairman of the Committee is Henri Konan Bédié, Ivory Coast Finance Minister. Henry J. Costanzo, an American, was elected Executive Secretary. Representatives of selected international organizations will participate in the Committee's meetings.

The formal mandate of the Committee is to maintain an overview of the development process; to advise and report on all aspects of the transfer of real resources to developing countries; and to make suggestions regarding implementation of its conclusions.

At its inaugural meeting, the Committee decided that priority attention should be given to the needs of the countries most seriously affected by the increase in oil and other prices in 1973–74. The Committee met twice more during the year—in January and June—each time in conjunction with meetings of the Interim Committee of the Board of Governors of the IMF on the International Monetary System.

At the session on January 17, 1975, the Committee endorsed the Interim Committee's recommendation to establish a special account in order to reduce, for the most seriously affected IMF members, the burden of interest payable by them under the 1975 IMF oil facility.[1] As of June 1975, no formal contributions had been announced, although there was continued widespread support in principle for concessional balance of payments assistance to poorest countries with urgent needs. The United States has suggested that consideration be given to using a portion of the profits from sale of IMF gold, in conjunction with voluntary contributions, to support the interest subsidy account.

The combination of high oil, fertilizer, and food prices along with industrial country inflation and recession has caused severe economic difficulties for many developing countries. Drawdowns of reserves and

[1] See exhibit 71.

increased borrowing in 1974 and 1975 will result in reduced availability of funds for the immediate future. To help meet balance of payments needs of the poorest countries, the United States has proposed that a trust fund be created, managed by the IMF, and financed by concessional contributions from the oil producers and other countries, as well as contributions related to the sale of a portion of IMF gold. At its meeting on June 12, the Development Committee urged the Executive Directors of the IMF to consider all aspects of such a trust fund as well as to continue their study of all possible sources of financing.[1]

The Development Committee was also concerned with the capital needs of middle- and high-income developing countries. In this regard, the Committee noted the importance of measures to facilitate and expand the access of developing countries to private capital markets and recommended expanded technical assistance to developing countries seeking such access. The Committee agreed to establish a working group to make a review of regulatory and other constraints affecting access to capital markets and also to study further proposals to support developing countries' access to private markets.

As a further step to lighten the debt burden of poorer countries in the present situation, the Development Committee gave its unanimous support to the establishment for 1 year of a new intermediate lending facility in the World Bank (known as the "third window") to lend on terms intermediate between those of IDA and of the World Bank. Such a proposal was unanimously accepted by the World Bank's Executive Board in late July. Since funds will be limited, eligibility criteria will favor the developing countries with an annual per capita income of less than $375.

During the coming year, the Development Committee will consider establishment of a trust fund for the poorest developing countries on the basis of study by the IMF Executive Board. Progress can also be expected with regard to increasing access to capital markets for middle and higher income developing countries. In addition, there will be consideration of financial aspects of the world food situation and measures to improve information systems on the flow of resources to developing countries.

Investment security

The Interagency Committee on Expropriation, whose membership includes the Departments of State, Treasury, Defense, and Commerce, was established in fiscal 1972 to implement President Nixon's policy statement of January 19, 1972, on expropriation. During fiscal 1975, this Committee continued to monitor investment security situations

[1] See exhibit 75.

and periodically to consider actual and potential investment problems in order to head off investment disputes where possible and initiate the U.S. response to countries which expropriate or unfairly treat U.S.-owned interests without providing for prompt, adequate, and effective compensation.

In response to a request by the Economic Policy Board and Council on International Economic Policy, Treasury submitted several papers outlining measures to broaden and strengthen the present U.S. policy toward expropriations. An improved investment climate in developing countries would benefit both the U.S. firms and the developing countries themselves because most developing countries need the management and technological skills as well as the capital which U.S. companies will provide if their investments are secure. Interagency discussions on these proposals are underway.

Debt rescheduling

On February 28, 1975, Secretary Simon submitted to Congress the administration's first annual report on debt relief granted by the United States to developing countries. (The report is required by section 634(g) of the Foreign Assistance Act of 1961, as amended in 1974.) The report is comprehensive, containing detailed information on the debt of major debtor countries and the means by which the United States and other creditor countries have dealt with debt service problems.

In fiscal 1975, discussions were held with the Governments of Pakistan and Bangladesh to conclude bilateral agreements for the debt rescheduling agreed to the previous year.

On May 2, 1975, a bilateral agreement was signed with India rescheduling $45 million in Indian debt service which became due to the United States during the Indian fiscal year ending March 31, 1975. This agreement effective as of June 13, 1975, implements an understanding reached with India by the World Bank, in its capacity as chairman of the Aid-to-India Consortium, on October 30, 1974. Other creditor nations rescheduled $149 million. However, at the 1975 Aid-to-India Consortium meeting the United States indicated that it would not grant debt relief to India in fiscal 1976, but expressed the view that its position not deter others from rescheduling if such action were appropriate under their governmental procedures.

Also in fiscal 1975 the United States, along with most of Chile's Paris Club creditors, agreed with IMF's analysis that Chile faced a very difficult economic situation. On that basis creditors agreed to a multilateral understanding whereby debt due from the Government of Chile in 1975 would be rescheduled. Debt due the United States in 1975 is about $183 million while that due other Paris Club creditors is approximately $350 million.

Local currency management

One of the responsibilities of the Secretary of the Treasury is to determine which foreign currencies in possession of the United States are in excess of normal requirements. The purpose of this determination is to assure maximum use of local currencies in lieu of dollars.

Since 1960, a total of 14 currencies have been designated as excess currencies. For fiscal 1975, the currencies of only seven countries were designated as excess: Burma, Guinea, India, Pakistan, Poland, and Tunisia. The only change from the fiscal 1974 determination was the removal of Yugoslavia which took place on December 31, 1973.

Bilateral assistance

The Department of the Treasury participates in the U.S. Government development finance program through its membership in the National Advisory Council on International Monetary and Financial Policies, on the Overseas Private Investment Corporation (OPIC) Board of Directors, and on the interagency committees designed to coordinate economic assistance programs. Treasury's principal concerns are to relate the various foreign economic assistance programs to overall U.S. economic interests and international development objectives, and to assure the interrelationship and consistency of bilateral and multilateral programs.

The three principal institutions responsible for U.S. bilateral assistance programs are the Agency for International Development (AID); the Department of Agriculture, which administers the Public Law 480 food-for-peace program; and OPIC.

Agency for International Development.—As a member of the Development Loan Committee of AID, Treasury focuses primarily on the economic and financial impact of AID development lending programs and on the macroeconomic policy performance of the borrowing countries. During fiscal 1975, AID authorized 53 new development loans, totaling $453.4 million, for specific projects and sector programs.

Public Law 480.—Treasury is represented on the Interagency Staff Committee, which reviews all Public Law 480 proposals. Treasury looks primarily at the impact of this program on the U.S. balance of payments and the domestic economy. During fiscal 1975, Title I sales agreements were signed with participating governments and private trade entities for a total value of $861 million, higher than the previous year but nevertheless down substantially from the levels of earlier years. Title II donations totaled $355 million, somewhat higher than the previous year.

The Overseas Private Investment Corporation.—Assistant Secretary for International Affairs Cooper represented the Department of the Treasury on OPIC's 11-man public/private Board of Directors during fiscal 1975. OPIC administers two major programs to encourage U.S. investment in the developing countries: Investment insurance against the political risks of expropriation, inconvertibility, and war, revolution, and insurrection; and investment finance which provides both direct loans and commercial risk guarantees.

OPIC issued $1,211.9 million in investment insurance in fiscal 1975, an increase from the $994.8 million issued in fiscal 1974. The financing program guaranteed $26.2 million of new investment in the developing countries and extended $6.9 million in direct lending during fiscal 1975.

ADMINISTRATIVE REPORTS

ADMINISTRATIVE MANAGEMENT

Special studies, projects, and programs

Numerous studies and projects were completed by the planning and management staffs of the Office of the Assistant Secretary (Administration) which developed program systems and operating procedures to strengthen general organization effectiveness.

Office of the Assistant Secretary (Administration).—The Assistant Secretary (Administration) established a task force to cooperatively implement the provisions of the Privacy Act of 1974 (Public Law 93-579) within Treasury. The task force provided for and reviewed an inventory of Treasury's "systems of records," prepared regulations, directives, and handbooks, created an administrative structure to process inquiries, and prepared estimates of resources, personnel, and support services required to make the act's provisions fully operational within the Department.

The Office of Administrative Programs was reorganized in response to increasing requirements in the management of the Department's telecommunications program, administrative support of the Secretary's representational activities, and renovation of the Main Treasury Building.

An analysis of the organization and management of the Office of Computer Science led to plans for procedural changes and improved controls over the allocation and management of ADP services in the Office of the Secretary.

The offices under the Assistant Secretary (Administration) continued their management by objectives program, in which even the smallest divisions in each office established objectives and developed action plans for achieving them. The Assistant Secretary (Administration) held a series of highly productive meetings with each of his office directors and their key staff members to discuss the objectives and related problems.

Office of the Secretary.—Treasury officials and analysts, with representatives from OMB and the Domestic Council, participated in a study and assessment of the general revenue sharing program. This program, administered by the Office of Revenue Sharing in the Office of the Secretary, is due to expire in December of 1976. The study recommended continuance of the program and made additional recommendations to improve its operations. The Secretary submitted the report with the conclusions and recommendations to the President.

The 1974 amendments to the Freedom of Information Act were implemented within the Department in time to become fully operational on February 19, 1975. Analysts assisted in developing procedures and directives for the purpose of processing requests for records received from the public by the Department. Locations to receive requests were identified, and additional staff was made available to process the requests for access to information.

Departmental.—The Department's position management policy was updated at the beginning of fiscal 1975. Requirements for bureau position management systems were revised in anticipation of the need for further cost reduction efforts.

At the request of the National Director of the U.S. Savings Bonds Division, an organization and management review was performed of the Division's operations, focusing on the Washington headquarters. The study made some 30 recommendations for modifying or improving Division operations.

A contract study of U.S. coinage requirements to the year 1990 is now in progress. This is a complex study which will take about 10 months. It will examine improved ways of forecasting coin demand over the next 15 years, the ability of the coinage production-inventory-distribution system to meet demand, and the options which are open for system change. The study will reexamine the entire family of U.S. coins: What should be the size, composition, and denominations of coins, given the future demands of the economy, the anticipated price and availability of different metals, and the effects changes would have on user groups and coin-operated devices?

Management by objectives.—The departmental management by objectives program was expanded to cover 69 priority projects throughout the bureaus and the Office of the Secretary. Seventeen of these were Presidential objectives that were updated regularly for the information of OMB. The key to Treasury's successful program has been individual quarterly meetings between the bureau/office head and his supervisory Assistant Secretary. In these meetings departmental managers reviewed progress, identified potential problems, and provided policy guidance.

Productivity.—The Department has a long history of commitment to productivity improvement and continued to participate vigorously in the Government-wide program initiated in 1970 to establish measures of productivity and foster productivity improvement. Several Treasury bureaus have been cited for productivity enhancement efforts in the Federal productivity reports issued by the Joint Financial Management Improvement Program.

Treasury bureaus have quantified productivity covering activities of 77 percent of the Department's man-years. Overall, Treasury's productivity management performance has been better than that of the Government as a whole in two respects. First, in measuring productivity, Treasury has covered a greater percentage of the man-years expended than the Government as a whole. Second, Treasury's average productivity, as reflected in data computed by the Bureau of Labor Statistics, was higher than Government-wide averages.

Long-range planning.—A new approach to long-range planning for Treasury bureau operations was initiated. The purpose of the revised planning approach is to help policy officials set the basic direction of bureau programs and monitor program performance. The new approach emphasizes three things: (1) Using a simplified planning document; (2) applying a planning methodology which provides a solid basis for policy and program evaluation and resource allocation decisions; and (3) encouraging a flexible process which permits policy officials to tailor the process to suit individual bureaus and their own management style.

Advisory committee management.—The Assistant Secretary (Administration), as departmental advisory committee management officer, continues to advise and assist all Treasury components in the application of procedures required by the Federal Advisory Committee Act (Public Law 92-463) and reviews advisory committee utilization and effectiveness.

Environmental quality program.—Major program accomplishments in fiscal 1975 included: a draft statement concerning the proposed construction of an additional facility for the Bureau of Engraving and Printing in Washington, D.C.; an environmental assessment in connection with the proposed relocation of the Consolidated Federal Law Enforcement Training Center to Brunswick, Ga.; participation in the preparation of an interagency draft environmental impact statement for the Energy Independence Act of 1975 and related tax proposals in support of legislation proposed by the President; and the establishment of an agreement between the Department and the Environmental Protection Agency to abate air pollution emissions from, and phase out by June of 1976, the incinerator operated by the Bureau of Engraving and Printing in Washington, D.C.

Technical assistance to foreign governments and officials.—Treasury continued its close cooperation with the Agency for International Development (AID) and other U.S. agencies and private organizations, as well as foreign governments, in programs of technical assistance to developing nations. During the year, customs and tax advisers were assigned on both a long- and a short-term basis to work in a dozen such countries. In the Treasury itself, orientation, educational, and training programs have been provided on a continuing basis to foreign visitors referred by AID and other agencies, both governmental and nongovernmental, involving in fiscal 1975 more than 100 man-days of such activity. Visitors have come from less developed countries and also from Western Europe and other industrialized areas of the world for more advanced and specialized consultations and training.

Emergency preparedness

The Mobilization Planning Staff has continued cooperation and coordination with the officials of the GSA Office of Preparedness (which becomes the Federal Preparedness Agency on July 1, 1975), the Federal financial agencies, and the Treasury bureaus in implementing and reviewing new concepts and policies for emergency preparedness planning and operation at both the national and regional levels. One new and interesting area for Treasury participation in interdepartmental emergency preparedness planning, which commenced this year, was the preparation of a Federal Response Plan for Peacetime Nuclear Emergencies. The purpose of this continuing, joint effort is to provide for coordinated Federal response to peacetime nuclear emergencies of wide-ranging variety and for coordinated supportive action with State and local governments and the private sector.

The latest revised Treasury emergency planning directives, providing policy and procedural guidance to the Department and its bureaus on preparedness requirements and plans for continuity of essential functions of government, organizational arrangements, and civil preparedness readiness levels, were issued in November 1974. The provisions of these directives were tested at national headquarters level

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and in selected regions during the conduct of civil readiness Exercise REX–75 in spring 1975. The overall Treasury participation in Exercise REX–75 emphasized the testing of (1) emergency alerting procedures, (2) contingency communications and operating plans/procedures, and (3) damage estimate/assessment procedures at its emergency operating facilities. The remote terminal querying capability recently introduced at the Treasury's alternate relocation site was used for obtaining, from the GSA Office of Preparedness computer system, damage assessment information concerning Treasury facilities nationwide.

Preparation for Exercise REX–75 included (1) a comprehensive briefing program, (2) review of emergency preparedness plans and procedures, (3) the conduct of an actual test to alert notification communications systems and procedures for the three Federal civil readiness levels, and (4) the designation of exercise action officers in the various offices within the Office of the Secretary and in the Treasury bureaus as ready points of contact for exercise action. During the exercise, three action/control teams, representative of the three emergency executive teams, relocated as appropriate for the play of the exercise scenario at the Treasury emergency operating facilities. An emergency checklist of actions to be taken and action documents to be used (under certain readiness levels for key Treasury officials responsible for directing such actions when required) which had been developed earlier in the year proved sound and practical when used for this exercise.

The consensus of Treasury participants was that the experience gained and lessons learned during the planning for and conduct of Exercise REX–75 were significantly valuable and well worth the time, effort, and resources expended. Participation in future exercises on an expanded scale is expected and desired. Certainly the benefits gained from participation in Exercise REX–75 enhanced the Department's readiness posture for the onsite review conducted by a joint Treasury-Office of Preparedness team on June 26, 1975.

Treasury payroll/personnel information system

In an effort to provide administrative guidance and management overview, the Assistant Secretary (Administration) established the Treasury Employee Data and Payroll Division during fiscal 1975. One of the tasks of the Division was to chair a study involving experts of various bureaus to "determine the requirements of a Treasury-wide payroll/personnel information system."

The task force study, approved by a departmental steering committee, concluded that an integrated payroll and personnel system would be more efficient and provide more data than the maintenance of the present diverse systems and could save as much as $6.6 million annually. Further, it was concluded after analysis of many systems and careful consideration of the cost involved that a Treasury-wide integrated payroll/personnel information system would be implemented utilizing as a base the departmental integrated personal service systems and a remote terminal data entry subsystem.

The task force based its conclusions on findings that the current separate departmental personnel systems and the five independent automated payroll systems, together with manual support, generally fulfill their function. However, there is a lack of standardization of data which results in the expenditure of considerable manual effort to prepare bureau and Department-wide reports. There is duplication of effort as the separate systems perform the same function, resulting in redundant staffing, systems programming, and systems changes, and they do not take full advantage of available technology. Data stored in the computer systems are not utilized to supplement manual recordkeeping and report preparation, nor is the most advanced communication means utilized to transmit data from its source to the data processing site.

Implementation of a Treasury payroll/personnel information system is estimated to take 18 months, following which all bureaus should be incorporated into the system. Implementation of the system is scheduled to start early in fiscal 1976. The implementation team will have 46 members, representing various areas of expertise and selected from most bureaus.

Internal auditing

Adequate staffing of bureau audit functions with qualified auditors continued as a high-priority goal for internal audit in fiscal 1975, and, as a result, the Office of Audit (OA) was involved in recruitment efforts of several bureaus.

An organizational change transferred the personnel, functions, and responsibilities of the former Fiscal Management Staff from the Office of Budget and Finance to OA, strengthening its central administrative role. Also transferred was the responsibility for reviewing accounting systems. In addition, the function of handling complaints from employees concerning merit system violations was assigned to the Director, OA.

OA performed an appraisal of the internal audit activities of the Internal Revenue Service. The review focused on the use of Federal audit requirements relating to organization, planning, reporting, and the qualifications of staff members. Audits were completed on the administrative accounts of the Consolidated Federal Law Enforcement Training Center, and the Exchange Stabilization Fund. An audit was also made of the Treasury Historical Association.

OA participated in a conference to explore ways in which agencies responsible for grant audits can assist the Office of Revenue Sharing by exchanging data on strengths and weaknesses of State and local audits. Some 44 States agreed to perform audits under Treasury's guide. Also, OA submitted to the Office of Revenue Sharing an analysis of its first financial statement, and proposals for strengthening controls over trust fund payments and improving the accounting system. A report to OMB was prepared on questions regarding general revenue sharing obligations, reserves, and balances.

In response to congressional interest, and in conjunction with the Bureau of the Mint and GAO, OA assisted in planning and observing the gold inventory at Fort Knox. Auditors found control to be adequate, and records maintained agreed with the gold inventory.

OA cooperated with a task force on administratively uncontrollable overtime, chaired by the Deputy Director, Office of Personnel. Agreement was reached to update the Treasury policy through provision for more specific criteria for the administration of such overtime.

OA was assigned responsibility for a portion of the departmental regulations and contributed to the final guidelines.

The Director, OA, chaired a meeting of the Committee on Practices and Standards of the National Intergovernmental Audit Forum, held at OA offices in November. Members of the Committee are drawn from city and State, as well as Federal, organizations. The purpose is to improve cooperation and coordination of intergovernmental auditing. The Director chaired a meeting again in May to recommend uniform accounting principles and audit guides for Federal, State, and local governments.

Continuous liaison was maintained with GAO on matters of mutual concern, including coordinating responses to reports on departmental activities.

Budgeting

The Office of Budget and Finance continued to develop policies and procedures and to direct and coordinate the formulation, justification, and presentation of appropriations for budget estimates which totaled nearly $44 billion in fiscal 1975. The amount includes $2.3 billion for operating appropriations, $1.8 billion for social security payments pursuant to the Tax Reduction Act of 1975, $33.1 billion for public debt and other interest and miscellaneous accounts, and $6.1 billion for general revenue sharing.

During fiscal 1975, the budget staff:

(1) Established and maintained controls on expenditures, number of personnel on roll, and motor vehicle fleet to comply with limitations and directives prescribed by OMB.

(2) Gave special budgetary consideration and emphasis, including the preparation of requests for budget amendments and supplemental appropriations and reimbursements, to programs of special concern to the administration. These included a supplemental appropriation, Public Law 93–554, for making payments to Eisenhower College, Seneca Falls, N.Y., and for the transfer of funds to the Samuel Rayburn Library at Bonham, Tex. Supplemental funds were also obtained: (a) under the Fishermen's Protective Act of 1967 to reimburse owners for fines paid to foreign countries to secure release of their fishing vessels and crews, and (b) to cover the costs of issuing 15 million additional checks for the special $50 payments made to social security recipients pursuant to the Tax Reduction Act of 1975.

(3) Obtained supplemental appropriations for the cost of pay increases authorized by Executive Order 11811, wage board actions, and administrative actions amounting to $58.3 million. A total of $15.3 million of the increased costs was absorbed by application of management savings, reimbursements, and certain administrative action.

(4) Assisted in the preparation and presentation of budget requests for funds totaling nearly $1 billion to be appropriated to the President for the U.S. share to the international financial institutions of which the Secretary of the Treasury serves as a Governor.

Personnel management

An affirmative action plan for employment, placement, and upward mobility of disabled veterans was developed in addition to an update for fiscal 1976 of the affirmative action plan on employment of the handicapped. During the past year Treasury facilities nationwide were reviewed to identify and, when feasible, eliminate architectural barriers to the handicapped.

A new agreement was negotiated with the Civil Service Commission which permits Treasury to appoint experts and consultants without securing individual authority for each case from the Commission.

A special excepted appointment authority (schedule A) was negotiated with the Civil Service Commission permitting the Office of Trade, Energy, and Financial Resources Policy Coordination to hire up to 10 persons to supplement the permanent staff in the study of complex problems relating to international trade and energy policies.

Staff leadership and assistance were provided resulting in (1) the successful termination of economic stabilization activities formerly carried out by the Cost of Living Council, and (2) the provision of approximately 30 Treasury employees by detail to assist in carrying out the mission of the Presidential Clemency Board.

Bureaus have made substantial gains in making the development of their managers and executives a systematic process. In formal programs, 34 managers and executives attended the Federal Executive Institute in Charlottesville, Va., and over 110 attended the various programs of the Executive Seminar Centers.

Each bureau within Treasury has an approved upward mobility plan which provides for the systematic identification, development, and placement of lower graded employees. In the first half of fiscal 1975, 1,286 persons were placed in target positions. This represents 68 percent of the fiscal year objective strength.

Sustained progress has been made in intensifying the Department's personnel management evaluation program. Evaluation system guidelines have been published. The personnel management evaluation systems in the Treasury bureaus have been strengthened. Onsite reviews in two bureau headquarters and a nationwide survey of the Bureau of the Mint were completed.

As in the previous fiscal year, labor relations activity within Treasury continued to increase in terms of both numbers of employees represented and coverage by negotiated agreements. Exclusive recognition was granted to three new bargaining units including over 900 employees. Some 89,010 Treasury employees are in units of exclusive recognition in 8 separate bureaus, and of this number 85,380 are covered by negotiated agreements. Treasury is the most highly organized of all Cabinet-level agencies, with over 90 percent of all eligible employees included in bargaining units. During the year, a sharp increase was noted in the referral of disputes to third parties. More unfair labor practice charges, disputes over agreement language, and negotiations impasses were referred to third parties than the combined number referred since the inception of the program.

Procurement and personal property management

During fiscal 1975, the negotiation of 36 blanket purchase agreements for office machines and miscellaneous supplies for use by all Treasury bureaus provided a savings in excess of $203,000. Consolidation of Treasury requirements for 575 undercover law enforcement vehicles, procured through GSA, resulted in a significant dollar savings over separate procurement methods and an improved quality of vehicle. Vehicles purchased included compacts, intermediate-size and full-size sedans, for average vehicle prices of approximately $3,600, $3,800, and $4,100, respectively. Added for the first time this year for undercover work were intermediate-size station wagons averaging in price at $4,100.

Treasury's personal property transactions during fiscal 1975 included reassignment within Treasury of property valued in excess of $850,000; transfer of personal property valued in excess of $1 million to other Federal agencies for their use; and the donation of personal property valued at approximately $302,000 no longer needed by the Federal Government for use by State organizations and nonprofit groups. Treasury also obtained, without cost, personal property valued at over $3 million from other Federal agencies and $638,650 worth from the former Cost of Living Council.

Real property management

The headquarters of the U.S. Customs Service has nearly completed moving into the Federal Building at 1301 Constitution Avenue (formerly known as the Main Labor Building); only the computer center remains to be moved. These moves will effect a consolidation of Customs Service headquarters activities from leased space in eight locations.

Two other consolidations of Treasury activities in Washington, D.C., were completed: the Office of Revenue Sharing was moved from several locations into the recently completed Columbia Plaza facility; and the Office of the Comptroller of the Currency completed moves from a number of locations into a new facility at L'Enfant Plaza.

Consolidation of the field offices of the Bureau of the Public Debt into a new building in Parkersburg, W. Va., was completed on schedule. The Bureau took occupancy of the building on November 1, 1974, and the move-in was completed by January 31, 1975.

The Department is entering its second year of operations under GSA's Federal buildings fund program. This program has and will continue to demand close coordination between Treasury's facilities management and budget staffs at both the bureau and departmental levels. One promising element associated with the program is the computerized listings and reports on the volume and characteristics of leased and Federal space, as well as the special services necessary to maintain suitable operational environments. This data, in conjunction with GSA's nationwide space utilization improvement program, will assist the Department in reducing the costs incurred for space and related services.

Major renovations in the Main Treasury Building are continuing, with installation of air-conditioning fan coil units in 2 of 10 zones of the building scheduled for early 1976.

Printing management

The GSA-funded renovation project of the Treasury Annex subbasement level to accommodate the consolidated departmental printing plant was completed during fiscal 1975. Several new major pieces of equipment were procured, including a large paper folder and four-unit offset press. A two-shift operation was also implemented.

In fiscal 1975 there was a significant increase in the amount of work coming from the bureaus for preparation and procurement by the Printing Procurement staff. Printing procurement was transferred to the working capital fund, providing a means to charge for such services on an equitable basis.

Physical security

Controlled-access procedures were implemented during fiscal 1975, based upon a physical security survey of the Main Treasury and Annex Buildings which revealed a number of deficiencies in the internal and external security posture of these buildings. As a result, the number of serious incidents occurring in the Main Treasury and Annex Buildings has decreased from an average of nine a month to three.

Procedures were issued for the installation and retention of security alarm systems in those Government owned and leased buildings occupied by the Office of the Secretary. Substantial savings have been realized as a result of technical physical security surveys conducted to upgrade, consolidate, or eliminate existing security alarm systems, along with comprehensive evaluations of individual requests for alarms.

Telecommunications

Treasury automated communications switch.—A study was made and draft specifications prepared for the automation of the Treasury Telecommunications Center. A request for proposal was finalized in fiscal 1975 and will be issued in fiscal 1976. The automated switch will be installed and become operational in fiscal 1976, replacing the existing manual torn-tape operation.

Treasury electronic telephone system.—The first major phase in the conversion of the Treasury telephone system to Centrex II service was accomplished during the move of the Office of the Comptroller of the Currency to L'Enfant Plaza in fiscal 1975. The conversion was begun following receipt of approval from GSA for the implementation of a Treasury electronic telephone system to replace the present antiquated electromechanical system. Conversion of the Federal Building at 1200 Pennsylvania Avenue, NW., to the new service is scheduled in fiscal 1976 followed by the remainder of Treasury early in fiscal 1977.

Treasury radio and paging system.—Planning for the implementation of the radio and paging system was completed in fiscal 1975 and installation was completed in June 1975. This system provides a departmental mobile radio capability, including radio-telephone interconnect service, in the Washington metropolitan area. Reliable, economical radio paging will also be available to replace the more expensive but less efficient leased service now provided by the telephone company and a commercial service vendor.

Telecommunications complex.—Plans were developed for the utilization of the vaults on the first floor of the Main Treasury Building to accommodate the departmental telecommunications facilities, some of which are now located in prime office space. Construction is scheduled for the period October 1975 through March 1976. At that time, the vault space should be completed and ready to accept the Treasury automated communications switch and, shortly thereafter, the Treasury electronic telephone system.

Secretarial secure travel communications.—During fiscal 1975, equipment was installed in the Treasury Telecommunications Center to provide a secure message communications capability for the Secretary of the Treasury and his immediate staff while in a travel status on trips throughout the world. Messages of all classifications may be exchanged directly with the Secretary's aircraft while in flight and on the ground during stopovers.

Secure communications for law enforcement.—Secure teletype circuits were established from the Treasury Telecommunications Center to the U.S. Secret Service, the U.S. Customs Service, and the Bureau of Alcohol, Tobacco and Firearms. The same capability is being programmed for the Internal Revenue Service in fiscal 1976.

Paperwork management

The departmental effort was concentrated on the development and installation of a new and innovative system for communicating the Department policies and procedures. Principal features of the new system include a manual for initial reference on any subject, a standard subject classification system to group related material, a codified index system, and a standard format and style to ease both preparation and reading. The new system replaces 18 separate issuances.

Additional significant accomplishments include the development of records disposition schedules for approximately 80 percent of the records maintained in the Office of the Secretary by the design and preparation of 21 functionally oriented schedules. This breaks with the traditional approach of individual schedules for each separate office and provides a flexible system for maintaining current schedules while the Office of the Secretary may undergo organization change. Also, complete inventories of all interagency reports required by components of the Department were compiled and a procedure established to evaluate the need and control the creation of interagency reports. A complete inventory was also compiled of all reports required of Department components by Congress and costs for each report estimated.

International support

Involvement of Treasury officials in international affairs continues to grow. The International Support staff and the Travel Office have been able to handle the increased workload of conferences, meetings, overseas trips, and embassy liaison only by working considerable overtime and by borrowing assistance from other areas of the Secretary's Office.

Cash Room

A new and modern Cash Room is being planned for Main Treasury. As presently envisioned, it will permit better accommodation of the public while improving the security and efficiency of the banking operations. The old Cash Room may be used as a large conference and meeting room, as a location for important ceremonies and significant Treasury events, and for certain departmental activities such as those associated with the Bicentennial. These uses are contingent upon the results of historical studies now being performed as required in national historic preservation laws.

Space planning

The continued growth in the substantive staffs of the Secretary's Office, the plans to relocate the Cash Room facilities, and the air-conditioning project have resulted in a shortage of some 20,000-plus feet of space in the Treasury Building. A housing plan has been developed to cover immediate, intermediate, and long-range requirements.

Safety

Treasury continued to maintain a low disabling-injury frequency rate during 1974. The Department's rate based upon internal reports was 2.9 injuries per million man-hours worked. This compared favorably with the all-Federal rate of approximately 6.0.

A program highlight of the year was the occasion of the annual meeting of the Treasury Safety Council attended by the Secretary of the Treasury and heads of bureaus or their representatives.

Library

A Library for numismatic reference was established at the San Francisco Mint in fiscal 1975. Materials for the collection were donated by the Pacific Coast Numismatic Society.

Treasury Historical Association

In 1974 the Association completed its first full year of operations. Quarterly meetings of the membership and the Board of Directors were held and the first annual meeting, attended by Secretary Simon, was held on April 29, 1975. The Association received tax-exempt status from the Internal Revenue Service and the District of Columbia.

BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

The Bureau of Alcohol, Tobacco and Firearms (ATF) is charged with regulating four industries—alcohol, tobacco, firearms, and explosives. During fiscal 1975, ATF also assumed responsibility for enforcing the revised wagering law.

The Bureau is staffed with 1,510 law enforcement officers who enforce criminal laws relating to the four industries, and 708 inspectors, who are regulatory officers. At the end of the year it had a total of 3,805 employees.

The primary task of ATF law enforcement officers is now the enforcement of Federal gun control laws, particularly in attempting to keep guns from criminals and would-be criminals. Traditionally, the Bureau's primary goal was to eliminate the manufacture and sale of illicit liquor, which defrauds the Federal revenue of potential taxes.

During the 1930's, as a result of the misuse of certain types of firearms by the criminal element, Congress passed the National Firearms Act and assigned enforcement responsibility to the Internal Revenue Service's Alcohol Tax Unit, the forerunner of the Bureau.

Thus, when the Federal Firearms Act, which regulated the interstate commerce in firearms, was passed in 1942, enforcement responsibility was given to ATF.

In the 1960's the assassination of a President, a Senator, and a prominent civil rights leader prompted Congress to pass the Gun Control Act of 1968, which encompassed the National Firearms Act and the Federal Firearms Act and added many controls not contained in the previous statutes. Since then, the primary efforts of ATF have been directed at controlling the flow of firearms to keep them out of the hands of criminals.

A more recent mission originated with the passage of title XI of the Organized Crime Control Act of 1970, which regulates explosives. Regulatory and enforcement jurisdiction over explosives also were assigned to ATF.

In November 1974, ATF launched the "significant criminal program—armed and dangerous," which is aimed toward identifying and perfecting criminal cases against the Nation's most violent and dangerous criminals.

During fiscal 1975, the Bureau collected $7.7 billion in excise taxes on alcohol and tobacco products. These taxes are the second largest source of revenue to the United States, following personal and corporate income taxes. This tax administration is the major function of the Office of Regulatory Enforcement.

ATF has held public hearings on the conversion of the wine industry to the metric system of measurement and has scheduled hearings on metrication for the distilled spirits industry.

Criminal enforcement

Project Identification.—This program was launched in 1973 in New York, Detroit, Atlanta, and New Orleans to determine the source of crime guns, the nationwide flow patterns of crime guns, and the types of handguns used in crimes. In its second phase, it was extended to Oakland, Kansas City, Denver, and Dallas.

The third phase of the project was completed during fiscal 1975 and included studies in Miami-Dade County, Fla., Philadelphia, Minneapolis-St. Paul, and Seattle. Statistical analysis of the third phase reinforced findings in earlier studies by showing that of 2,452 weapons traced, 29 percent were in the cheaply made "Saturday Night Special" category and approximately 30 percent were purchased in a State other than that in which they were used in a crime.

On January 15, 1975, Project I was extended to the cities of Boston, Charlotte, N.C., Los Angeles, and Louisville, and on May 12 to the Washington, D.C., metropolitan area.

Interstate firearms theft reporting program.—The interstate firearms theft reporting program was initiated during fiscal 1974 and is designed to eliminate firearms shipments as a source of weapons for criminal elements. By establishing a system of notification by common carriers, ATF is able to investigate immediately reported thefts or losses of firearms.

During fiscal 1975, 687 reports of lost or stolen firearms were received, covering approximately 3,500 weapons. Of this total, approximately 110 guns were recovered by special agents and 13 criminal cases were perfected against 27 individuals.

One ATF case resulting from this program occurred in North Carolina, where 275 handguns were stolen en route from Miami to South Carolina. During the latter part of fiscal 1974 and early fiscal 1975, special agents recovered 251 of the weapons and prepared criminal cases against 2 suspects.

During fiscal 1975, there was a marked decrease in reported losses, from an average of 75 per month to approximately 55 per month. It is believed that ATF's emphasis on this problem has made carriers more aware of their losses, which in turn has led to an industrywide improvement in security measures.

International traffic in arms.—This program was created to cope with the continuing illegal international gunrunning activities that originate within the United States by utilizing ATF's licensing and inspection authority. Firearms, ammunition, and explosives illegally exported frequently are acquired within the United States in direct violation of the Gun Control Act of 1968 and title XI of the Organized Crime Control Act of 1970. Most of ATF's cases have involved the Irish Republican Army (IRA) and Mexican gunrunners.

One case under this program occurred in Texas when a foreign national, suspected of being a smuggler, purchased 25 firearms, using a fictitious Texas driver's license. This person was arrested attempting to transport the weapons out of the United States.

Five IRA gunrunners, charged with 23 violations of the Gun Control Act, were convicted during fiscal 1975. The violations with which they were charged included the use of fictitious names, counterfeiting Federal firearms licenses, and illegally transporting firearms and explosives across State lines.

Illicit liquor.—During fiscal 1975, ATF's illicit liquor enforcement continued with the perfection by special agents of 1,149 criminal cases and the arrest of 992 individuals.

Seizures of illicit liquor during this same period totaled 16,046 gallons. Gallons of mash seized totaled 283,043. In addition, 676 illicit distilleries were seized.

Though illicit liquor operations have shown a gradual decline in recent years, ATF's continued enforcement efforts have averted a major tax fraud against the Federal Government.

Explosives.—Explosives investigations continued to receive high priority during fiscal 1975, due to the potential threat to public safety.

During fiscal 1975, a total of 644 explosives incidents were investigated by special agents, including 479 bombings, 126 attempted bombings, and 39 accidental explosions.

ATF prepared 139 cases for prosecution relating to explosives violations. One hundred eighty-two persons were arrested during these investigations, and special agents seized 61,711 lbs. of explosives and 516 actual destructive devices.

Typical of the explosives investigations conducted by special agents is a case involving two bombings in a northeastern city, where the residence of a witness in a State criminal case was bombed, followed in 2 days by the bombing of the residence of the State judge who was hearing the case. The first bomb destroyed the witness' home occupied by his wife and four children. However, all escaped injury. Similarly, the judge's residence received major damage, but no injuries were sustained.

ATF, with local authorities, conducted an extensive multi-State investigation that culminated in the arrest of seven persons. Convictions were obtained in both State and Federal court. Five of the individuals were convicted, one committed suicide before being brought to trial, and the remaining person was acquitted.

Wagering.—On December 24, 1974, Secretary Simon delegated to ATF the enforcement of the revised wagering law (26 U.S.C. 4401) which became effective on December 1, 1974.

On January 15 the Office of Criminal Enforcement began a program to train and orient special agents in wagering violations. This task was completed May 28, with 1,200 Criminal Enforcement personnel trained to carry out this new responsibility. An intensive training program for Regulatory Enforcement inspectors, to enable them to work in effective partnership with special agents in the fight against illegal gambling, was also begun.

During May, criminal enforcement operations relative to wagering violations were completed successfully in two metropolitan areas. One resulted in the arrest of two alleged organized crime members who operated an estimated $1 million yearly gambling network. The other involved a large "numbers" operation and culminated in the seizure of 20 vehicles used in the operation.

Enforcement of wagering laws has been incorporated into the significant criminal program.

State and local assistance.—ATF assistance to States and localities has evolved into a relationship of cooperative sharing of personnel, equipment, information, and expertise. Much of this involves enforcement of title I of the Gun Control Act and work on the significant criminal program.

During fiscal 1975, the ATF assigned approximately 35 percent of its total criminal enforcement resources to State and local assistance. This commitment included direct investigative and technical assistance in explosives incidents, direct investigative assistance in firearms-related crimes of violence, tracing of weapons used in crimes for some 2,000 local agencies, and the continued training of local and State officers.

Direct investigative assistance is typified by a case in a major southern city, where ATF was concentrating its efforts on a significant criminal. The investigation revealed active involvement of the suspect in major armed robberies. Information obtained through ATF surveillance was forwarded to appropriate local agencies in three different States. Working jointly with those jurisdictions, ATF was able to coordinate multiagency and multi-State efforts which resulted in the arrest of the significant criminal by State authorities.

Another example of State assistance occurred in a Midwest city where ATF undercover agents were able to purchase weapons from an alleged ringleader of a large burglary gang. As a result of this undercover probe, ATF was able to assist local officers not only in the arrest of this individual but also in the solution of approximately 140 different burglaries.

Significant criminal program—armed and dangerous (SCAD).—During fiscal 1975, the Office of Criminal Enforcement developed new programs and revitalized existing projects in order to fulfill ATF's responsibilities to the public. This work resulted in the submission for prosecution of 4,532 criminal cases; the arrest of 4,894 individuals for crimes ranging from bombings to felons in possession of firearms; and the seizure of 11,328 firearms, 61,711 lbs. of explosives, and 676 illicit distilleries.

On November 1, 1974, ATF initiated the nationwide SCAD program, which directed Criminal Enforcement's resources in a concerted effort to identify and perfect criminal cases against the most violent and dangerous criminals in the United States.

There are two major goals of the program. The first is to investigate those significant violations in which there is a paramount Federal interest in prosecution, due to the particular danger to public safety posed by armed and dangerous criminals. The second is to assist State and local law enforcement officials as mandated by Congress.

The "significant criminal" is defined under the program as an individual currently and actively engaged in felonious criminal activity which presents a serious threat to the public safety.

Since inception of the program, 1,064 criminals have been identified as meeting the program's criteria and are currently subjects of active investigations by ATF. From November 1, 1974, to June 30, 1975, 423 armed and dangerous criminals were recommended for prosecution. Of this total, 366 actually were apprehended.

Typical of this type of criminal case is a Paducah, Ky., investigation in which a significant criminal was apprehended while in possession of a short-barreled shotgun and in the act of casing a grocery store. This previously convicted felon was with two other felons, one of whom was in possession of a pistol stolen from a policeman in Alabama. The significant criminal was convicted of violating the Gun Control Act and was sentenced to serve concurrent prison terms of 2 and 3 years.

Two significant criminals were convicted in New York City during May 1975 of multiple violations of the Gun Control Act. During the investigation, an ATF undercover special agent purchased 95 firearms, including silencers and short-barreled shotguns, from the defendants, who were reputed to be a prime source of weapons for the criminal element in Metropolitan New York. At the time of this arrest, enough firearms parts were seized to assemble 400 handguns.

Recent statistics of ongoing investigations indicate the arrest of 19 significant criminals throughout the country who, through prior records or reputations, could be characterized as "hitmen."

Regulatory enforcement

Ingredient labeling.—ATF held public hearings on proposals to require the listing of ingredients on alcoholic beverage container labels. This is in keeping with ATF's belief that consumers have the right to know—and ATF the duty to inform them—exactly what is contained in the alcoholic beverages they purchase. ATF specialists will determine, after examining the hearing records and other data, the direction to be taken on ingredient labeling.

Joint custody.—ATF continued to examine the roles of Government and industry in the custody and supervision of activities in distilled spirits plants, with the goal of streamlining Government supervision. The result could mean the continued protection of Federal revenues, while freeing ATF inspectors from routine plant duties and enabling them to apply their time to ATF's ever-widening range of programs.

Consumer protection.—Fiscal 1975 was another successful year in ATF's fight against unlawful trade practices and consumer deception prohibited by the Federal Alcohol Administration Act. A total of 43,642 man-hours were spent enforcing the act during fiscal 1975. The fiscal 1974 total was 76,408 man-hours.

During fiscal 1975, ATF accepted 103 offers in compromise, totaling $410,224. The preceding fiscal year, ATF accepted 87 offers in compromise, totaling $548,015.

ATF also aggressively investigated cases involving consumer deception, such as the false or misleading labeling or advertising of alcoholic beverage products. All labels on these products are subject to prior approval by ATF. During fiscal 1975, more than 50,000 proposed labels were reviewed by ATF specialists in Washington. ATF field inspectors scrutinized approved labels and contents of alcoholic beverages at every marketing level, including the retail establishment. Inspectors made unannounced appearances at retail businesses to insure that products contained in bottles are of the same proof that the label indicates or that the contents of the bottle have not been replaced by an inferior product.

Metric conversion.—During fiscal 1975, ATF held public hearings on the conversion of the wine industry to the metric system of measurement. ATF subsequently decided to proceed with metric sizes for wine, with final implementation set for January 1, 1979. Hearings were scheduled for the summer of 1975 on metrication for the distilled spirits industry. ATF's action will make the alcoholic beverage industry the first major segment of the Nation's business community to convert completely to the metric system.

ATF views the metric conversion plans as an opportunity for the Bureau, in partnership with the regulated industries, to lead the way toward implementation of a system which will benefit the Government, industry, and, most importantly, the American consumer. The advantages of metrication include: Elimination of consumer deception resulting from the use of many similar bottle sizes; facilitation of unit pricing and price comparison; and establishment of case sizes with standard whole number contents, thus easing handling and inventory problems for the trade as well as customs duty and excise tax computations.

Tobacco.—The excise tax on tobacco products continued to be an important source of Federal revenue. In recent years, ATF's tax determinations—for example, whether a product is a cigarette or a little cigar—have assumed new importance because other Federal agencies rely on ATF's determination as a basis for enforcing Federal laws relating to the product's packaging and its eligibility for advertisement on the electronic media.

Firearms and explosives inspections.—During fiscal 1975, inspectors of the Office of Regulatory Enforcement were assigned increased responsibilities in the area of firearms and explosives compliance inspections. Prior to fiscal 1974, these were principally the responsibility of the Office of Criminal Enforcement. When the shift to Regulatory Enforcement is fully implemented in fiscal 1976, this office will be required to complete approximately 31,000 application inspections and an estimated 51,000 inspections yearly.

Technical and scientific services

Laboratories.—ATF laboratories provided technical and scientific support to the Bureau in enforcing the laws and regulations administered by ATF. In addition, the laboratories assisted without charge any requesting State and local law enforcement agency.

ATF's Scientific Services Division operated the Nation's most complete ink library, which includes more than 3,000 domestic and European ink standards, and used it to identify and date inks on questioned documents.

The Identification Branch began implementation of a national ink tagging program, involving the voluntary addition of chemical tags to inks during the manufacturing process. The tagging program will enable ATF examiners to determine the manufacturer of inks on questioned documents as well as the exact year of production.

The Identification Branch performed about 500 fingerprint identifications and devised a procedure to begin collecting a national ATF fingerprint file on persons arrested by ATF. This file will be valuable in the identification of recidivist ATF violators. In addition, a procedure for all ATF special agents to begin taking palmprints as well as fingerprints of persons arrested will be implemented.

ATF firearms and toolmark examiners completed about 250 cases.

ATF laboratories offered a wide range of document examination services such as handwriting identification, typewriting identification, watermark examinations, and deciphering of obliterated writing. During fiscal 1975, 1,400 cases including more than 50,000 documents were processed.

ATF continued to pioneer in the development of voiceprint identification. The headquarters laboratory voice identification program processed about 70 cases, contributing greatly to acceptability of the voiceprint method by the courts. Since ATF became involved in this work, several favorable appellate decisions have been rendered.

The photography laboratory handled both still photography and sound motion picture photography. The photo lab was converted largely to automatic processing techniques, greatly increasing productivity. The workload in this area doubled during fiscal 1975, yet no additional personnel were required.

Criminal bombings in recent years have made the misuse of explosives a major national problem. Within the last 2 fiscal years, ATF agents participated in more than 2,400 explosives investigations and the ATF laboratory analyzed evidence from more than 1,400 explosives cases, of which approximately 700 cases were in direct support of State and local law enforcement agencies.

ATF laboratory personnel pioneered the use of neutron activation analysis in forensic crime work. This system was used to process 1,200 such cases in fiscal 1974 as a service for local law enforcement agencies. A new method, the technique of flameless atomic absorption analysis of gunshot residue, was initiated in fiscal 1974, increasing the speed of analysis fourfold. During fiscal 1975, more than 4,200 specimens were processed.

In January 1974, the ATF headquarters laboratory began a program of serological testing to augment its present trace evidence analysis capabilities. From a caseload of 10 cases per month, requests for examinations are expected to reach several hundred per year by fiscal 1976.

For alcoholic beverages, distilled spirits, wines and beers, ATF laboratory personnel checked the fill of containers, the proof, the additives, and the presence of harmful ingredients such as lead in canned alcoholic cocktails. Imported wines were examined to assure that overcarbonated wines are taxed at the champagne rate. Checks were made to determine that colors used in alcoholic beverages are those authorized by the Food and Drug Administration, that products containing artificial flavors are so labeled, and that alcoholic beverages are properly labeled as to their standard of identity.

ATF also regulated denatured alcohol articles (toilet preparations and industrial alcoholic products) and nonbeverage drawback products (foods, flavors, and medicines). ATF ensured that denatured products were properly labeled to indicate their point of origin, and that denatured articles and drawback products contained sufficient ingredients to protect them from recovery as beverage alcohol. During fiscal 1975, ATF specialists examined 5,266 samples, 4,718 formulas, and more than 8,000 labels for specially denatured alcohol products, as well as 1,735 samples and 2,470 formulas for nonbeverage foods, flavors, and medicinal products.

Tobacco was examined for tax purposes to distinguish between cigars and cigarettes and to protect consumers by proper labeling. Lubricants, filled cheeses, and other miscellaneous articles were also examined for tax classification purposes for the Internal Revenue Service.

National Firearms Act weapons.—For NFA weapons, ATF exercised control over their importation, exportation, registration by State and local government entities, and manufacture and transfer between owners of all devices described as nonsporting weapons, such as short-barreled shotguns and rifles, machineguns, bombs, and grenades. ATF also maintained the National Firearms Registration and Transfer Record, which is the control file for these weapons and supplies the information needed to support criminal enforcement activities and provide expert court testimony. During fiscal 1975, 2,851 certificates were prepared to be used as documentary evidence in investigations of possible criminal violations involving NFA weapons.

Gun tracing.—The ATF National Firearms Tracing Center traced firearms from the manufacturer or the importer to the wholesaler to the retailer to the first retail sale. During fiscal 1975, 34,622 traces were requested and 53 percent (or 18,476 traces) of these requests were from State or local agencies.

Explosives Technology Branch.—During fiscal 1975, the Explosives Technology Branch evaluated more than 150 criminal bombing cases. These evaluations resulted in more than 50 destructive-device determinations, requiring more than 1,445 man-hours and the expenditure of an additional 585 court-related man-hours.

The Explosives Technology Branch also completed 453 explosives traces for ATF and Federal, State, and local law enforcement agencies. These traces were nearly 90 percent effective.

ATF has initiated an explosives tagging program to trace explosives once they have been removed from their original containers and to trace explosives from their residue after detonation. This is a development program which will be implemented fully as funds become available. ATF served as coordinator of all U.S. and foreign efforts in this program. Eight foreign countries have expressed interest in participating in the program once the technique has been developed.

Data processing.—During fiscal 1975, the Bureau developed automatic data processing programs to register approximately 160,000 firearms licensees and 5,000 explosives licensees and permittees. The ATF computer can also produce licensee and permittee mailing tapes.

The IRS Data Center in Detroit continued to support ATF in preparing ATF paychecks and maintaining a property inventory control through the property accountability and recording system. The Data Center brought to operational capability the management information system for criminal enforcement cases.

Imports Branch.—During fiscal 1975, the Imports Branch issued 15,151 import permits for firearms defined in the Gun Control Act of 1968, and all arms, ammunition, and implements of war covered by the Mutual Security Act of 1954. Of these, 13,020 were for firearms, 1,075 for firearms and ammunition, 531 for ammunition only, and 525 for other implements of war; 243 applications were disapproved.

Administration

Management by objectives.—Significant objectives for fiscal 1975 were in the areas of explosives tagging, elimination of joint custody in distilled spirits plants, development of firearms strategy, and requirements for ingredient labeling in the alcoholic beverage industry.

ATF currently is developing an internal management by objectives program involving all levels of Bureau management.

Financial management-planning system.—The Bureau solicited the assistance of the Government's Joint Financial Management Improvement Program in developing a new ATF financial management-planning system. When completed, the system will integrate the payroll, personnel, accounting, and management information systems.

Under phase I, a five-team task force prepared a flow chart on all the Bureau's processes and functions. During phase II, each team made field visits to verify the described information. The final two phases, culminating in definition of system requirements, are scheduled for completion in fiscal 1976.

Paperwork management.—ATF's separation from the Internal Revenue Service required the establishment of a new internal management document system suitable to the needs of the Bureau.

ATF formulated and implemented a standard subject classification system. A series of numerical codes provides a means of classifying, numbering, referencing, identifying, and filing all ATF documents and records by subject. At the same time, a Bureau-wide directives system was established, bringing together all written documents that change or establish organization, methods, policy, or workload, or which provide essential information concerning the administration or operation of the Bureau.

Together, the classification and directives systems provided basic guidelines for implementing ATF's forms program. All ATF organizational units currently are using or are converting to the new paperwork management system.

Office relocations and changes.—Several ATF field offices were relocated or renovated as part of continuing efforts to improve service. Four regional offices, in New York City, Chicago, Dallas, and San Francisco, were moved to facilities more accessible to the public and allowing more efficient use of office space, with no increase in long-term costs. A new Regulatory Enforcement area office was opened in Indianapolis to provide needed service to the residents of Indiana. Some of the Bureau's smaller local offices, particularly those in the Southeast, were consolidated or moved, to reduce overall costs and provide more efficient operation.

Distribution Center.—An evaluation of the Bureau's distribution function conducted early in fiscal 1975 led to the reorganization of the unit as the ATF Distribution Center and its relocation into warehouse space approximately 8 miles from Bureau headquarters.

The Center is responsible for providing forms, publications, and all other printed matter published by the Bureau of ATF headquarters and field offices, members of the regulated industries, other law enforcement agencies, and the general public. More than 1,700 different items are stocked in 20,000 square feet of storage space. The average order is processed and delivered in 4–10 days; those who need items on an immediate or emergency basis can receive their orders in 14 hours or less through special services offered by commercial delivery systems.

Centralizing the Bureau's distribution functions resulted in financial and space savings at the regional office level and brought about a significant improvement in the quality of service provided to the public.

Training.—New training programs included 10 Kepner-Tregoe Government Management Seminar II courses for ATF executives and managers, a self-paced supervisory course for firstline supervisors, training classes in the Federal wagering laws for the Bureau's special agents and inspectors, an instructor training course, and on-the-job instruction to improve the quality of field training programs.

Under the Law Enforcement Assistance Administration interagency agreement, the Bureau also conducted subsidized training for State and local police officers throughout the United States.

The assembled training courses (steps I and II) for ATF's Regulatory Enforcement inspectors were redesigned. The basic (step I) curriculum was expanded to include methods for conducting firearms and explosives inspections. A statistical sampling class was added to familiarize inspectors with modern accounting procedures.

Most important of the instructional aids acquired during fiscal 1975 was a Bureau-wide video-tape system.

Executive development program.—The Bureau's executive development program was established January 10, 1975, with the issuance of ATF Order 2412.1. Three essential elements are provided by this program: A means of identifying managers and high-potential employees, guidelines for subsequent development, and program evaluation methods.

Personnel management evaluation.—To ensure the integrity and effectiveness of the merit system, the position of personnel management evaluation coordinator was created on the staff of the Chief, Personnel Division. A team comprised of the coordinator and a member from each of the three branches of the headquarters Personnel Division visited all regional offices to evaluate their personnel functions. Survey findings were reported to each regional director.

Labor and employee relations.—A contract between the Bureau and the National Treasury Employees Union (NTEU) became effective in July 1974. Since that time, the union has established chapters and appointed representatives throughout the regions.

Numerous consultations took place between ATF headquarters and NTEU headquarters. Regional consultations increased as the union increased its number of representatives throughout the Nation. Specific topics were discussed and resolved in these meetings, but, more importantly, ATF and NTEU engaged in a learning process that will result in more meaningful and efficient negotiations of their second contract.

Upward mobility program.—The Bureau developed and provided the regions with a complete plan of action for conducting employee upward mobility programs. Specific achievements included a skills survey for all eligible employees, the redesigning of some positions into a crossover network, and appointment of several employees to upward mobility positions.

Equal employment opportunity.—For the first time, Bureau headquarters and field offices implemented a comprehensive equal employment opportunity action plan which established consistent goals throughout the Bureau. These include the appointment of Spanish-speaking coordinators in each region, extensive efforts to recruit Spanish-speaking individuals in regions with hiring quotas, the hiring of an additional 10 women as Regulatory Enforcement inspectors, and the development and presentation of ATF's first Women's Day.

Recruiting brochures.—The headquarters Personnel Division prepared two recruiting brochures describing the qualifications for, and duties of, ATF's two principal occupations, Criminal Enforcement special agent and Regulatory Enforcement inspector. These pamphlets, available nationwide to citizens interested in employment with the Bureau, provide useful information on its central functions.

Communications.—A limited special assembly telephone switchboard was installed in the Bureau's headquarters communications center, enhancing ATF's capacity to respond to other law enforcement agencies and the general public. This facility provides immediate public and private access to key ATF operating officials full-time.

The Bureau also developed an automated ATF personnel authenticator/locator file for inclusion in the data base of the Treasury enforcement communications system (TECS). This file is unique among law enforcement computer systems in that it readily identifies those ATF employees requiring "need to know" access to records stored in TECS and other computerized Federal, State, and local law enforcement data banks. TECS, a nationwide communications network which ATF utilizes along with other Treasury bureaus, contains the data base for a central summary index of criminal information maintained by the Office of Criminal Enforcement.

During fiscal 1975, the system became fully functional and supportive of all Criminal Enforcement field offices. As of June 30, 1975, ATF had entered 53,000 records into TECS at an average of 2,000 per month. These records included data on the following:

1. All persons and corporations granted or denied relief from Federal disabilities regarding firearms and explosives.
2. Significant criminals.
3. Significant and sensitive investigations.
4. An authenticator/locator file for all ATF employees.
5. Data on all explosives thefts and recoveries.
6. Suspect firearms.
7. Subjects of investigations.
8. Major liquor violators.
9. Arrested persons.

Field offices increased their usage of this computerized system by 250 percent during fiscal 1975. A total of 310,266 queries had been made by the end of the period.

Also during fiscal 1975, the following additional information was entered into the system:

1. All National Firearms Act special occupational tax stamp holders.
2. National Firearms Act registrants who reported their registered guns stolen.
3. Mutual Security Act registrants.

The system contains appropriate access controls to prevent unauthorized disclosure.

Inspection

The Office of Inspection is charged with four significant areas of responsibility: (1) Protecting the integrity of the Bureau; (2) reviewing all operational activities within the Bureau; (3) auditing the Bureau's fiscal position; and (4) implementing the Bureau's security program.

Integrity investigations.—During fiscal 1975, the Operations Review Division conducted 58 integrity investigations involving 64 employees. Of that number, 29 investigations resulted in a finding of clearance of any misconduct and 29 resulted in a basis for criminal prosecutive action or administrative disciplinary action.

Operations review.—The Operations Review Division also conducted four reviews to determine effectiveness and conformance with established policies and procedures in the areas of criminal enforcement, regulatory enforcement, technical and scientific services, and administration. The findings of these reviews were used by management to initiate corrective action wherever necessary.

Internal auditing.—The Internal Audit Division performed audits generally in accordance with the guidelines established by the General Services Administration, Office of Federal Management Policy Circular FMC 73-2; Treasury Administrative Circular No. 224 (Revised); and the Comptroller General's Standards for Audit of Governmental Organizations, Programs, Activities and Functions. The objectives of internal auditing at ATF are to assist management in attaining its goals by furnishing information, analysis, objective appraisals, and practical recommendations pertinent to management's duties and objectives.

During fiscal 1975, audits and reviews were conducted to appraise selected Bureau activities, including appropriated accounting, procurement, service operations, license collections, and administrative activities in five of the seven regions. The team concept of having personnel of the Internal Audit Division and the Operations Review Division participate jointly in reviews of selected operating areas brought diverse disciplines to bear on complex and potentially troublesome aspects of Bureau operations.

To provide adequate coverage of national programs, which a small centralized audit staff could not do, ATF developed a plan to locate professional auditors in regional offices. Implementation began with the establishment of the San Francisco branch of the Internal Audit Division in June 1975. This approach should permit reacting quickly and decisively to changes, reducing the potential cost of travel and per diem necessary to support a centralized audit staff, and providing more timely review of field operations.

Security.—The Security Division coordinated background and character investigations pertaining to all persons employed by the Bureau, of which there are 1,600 employees in the GS–1811 criminal investigator series and a lesser number of support personnel (managerial, technical, and clerical) in the critical-sensitive category. In addition, ATF has more than 1,800 employees in non-critical-sensitive positions. The employees in this category also require security investigations, but on a postappointment basis.

Executive Order 11652, entitled "Classification and Declassification of National Security Information and Material," imposes stringent measures regarding classification and declassification of national security information and prevention of overclassification of such information. This program is ongoing in the Bureau together with a program for appropriate protection of such information from loss or compromise.

To ensure compliance with Executive Orders 10450 and 11652 as they apply to the Bureau, the Office of Inspection is charged with the responsibility of maintaining an appropriate security program for the Bureau by conducting investigations and certifying critical-sensitive employees for top-secret clearances, updating top-secret clearances every 5 years, and safeguarding classified information. During fiscal 1975, 728 security and security update investigations were completed.

Pamphlets and publications

ATF provided the public with a variety of technical pamphlets and publications relating to alcohol, tobacco, firearms, and explosives. Information contained in these publications involves the public's rights or duties, industry regulations, and new interpretations and positions taken by ATF. These publications include The Explosives List, Monthly and Cumulative ATF Bulletin, Published Ordinances Firearms, and Questions and Answers concerning the Gun Control Act of 1968.

Public affairs

Firearms security program.—To promote the theme of firearms security by individuals and licensed dealers, and thus keep firearms out of the hands of criminals, a series of public service announcements was prepared for television and radio featuring Director Rex D. Davis and actor Chuck Connors. These were distributed to all networks and nationally to individual stations by ATF special agents and investigators.

Public information services.—The headquarters Office of Public Affairs distributed 44 news releases during fiscal 1975, covering such topics as legislative changes and major cases involving ATF. Staff members frequently accompany special agents on significant raids and arrange for attendant news coverage by media representatives.

Congressional liaison.—Members of the Congressional Liaison Staff dealt directly with Members of Congress and their staffs. In addition to this personal contact, they prepared 657 letters in response to congressional inquiries during fiscal 1975.

Public and industry liaison.—A public affairs officer participated in 16 conferences dealing with law enforcement or industry regulation. These included the Department of Transportation-sponsored convention in Chicago, where they discussed ATF's firearms security program, and the AFL-CIO industry show in Milwaukee.

Disclosure.—The Disclosure Staff was organized to handle inquiries resulting from passage of the 1974 amendments to the Freedom of Information Act and of the Privacy Act of 1974.

OFFICE OF THE COMPTROLLER OF THE CURRENCY [1]

The National Currency Act of 1863, reenacted in 1864 as the National Bank Act (12 U.S.C. 38), established the Office of the Comptroller of the Currency as Administrator of National Banks. The Comptroller's responsibility is the regulation of the national banking system, a function directly conferred on it by the banking statutes. In fulfilling this mission the Comptroller performs various functions: (1) he renders decisions on applications affecting individual bank structure and activities; (2) he conducts bank examinations to assure compliance with laws and sound banking practices; and (3) he influences the conditions under which banks function by promulgating rules and regulations which govern their operations.

Swift and profound changes in the banking industry have created new and complex challenges both for the Comptroller of the Currency and the individual bank examiner. The growth of assets, spurting by approximately $9 billion or 3.7 percent in fiscal 1975, increased the national banks' total assets to approximately $535.0 billion.

[1] Additional information is contained in the separate Annual Report of the Comptroller of the Currency.

To ensure that the regulatory process keeps pace with the industry, the Comptroller selected, from proposals submitted at his request, the accounting firm of Haskins & Sells to initiate in fiscal 1974 a complete examination of all bureau practices and procedures. That study was completed in June 1975, although some preliminary recommendations were implemented throughout the year. It is expected 12 to 15 months will be required to put into effect all accepted recommendations. The results of the study will enable the Comptroller to improve the quantity and quality of services provided the public and the national banks and to ensure those services are applicable to today's needs.

Rapid changes in banking have suggested the Comptroller make long-range projections of directions the bureau will pursue in the near future. He established a Division of Strategic Policy Planning to determine which areas should receive greatest attention. Intellectual exchange concerning banking and economic developments has been enhanced through the "Meet the Comptroller" conference cycle, a series of meetings at which bankers, the Comptroller, and members of his staff gather to discuss issues and to communicate ideas. In addition to that series, communication between bankers, consumers, and regulators has been strengthened by the Comptroller's extensive speaking schedule.

The information services program, through issuance of publications, distribution of press releases, and responses to inquiries, publicizes the bureau and facilitates communications among agencies, the banking community, and the general public. Standard publications available to employees, banks, and other interested parties are: Comptroller's Manual for National Banks, Comptroller's Manual for Representatives-in-Trusts, and the monthly Summary of Actions. A directory containing the address and telephone number of every decisionmaking bureau official, with photographs and biographical sketches, is published. The Annual Report of the Comptroller of the Currency contains a general statement of policy, descriptions of the state of the national banking system, and reprints of selected documents relating to public issues in banking. Computer-generated microfilm containing the reports of condition and income of all national banks has been placed on an indexed microfilm retrieval system to enable employees to respond more quickly to public requests for this information.

One outgrowth of the changes in the economy was a slight increase in the number of problem banks. Difficulties arose particularly in the areas of liquidity, foreign currency transactions, real estate loans, and past due loans. Greater emphasis was applied to improving detection, monitoring, and dealing with such problem areas. Major systems developed during the year to spot potential problems include: (1) bimonthly reports from all national banks outlining the status of past due loans; (2) quarterly reports from large national banks detailing the schedule of maturities; and (3) weekly accounts from banks having more than a 1-million-dollar net position in any foreign currency to detail the status of foreign currency transactions. This improved monitoring resulted partly through the utilization of large-scale computers, including an IBM 370/168 and 370/158, and two Univac 1108's. This was accomplished through the installation of both high- and low-speed remote access terminals.

Interdisciplinary project teams were established to conduct a number of special studies. Among these was the fair housing lending practices pilot project in which the mortgage lending practices of national banks in 18 standard metropolitan statistical areas were surveyed. The study was carried out in cooperation with the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board. Other special studies included evaluation of examination software, preparation and analysis of data on direct lease financing, and development of data base management systems.

Several ongoing programs were actively supported, including management by objectives, emergency planning (including vital records preservation), program planning and evaluation, productivity measurement, energy conservation, use of advisory committees, maintenance and operation of 53 data processing systems, and the conduct of functional and procedural reviews.

While there were no major changes to the financial reporting system during the year, the Fiscal Management Division implemented a number of changes to provide more efficient processing of voucher payments. One such change in travel voucher processing substantially reduced keypunch and machine time required to prepare reimbursement checks. A significantly greater volume of vendor payments was processed during calendar 1974. A large part of this increased workload was attributable to consolidation of Washington headquarters offices at L'Enfant Plaza East.

Plans were developed to convert the present EAM accounting system to a computer operation. The computer system will provide more timely and detailed information than is available under the present system.

The bureau's travel regulations are administered by the Fiscal Management Division. During 1974, per diem and mileage allowances were increased after extensive analysis disclosed such increases were warranted to adequately compensate employees. Additionally, that division analyzed and reviewed regional requests for additional subregional offices. Establishment of these offices reduced travel costs and permitted examiners to spend less time away from home.

The investment portfolio contributed $3.5 million to the bureau's operating funds in 1974, an increase of 19 percent over the previous year. The interest earned on investments over the past several years has contributed substantially to financing the bureau's operating costs, by virtue of the policy of keeping all available funds fully invested so as to maximize interest revenue.

In late 1974, the Personnel Management Division was reorganized into five branches: employee relations, position management and classification, placement, training, and personnel operations. The reorganization was planned, first, to provide qualified applicants for positions and assist officials making decisions affecting employees, and second, to establish a career ladder to facilitate progression of employees into more responsible positions.

Thereafter attention was focused on evaluating the existing position classification program to determine improvements required to develop a viable, management-oriented position management classification program. Other improvements in daily operations included more timely service in processing personnel action requests, assurance of compliance with position management objectives prior to undertaking classification actions, assurance that position descriptions reflected duties actually performed, and creation of an effective follow-up system of projected positions established to permit expedient recruitment.

During 1974, a pilot program based on the training crew concept was devised for assistant national bank examiners and is scheduled for implementation in 1975. The training crew concept involves a 6-month program of planned rotating assignments in various phases of the bank examination process. A second program was initiated to establish ongoing training programs for examiners and support staff. A comprehensive supervisory-management training program was developed with implementation set for 1975.

The executive development program received special attention as regional administrators and department and division heads nominated 32 candidates from a total of 78 applicants. Six employees were selected to participate in the program.

At the end of 1974 there were 256 financial interns enrolled in the cooperative education program, a 70-percent increase over 1973. Approximately 35 percent of the financial interns are members of minority groups and 27 percent are women.

Increased program activity and intensified examination functions resulted in an increase in the number of examiners and support staff from 2,366 to 2,581. Special progress was made in hiring members of minority groups and women for the examining force. Of a total number of 541 regional minority employees, 505 are in the examination field of which 278 are women.

New goals were set for the Federal women's program. One major objective was instilling into men new ways of thinking about women and their career needs, and taking the action necessary to improve women's status. As part of this program, a committee was selected to support and advise the Federal women's program coordinator on policies and programs specifically designed to assure advancement and self-improvement opportunities for women employees.

As a result of 1975 being officially declared "International Women's Year," several activities were planned. Geared to the special interests of women, these programs included a luncheon/seminar for all bureau women with a career management consultant as guest speaker, a self-defense demonstration program, a security precautions program, and a series of investment seminars. Continuous functions have been: (1) Consulting with women on adequacy of their representation in various training programs; (2) exchanging and distributing information on women's issues to bureau employees; (3) developing referral sources for both women and managers to furnish assistance on available positions and skills; (4) computing average grade levels annually for men and women in each series to determine inequities; and (5) monitoring the filling of positions in the bureau.

Evaluations were conducted in eight regions to assess the effectiveness of regional personnel management programs. Those evaluations helped resolve individual and regional problems and assisted institution of new practices.

The incentive awards program produced 69 awards for adopted suggestions and superior achievements. One hundred thirty-one employees were recognized with high quality increase awards for their superior performance. Awards distributed totaled $21,350 for the year.

OFFICE OF COMPUTER SCIENCE

The Office of Computer Science was established in April 1973. The Office furnishes computer and related support to the analytical, policy formulation, accounting, and administrative functions of the Office of the Secretary, Bureau of the Public Debt, and the Office of Revenue Sharing. It assists in computer development work for bureaus that do not have their own computer facilities, and provides central management review, approval, and guidance functions for ADP management planning, policy, and procurement throughout the Department.

In fiscal 1975, the Department used 135 computer systems, expended 28,412 average positions, and obligated $446 million in its ADP operations. These resources continue to provide such benefits as improved tax administration, support for implementation of general revenue sharing, enhanced debt management and payment systems, revenue collection, and enforcement and protective intelligence functions.

The Office actively pursued its analytical and computer service support functions during the year. Special projects included support for the Office of Tax Analysis in development of a large-scale file merging system; successful completion of several industrial surveys for the Office of Industrial Economics; development of automated accounting systems for two funds of the Office of the Secretary; provision of assistance to the Bureau of Engraving and Printing in establishment of ADP support functions and long-range plans; and undertaking a feasibility study for the automation of departmental budget preparation activities.

The computer facility was expanded to accommodate growth in interactive program development and in batch production. A front-end minicomputer was installed to support more interactive terminals. A nine-track tape system was added for batch production. The 10 tape drives in this system represent the first installation of plug-to-plug equivalents of Univac tape drives. The Systems Engineering staff was instrumental in assisting the manufacturer in resolving a few remaining software problems with this system.

The major departmental functions of the Office included continued work with the Internal Revenue Service on its new tax administration system and providing project and technical support in the Department's efforts to implement the Privacy Act of 1974. Assistance was also provided to the Bureau of Government Financial Operations, the U.S. Secret Service, the U.S. Customs Service, and the Bureau of the Public Debt in development of plans for and acquisition of computers and ADP contracting support. The Office also continued development of improvements to the long-range ADP financial planning system and in its management and coordination of Government-wide ADP standards.

The Office of Computer Science, as a relatively new Office, also took initiative in development of internal management systems by developing and presenting a plan for a management committee to supervise the Office's service functions; developing and implementing an internal project management and resources utilization system; and undertaking professional and technical development and training courses.

CONSOLIDATED FEDERAL LAW ENFORCEMENT TRAINING CENTER

The Consolidated Federal Law Enforcement Training Center (CFLETC) is an interagency training facility formally established within the Department of the Treasury on March 2, 1970. It is under the supervision of the Assistant Secretary (Enforcement, Operations, and Tariff Affairs).

The Department of the Treasury serves as the lead agency for the operation of the Center and, as such, controls the Center's day-to-day activities. A Board of Directors, comprised of representatives at the Assistant Secretary level from the major departments which have agencies participating in the Center and on which there are nonvoting members from OMB and the Civil Service Commission, determines CFLETC training policy, programs, criteria, and standards and resolves conflicting training requirements.

The CFLETC conducts the criminal investigator and police training given personnel of more than one agency and furnishes facilities for the participating agencies to conduct advanced, inservice, refresher, and specialized training for their own law enforcement personnel. At present, 26 agencies representing most major executive departments and independent Federal agencies and the legislative branch participate in Center programs. In fiscal 1975, the Office of Investigation in the Department of Agriculture and the U.S. Capitol Police were added as participating agencies. The Center also has furnished training on a space-available basis to personnel from 15 other Federal, State, and local agencies.

In addition to conducting common advanced training, the Center provides administrative and educational support to (1) consolidate requirements of participating agencies and develop proposed curricula, (2) develop content and teaching techniques for courses, and (3) instruct and evaluate students. These functions are administered primarily through the Police School and the Criminal Investigator School.

Training facilities

A lawsuit filed under the National Environmental Policy Act delayed construction of the Center's proposed Beltsville, Md., facilities for 3 years, during which time estimates of construction costs increased substantially. Consequently, an amended prospectus was submitted to the Public Works Committees of the House and Senate requesting authorization to expend $74.4 million, an increase of $21.8 million over that authorized in 1971.

Citing the extremely high cost to complete the Beltsville facilities, the Senate Public Works Committee requested that Treasury, the General Services Administration, the Department of Defense, and OMB conduct a survey of available Federal installations to determine if any could be adapted for use by the Center at a substantial savings to the Government.

Based on criteria set forth by the Center, GSA, in conjunction with Defense, screened 90 potential sites and selected 6 which were then evaluated by teams from GSA and the Center.

On March 24, 1975, GSA reported to the appropriate congressional committees that a present-value cost analysis showed the Glynco Naval Air Station near Brunswick, Ga., could best be utilized by the CFLETC.

Upon the recommendation of the Center's Board of Directors, Secretary Simon on March 28, 1975, requested that the Public Works Committees of the House and Senate authorize the expenditure of the necessary funds to adapt the Glynco Naval Air Station for the activities of the Consolidated Federal Law Enforcement Training Center. The House Committee on Public Works and Transportation on April 24, 1975, and the Senate Committee on Public Works on May 15, 1975, authorized the expenditure of not to exceed $28,125,000 to relocate the Center's major functions at Glynco and provided an additional $2 million to allow for accelerated interim occupancy of the facility. In the second supplemental appropriations bill for fiscal 1975, the Congress approved the expenditure of previously appropriated construction funds at the Glynco facility.

The Center immediately began work with the Department of the Navy and GSA to transfer title to the property to Treasury and to prepare the facility for the commencement of training in September 1975.

Training

Attendance in the Criminal Investigator School registered an increase of 25 percent in fiscal 1975 over fiscal 1974 with a total of 657 agents being trained in 16 classes. The trainees represented 22 Federal agencies and 3 non-Federal agencies. In addition, 51 enforcement officers received advanced law enforcement photography instruction.

The Center's Police School in fiscal 1975 more than doubled the number of graduates over the preceding year. Twenty classes were conducted in the three basic 5-, 8-, and 12-week courses, processing 838 police officers. The 5-week course was initiated to meet the needs of agencies whose police functions are not as extensive as the agencies which have patrol responsibilities. The development of the 5-week course enabled the Center to provide basic training within Treasury for special policemen of the Bureau of the Mint and the Bureau of Engraving and Printing. In addition, the Police School provided training assistance to the U.S. Park Police, the U.S. Customs Service, the National Park Service, and the Armed Forces Police, and administered several inservice and specialized courses for the National Zoological Park Police.

Curriculum development

During fiscal 1975, the Center developed and coordinated a broad range of programs and materials for its basic curricula and for the advanced, inservice, refresher, and specialized programs of the participating agencies.

Field performance evaluation materials were prepared for use by the U.S. Park Police. Inservice training in connection with a new judgment pistol-shooting program was also developed. Curriculum assistance was given in connection with human relations training of seasonal park rangers. Written materials, instructor assistance, and a video-tape production were provided for the segments of 2-week courses held by the Consumer Product Safety Commission in Kansas City. In addition, the CFLETC provided developmental support services for a mine safety inspector course held at the Center under sponsorship of the Mining Enforcement and Safety Administration, Department of the Interior.

During fiscal 1975, several audiovisual presentations were produced incorporating an illustration of offensive formations for use in civil disturbances, a depiction of the interrelationships among members of the International Criminal Police Organization, and a student orientation to the Center's judgment pistol-shooting exercise.

OFFICE OF DIRECTOR OF PRACTICE

The Office of Director of Practice is part of the Office of the Secretary of the Treasury and is under the immediate supervision of the General Counsel. Pursuant to the provisions of 31 CFR, part 10 (Treasury Department Circular No. 230), the Director of Practice institutes and provides for the conduct of disciplinary proceedings against attorneys, certified public accountants, and enrolled agents who are alleged to have violated the rules and regulations governing practice before the Internal Revenue Service. He also acts on appeals from decisions of the Commissioner of Internal Revenue denying applications for enrollment to practice before the Internal Revenue Service made under 31 CFR, section 10.4. During this fiscal year, the Director of Practice was appointed executive director of the Joint Board for the Enrollment of Actuaries, which was established pursuant to section 3041 of the Employees Retirement Income Security Act of 1974.

On July 1, 1974, there were 85 derogatory information cases pending in the Office under active review and evaluation, 5 of which were awaiting presentation to or decision by an administrative law judge. During the fiscal year, 154 cases were added to the case inventory of the Office. Disciplinary actions were taken in 66 cases by the Office or by order of an administrative law judge. Those actions were comprised of 3 orders of disbarment, 31 suspensions (either by order of an administrative law judge or by consent of the practitioner), and 32 reprimands. The actions affected 14 attorneys, 22 certified public accountants, and 30 enrolled agents. Forty-seven cases were removed from the Office case inventory during fiscal 1975 after review and evaluation showed that the allegations of misconduct did not state sufficient grounds to maintain disciplinary proceedings under 31 CFR, part 10. As of June 30, 1975, there were 126 derogatory information cases under consideration in the Office.

During the fiscal year, 13 attorneys, certified public accountants, and enrolled agents petitioned the Director of Practice for reinstatement of their eligibility to practice before the IRS. Favorable disposition was made on those petitions and reinstatement was granted. In addition, there was one decision on an appeal from a denial by the Commissioner of Internal Revenue of an application for enrollment to practice before the IRS. The decision affirmed the denial.

Twelve administrative proceedings for disbarment or suspension were initiated against practitioners before the Internal Revenue Service during fiscal 1975. Together with the 5 cases remaining on the administrative law judge docket on July 1, 1974, 17 cases were before an administrative law judge during the year. Five of those cases resulted in the acceptance of an offer of consent to voluntary suspension from practice before the IRS, pursuant to 31 CFR, section 10.55(b), prior to reaching hearing. Initial decisions imposing disciplinary actions were rendered in five of the cases. In four cases, the initial decision of the administrative law judge was that the respondent be disbarred from further practice before the Internal Revenue Service. One suspension from practice before the Internal Revenue Service was invoked. In one case, the complaint was dismissed. On June 30, 1975, six cases were pending on the docket awaiting presentation to or decision by an administrative law judge.

Under authority of 31 CFR, section 10.71, two cases resulted in appeals to the Secretary from initial decisions for disbarment rendered by an administrative law judge. The decision on one appeal was an affirmation of the order for disbarment. In addition, one decision was issued by the Secretary on an appeal from the initial decision of an administrative law judge pending on July 1, 1974. In that appeal, the administrative law judge's order of suspension was affirmed. One appeal was pending at yearend.

During the fiscal year, the Office represented the Department in two employees' appeals to the Civil Service Commission from adverse actions taken by bureaus of the Department against them.

OFFICE OF DOMESTIC GOLD AND SILVER OPERATIONS

The Office of Domestic Gold and Silver Operations, in the Office of the Under Secretary for Monetary Affairs, assists the Under Secretary and the Assistant Secretary (Economic Policy) in the formulation, execution, and coordination of policies and programs relating to gold and silver in both their monetary and commercial aspects.

Gold regulations

Public Law 93–373, enacted August 14, 1974, provided for an end to all Government restrictions on the purchase, sale, or ownership of gold on December 31, 1974. Persons subject to the jurisdiction of the United States may now freely import, export, and trade in gold and gold coins within the United States and abroad.

Use of gold for industrial purposes

Estimated net industrial use of gold in the United States during calendar 1974 was 4,651,000 ounces, a decrease of 31 percent from the previous year. The 1974 decrease in industrial purchases was due both to a decline in the production of jewelry and electronic products, reflecting further increases in the price of gold and a slowdown in the economy. The estimated total purchases of gold and allocation of purchases by industry group for the years 1968–74 are shown in table 1.

Sources of gold

Of the 4,651,000 fine troy ounces of gold used by American industry in 1974, 1,206,000 ounces came from U.S. mine production and 3,445,000 ounces from sources abroad. Countries from which the gold was imported are shown in table 2. In addition to industrial gold imports, an estimated 1,350,000 ounces were permitted entry in December 1974 in anticipation of purchases by individuals following the end of restrictions on gold ownership.

Gold sales[1]

With the lifting of the restrictions on the private holding of gold, the Treasury on January 6, 1975, offered 2 million ounces of gold for competitive public bidding. Bids were accepted for 754,000 ounces of gold ranging from a high of $181 per ounce to a low of $153 per ounce. The average accepted bid price was $165.67 per ounce. Gross revenue from the auction was $124,911,585.

On June 30, 1975, 500,000 ounces of gold were offered for competitive bids. Bids were accepted for 499,500 ounces of gold at a price of $165.05 per ounce. The gross revenue from the auction was $82,442,475.

TABLE 1.—*Estimated industrial use of gold in the United States, calendar years 1968–74*

[Thousands of fine troy ounces]

	1968	1969	1970	1971	1972	1973	1974
Estimated total purchases of gold by U.S. industry	6,604	7,109	5,973	6,933	7,285	6,729	[1] 4,651
Converted into fabricated products	6,073	6,568	6,148	6,542	7,253	6,638	4,829
Increase in inventories	531	541	−175	391	32	91	−178
Allocation of purchases by industry group	6,604	7,109	5,973	6,933	7,285	6,729	4,651
Jewelry and arts	3,908	3,839	3,340	4,299	4,344	3,473	2,402
Dental	771	710	658	750	750	679	509
Industrial, including space and defense	1,925	2,560	1,975	1,884	2,191	2,577	1,740

[1] Excludes an estimated 1,350,000 ounces acquired by refiners and dealers in December 1974 to meet expected demand by individuals following the end of ownership restrictions.

[1] See exhibit 77.

TABLE 2.—*Exports and imports of gold into the United States for industrial use, calendar year 1974*

[Thousands of fine troy ounces]

Country	Exports	Imports
Austria		[1] 1,014
Canada	19	841
Japan	19	
Singapore	27	
Switzerland	13	[1] 1,979
United Kingdom	408	16
U.S.S.R.		120
West Germany	124	21
Yugoslavia		81
Other countries	23	6
Total	633	4,078
Net imports of gold		3,445

[1] Includes purchases from foreign accounts at the Federal Reserve Bank of New York.

NOTE.—Imports are shown from country of final export as reported by Department of the Treasury gold licensees and do not indicate prior shipment from country in which the gold was produced.

BUREAU OF ENGRAVING AND PRINTING

The Bureau of Engraving and Printing, one of the world's largest securities manufacturing establishments, designs and produces the major evidences of a financial character issued by the United States. It is responsible for the production of U.S. currency, postage stamps, and public debt instruments, as well as miscellaneous financial and security documents.

Reorganization

Faced with increasingly more complex demands from customer agencies for security printed products, the Bureau reviewed the appropriateness of its organizational structure for initiating and controlling the technological and operational changes needed to continue cost-effective completion of mission requirements. A Bureau-wide reorganization, effective in fiscal 1976, will provide cohesive top management direction and functional concentration in the areas of research and engineering, operations, and administration.

Finances

Operations of the Bureau are financed by means of a revolving fund established in accordance with the provisions of Public Law 656, approved August 4, 1950. This fund is reimbursed by customer agencies for the direct and indirect costs of the Bureau for work and services performed, including administrative expenses.

In followup of the directive by the House Subcommittee on Appropriations to develop alternate methods of financing, the Bureau incorporated a surcharge in the cost of its products beginning in fiscal 1975. The surcharge provides funds to help finance predictable equipment acquisitions. However, it was recognized that the new surcharge alone would not provide sufficient funds to acquire major equipment in adequate quantities to meet current needs. Therefore, the Bureau entered into equipment contracts on a monthly lease-with-option-to-buy financing arrangement (lease-to-ownership), without termination contingency liability. The absence of liability requirements enabled the Bureau to obtain essential major equipment without cash outlay.

Utilizing this method of financing, contracts were let for the acquisition of six modern high-speed intaglio printing presses and six production models of the currency overprinting and processing equipment (COPE). Delivery of two of the intaglio printing presses is expected by July 1975, and three of the COPE machines by August 1975. Estimated annual savings in currency production costs from complete utilization of this equipment is $3 million.

Currency program

Currency deliveries in fiscal 1975 totaled 2.8 billion notes, compared with 2.3 billion notes in fiscal 1974. The smaller volume in fiscal 1974 reflected a reduction by the Federal Reserve System in the level of its cash inventory due to reassessment of its emergency reserve requirements.

Heretofore the Bureau has destroyed currency and other securities mutilated during the production processes by burning in the Bureau incinerator. Due to air pollution, the District of Columbia Government requested the Bureau to develop other means. During February 1975, the Bureau installed a system whereby the mutilated currency is shredded, baled, and shipped to the Crane Paper Co. in Dalton, Mass., for recycling into newly manufactured currency paper. Each month, approximately 20,000 pounds of shredded currency paper is being disposed of in this manner instead of incineration, resulting in reduced air pollution and paper conservation. Alternate nonpolluting systems for destruction of other mutilated paper products of a security nature are planned for fiscal 1976.

Operational changes accomplished during fiscal 1975 included the shrink wrapping of currency packages, which replaced the traditional method of the kraft wrapping process, and the installation of paper lifts at the guillotine cutting machines, which eliminates the need for manual handling. Both are labor-saving improvements.

Food coupon program

During fiscal 1975, the Department of Agriculture issued a new series of food coupons, designed by the Bureau, with different denominations and book conformations. Since the private sector banknote companies were unable to undertake production of the total number of coupons needed by the changeover date of March 1, 1975, OMB approved the Bureau's request to continue production of the old series through January 1975.

On January 24, 1975, the Department of Agriculture requested the Bureau to extend production of the old series for an emergency requirement of 4 million $30 food coupon books by February 15, to meet the increase in eligible recipients. During March 1975, the Department again requested the Bureau's service, this time to assist in producing the new series, since the private sector banknote companies were unable to meet production requirements under the escalated program.

Total deliveries in fiscal 1975 were 3.3 billion food coupons (approximately 16 percent of the requirements of the Department of Agriculture), compared with 2.5 billion delivered in fiscal 1974.

Postage stamp program

Deliveries of U.S. postage stamps were 26.7 billion pieces in fiscal 1975, compared with 29.5 billion in fiscal 1974. (Abnormally heavy production requirements in fiscal 1974 were occasioned by the postal rate increase.)

The Bureau began installation of two modern postage stamp presses ordered in 1972. One is a multicolor intaglio web press to be used for printing stamps in coil form. The other is a combination gravure-intaglio web press which will introduce a new dimension in the production of other types of multicolor postage stamps. The versatility of these presses will materially broaden the range of printing process capabilities and provide operational experience to help determine the new generation of presses to be designed for replacement of obsolete single-color web presses.

The Bureau also purchased equipment for mechanizing the manufacture of postage stamps in book form. This equipment can print the book covers, collate the covers with preprinted intaglio stamps, and process the finished books in one continuous operation. Substantial manpower savings and lower production costs will be realized.

During fiscal 1975, the Bureau manufactured its first pressure-sensitive postage stamp, a 1974 Christmas design, "Peace on Earth," which eliminated the need for moistening prior to affixing the stamp to the envelope surface. Distribution was limited to five postal regions as a pilot project for determining public acceptance. The six-color stamp was printed by the gravure process and then converted to die-cut sheet stamps on prototype equipment.

Offset printing presses

A sheet-fed multicolor offset press to produce postage stamps was installed during fiscal 1975 and will be operational early in the next fiscal year. This press will eliminate the need for multiple passes of sheets through two presses when more than two-color offset printing is required.

Acquisition of a web-fed offset printing press is proposed during fiscal 1976, to be used primarily for the production of red strip stamps for distilled spirits. The elimination of the need to number such stamps in a separate printing operation will result in significant recurring annual savings.

Internal audit

An intensive program of internal audit evaluated operational efficiency and economy, and ascertained compliance with prescribed regulatory directives. During fiscal 1975, 61 reports of audit containing 229 recommendations for improvements were released for management consideration. Coverage included fiscal and management audits and reviews of operations and programs, conducted on a scheduled, special, and unannounced basis.

Quality control

During fiscal 1975, improved quality control measures provided greater assurance that postage stamp books, coils, and sheets were consistently maintained at acceptable quality levels. In addition, two new quality assurance programs were implemented for the early identification and correction of causes of excessive postage stamp spoilage during manufacturing and processing operations, and for monitoring in-house handling and storage of paper to reduce waste and spoilage.

Warehouse

To resolve the Bureau's critical shortage of warehouse space, interim arrangements were made to utilize 10,000 square feet of space at the Naval Gun Factory to store paper which was ordered for production of the Christmas postage stamps. In April 1975, the Bureau was successful in obtaining space in a modern warehouse located at Lorton, Va.

Executive development

The first phase of the Bureau's executive development plans involved the identification of specific kinds of knowledge and ability necessary at each level of Bureau management. In the second phase, an assessment center matched those requirements with candidate potential. Development plans for incumbent managers are based on a series of personal and operational goals for improvement. Followup development and career planning has been ongoing with eight candidates who emerged from the management assessment center. In the initial seminar of a planned series the group met with members of top management to develop an awareness of current management approaches, issues, and priorities.

The Kepner-Tregoe process for problem analysis and decisionmaking is being utilized for incumbent managers and executive development candidates. The objective is to provide participants with basic ideas for organizing and using information in solving problems, making decisions, and anticipating future problems. The approach deals with major problems of the Bureau without regard for internal organizational boundaries which may or may not conform to the functional dimensions of the problem. This not only serves to upgrade the manager's problem-solving and decisionmaking skills, but also provides a developmental team-building approach to solving internal problems.

Supervisory development system

During September 1974, a special projects group was organized to study and revise the supervisory personnel system. The new system provides for an assessment center, a supervisory intern program, revised development program, and a new evaluation plan. The initial outline of the total system was approved in February 1975, and the special projects team has since initiated revisions of existing selection and promotion guidelines, development of instruments for use in the assessment center, and development of a modular training program. The final program plan will be completed and ready for implementation during the next fiscal year.

General educational development

During fiscal 1975, 70 employees participated in various phases of the general educational development (GED) program. Seven employees completed the courses and elected to take the GED examination, receiving their high school equivalency diplomas.

Upward mobility program

The upward mobility program was initiated with a survey of interest conducted in August 1974. Approximately 320 employees responded. Following completion of a skills inventory, each candidate was counseled by trained upward mobility career counselors. Seven target positions which were identified to be filled through this program were formally advertised during March 1975. Eighty-three candidates were processed through the upward mobility center and were ranked and certified on a promotion register which will remain active for such positions for a 1-year period. Each selected candidate will be afforded individual training and development to enable him or her to meet the qualifications of the target position in accordance with Civil Service Commission regulations.

Awards program

During fiscal 1975, 1,141 employees received special achievement awards and 47 employees were granted high quality pay increases. Nonrecurring savings of $139,278 were realized this fiscal year from this part of the incentive awards program. Under the employee suggestion program, 174 suggestions were received, of which 61 were adopted, and it is estimated that the Bureau will realize annual recurring savings of $15,455 and nonrecurring savings of $1,980.

Equal employment opportunity program

The Bureau's equal employment opportunity program, in an effort to increase the number of Spanish-speaking employees, broadened recruitment contacts in fiscal 1975. Employee committees for equal employment opportunity provided an effective and direct avenue of communications between employees and top management. Employment statistics indicate definite progress in the advancement of minorities and females in the number of craft journeyman and higher grade General Schedule and Wage Grade positions.

Labor-management relations

The Bureau continued to give special emphasis and attention to the conduct of all labor-management dealings within the spirit and intent of Executive Order No. 11491, as amended by Executive Order No. 11838 of February 6, 1975. At the close of the fiscal year, there existed within the Bureau grants of exclusive recognition to 17 AFL-CIO affiliate unions covering 25 craft units, 1 noncraft unit, 1 guard unit, and 1 GS clerical/technical unit. There were 12 approved substantive labor-management agreements. The unions functioned as a dynamic part of the Bureau and were a major factor in management considerations.

Safety program

During the 4-month period from January through April 1975, there was an increase of 10 injuries over the same period in 1974. However, the frequency rate of lost-time injuries when compared for the same period reflected a dramatic upward spiral. Projecting the monthly average of lost-time cases during 1975 to date, it is anticipated that approximately 120 such injuries, representing a 167-percent increase, will occur during this calendar year.

Primarily, this is attributable to changes in the Federal Employees' Compensation Act which became effective November 6, 1974. The factor having greatest impact is that the employee becomes immediately eligible for continuation of pay by the Bureau for up to 45 days without charge to any leave account. The prior regulation required placing an employee in a leave-without-pay status for 3 days, awaiting compensation claim adjudication. In light of the changes in the act, attention was concentrated upon reported injury cases which could be expected to result in continuation of pay. Investigations were promptly conducted, with a comprehensive report of findings and, as appropriate, referral to the area manager for remedial action to eliminate the cause or minimize recurrence.

Constant communication with supervisors continued to broaden the basis for understanding plant safety and the supervisor's role in accomplishing safety goals. Also solicited was union representative participation in the Bureau's safety awareness program, including surveys of work areas, machinery, and processing operations.

The Bureau's comprehensive industrial safety program includes close collaboration with the medical office. The Bureau has acquired an electronic audiometer and soundproof hearing testing chamber for use in a hearing conservation program for employees.

Service to the public

The Bureau continued to promote increased public awareness of the security characteristics of genuine currency.

Security exhibits were furnished for four numismatic and philatelic shows. In addition, the Bureau produced two distinctive souvenir cards in conjunction with the American Numismatic Association's 83d anniversary convention in Bal Harbour, Fla., and the National Philatelic Exhibitions of Washington, D.C. Sales of the souvenir cards not only responded to expressed public interest but also defrayed costs of participation by the Bureau at these events. Participation at exhibits is expected to accelerate during the Bicentennial era.

The Bureau of Engraving and Printing continues to be one of the major points of interest for visitors to the Washington area. During fiscal 1975, 616,040 visitors took the self-guided tour of Bureau operations. Other tours geared to technical needs and particular interests are conducted on an individual need basis such as for agents of the U.S. Secret Service, representatives of domestic and foreign firms in the printing industry, and news media personnel.

OFFICE OF EQUAL OPPORTUNITY PROGRAM

Total program operations

The Office of Equal Opportunity Program operates within the Office of the Secretary and is under the immediate supervision of the Assistant Secretary (Administration). It assists the Secretary and the Assistant Secretary (Administration) in the formulation, execution, and coordination of policies related to equal opportunity for Treasury employees (implementing the Equal Employment Opportunity Act of 1972 governing equal employment in the Federal Government) and employment policies and programs of banks, savings and loan associations, savings banks, and other financial institutions that are Federal depositaries or issuing and paying agents of U.S. savings bonds and savings notes (implementing Executive Order 11246, as amended, and Treasury regulations governing equal employment for Treasury contractors).

Federal equal employment opportunity program

Progress in the administration of Treasury's equal employment opportunity program during the year was marked mainly by increased emphasis on the upward mobility program, the Federal women's program, and the Spanish-speaking program. To emphasize the Spanish-speaking program, a handbook entitled "Department of the Treasury Program for Spanish-Speaking Americans" was completed. The Office also revised the EEO complaint processing system to include the 40 to 65 age provisions of the Age Discrimination in Employment Act of 1967, as amended, in 1974 (Public Law 93–259). On October 1, 1974, the Civil Service Commission commended the Department on the average time to process EEO complaints, which was 154 days. The average for all other agencies was 201 days, which is 21 days above the prescribed limit.

A memorandum was issued by the Secretary on May 8, 1975, to all employees stressing his concern for that kind of effective operation of the equal employment opportunity program that would have the most positive impact on all personnel, especially women and minorities, in the total agency work force. Position statements of a similar vein, supporting the specific principles and goals of upward mobility, the Federal women's program, and the announcement of "International Women's Year" emphasis, were also issued by the Secretary in May and June of 1975.

On June 18, 1975, the Department, under the aegis of its top-level Women's Advisory Committee, successfully conducted a women's day convocation of all bureau heads, top-level managers and supervisors, and selected employee representatives. In addition to Secretary Simon, Dr. Estelle Ramey, professor of physiology and biophysics, Georgetown Medical School, and the Honorable C. Delores Tucker, secretary of state, Commonwealth of Pennsylvania, were the keynote speakers. This conference, with its main theme being to emphasize the objectives of International Women's Year, included a special afternoon session in which employees at all grade levels engaged in open dialog with the Committee's member panelists, who also made short presentations on their ideas for effective approaches to personal career success. The Committee and top management also answered specific questions of interest concerning employees' desires for more training and obtaining greater merit promotion and upward mobility opportunities, and other viable forms of self-development preparation.

On April 15, 1975, the Civil Service Commission reviewed the following Treasury full-time employment statistics for the period from December 1968 through November 1974 and complimented the Department on the progress made during this period.

Department of the Treasury full-time employment by minority group status

	1968	1970	1972	1973	1974	Comparison 1973–1974		Comparison 1968–1974	
						No.	Percent	No.	Percent
Total employees*	82,155	88,351	102,813	106,157	116,444	10,287	9.7	34,289	41.7
Negro	11,777	13,234	15,619	16,170	18,478	2,308	14.3	6,701	56.9
Spanish-American	1,052	1,489	2,247	2,788	3,539	751	26.9	2,487	236.4
American Indian	79	104	128	146	179	33	22.6	100	126.6
Oriental	482	596	813	1,084	1,238	154	14.2	756	156.8
Other	68,765	72,928	84,006	85,969	93,010	7,041	8.2	24,245	35.3
GS 1–4:									
Total	19,120	18,867	24,126	23,869	27,039	3,170	13.3	7,919	41.4
Negro	4,947	5,156	5,904	5,932	6,892	960	16.2	1,945	39.3
Spanish-American	255	398	791	922	1,146	224	24.3	891	349.4
American Indian	25	33	45	45	60	15	33.3	35	140.0
Oriental	80	96	159	186	206	20	10.8	126	157.5
Other	13,813	13,184	17,227	16,784	18,735	1,951	11.6	4,922	35.6
GS 5–8:									
Total	19,480	23,826	27,601	30,793	33,485	2,692	8.7	14,005	71.9
Negro	2,708	3,467	4,290	4,837	5,571	734	15.2	2,863	105.7
Spanish-American	264	422	551	738	1,012	274	37.1	748	283.3
American Indian	26	30	35	46	52	6	13.0	26	100.0
Oriental	141	183	249	394	444	50	12.7	303	214.9
Other	16,341	19,724	22,476	24,778	26,406	1,628	6.6	10,065	61.6
GS 9–12:									
Total	28,893	28,960	32,321	32,615	35,580	2,965	9.1	6,687	23.1
Negro	1,144	1,283	1,587	1,769	2,097	328	18.5	953	83.3
Spanish-American	332	389	519	709	826	117	16.5	494	148.8
American Indian	21	30	34	40	44	4	10.0	23	109.5
Oriental	186	203	222	299	363	64	21.4	177	95.2
Other	27,210	27,055	29,959	29,798	32,250	2,452	8.2	5,040	18.5
GS 13–18:									
Total	9,491	10,665	12,037	12,562	13,297	735	5.9	3,806	40.1
Negro	151	218	307	353	403	50	14.2	252	166.9
Spanish-American	35	54	88	117	135	18	15.4	100	285.7
American Indian	3	5	8	9	15	6	66.7	12	400.0
Oriental	55	67	90	102	104	2	2.0	49	89.1
Other	9,247	10,321	11,544	11,981	12,640	659	5.5	3,393	36.7

*The totals include wage board personnel. Grade comparisons are for GS series only.

NOTE.—For figures for 1969 and 1971, see 1974 Annual Report, p. 116.

Contract compliance

During fiscal 1975, only 226 [1] compliance reviews were initiated. This reduction in the number of reviews conducted in relation to past years was a direct result of the expanded scope of coverage required by Office of Federal Contract Compliance Revised Order No. 14.

However, notwithstanding the embarkation on a more sophisticated compliance review approach, the Treasury contract compliance program nonetheless made other outstanding management and administrative strides during fiscal 1975. To improve operating efficiency, the contract compliance responsibility which had been centralized in the national office was decentralized to the regional field offices. As a part of this effort four regional managers were hired to manage the field offices in Atlanta, Chicago, Houston, and Los Angeles. In addition, a new regional office was established in Washington, D.C., and a sixth regional office is planned for New York City. A new compliance review workbook was adopted to enable the regional managers to meet the more detailed contract compliance requirements. The Office is also planning the installation of a computerized record retrieval system that will provide for improved identification of clientele and a more systematic scheduling of reviews. Likewise it will assist in maintaining required statistics and aid in the preparation of reports.

FISCAL SERVICE

Bureau of Government Financial Operations

The functions of the Bureau are Government-wide in scope. It disburses by check, cash, or other means of payment for most Government agencies; settles claims involving loss or forgery of Treasury checks; manages the Government's central accounting and financial reporting system by drawing appropriation warrants and other funding authorizations, by maintaining a system of accounts for integrating Treasury cash and funding operations with the financial operations of disbursing and collecting officers and of Government program agencies including subsystems for the reconciliation of check and deposit transactions, and by compiling and publishing reports of budget results and other Government financial operations; provides banking and related cash services involved in the management of the Government's cash resources; administers certain U.S. currency matters such as directing the various aspects of the issue, redemption, and custody of Treasury and Federal Reserve currency, and maintaining facilities for and overseeing the destruction of currency unfit for circulation; provides central direction for various financial programs and practices of Government agencies; and directs a variety of other fiscal activities.

[1] Included in this figure is one completed review of Bank of America, N.T. & S.A., headquartered in San Francisco, Calif. (which has over 1,050 branches and subsidiaries, and some 55,000 employees).

Disbursements and check claims

Disbursing operations.—The Division of Disbursement's 11 disbursing offices produced a total of 727 million checks and savings bonds in payment of Government obligations for more than 1,400 civilian offices during fiscal 1975 at an average unit cost of 3.7 cents. Over 98 percent of these payments were produced by computers. In addition, more than 115.6 million computer-generated Federal tax deposit forms were produced and mailed.

Government agencies and the general public benefited from the performance of the diversified activities of the Treasury's centralized disbursing system by computerized methods which continued to result in increased productivity. A number of small agencies received automated payroll accounting service from the disbursing centers.

Fiscal 1975 significant achievements are as follows:

1. The prototype check-wrapping system, which manufactures an envelope from a roll of paper while simultaneously imprinting a signature and inserting a check and as many as three separate inserts, was continued in operation in the Philadelphia Disbursing Center. More than 90 million checks were processed in the system. The first production model system was delivered to the Kansas City Disbursing Center on June 26, 1975. Current plans provide for a total of 14 such systems to be installed in 6 disbursing offices by the end of fiscal 1976.

2. The Washington Disbursing Center completed a second year of operation on its optical character recognition (OCR) system, where typed voucher schedule payment data is read and converted onto magnetic tape for computer input. During fiscal 1975, an average monthly volume of 225,000 payments was processed on that system. The OCR system in the Denver Disbursing Center became operational October 1, 1974. Since that date, administrative agency stations with a combined monthly volume of over 136,000 payments have been converted to the OCR method of check processing. The OCR system in Chicago became operational January 2, 1975. This installation encompasses plans for converting to OCR check processing the miscellaneous payments of administrative agency stations with a volume of 145,000 payments monthly at full conversion. During June 1975, the Chicago Disbursing Center processed over 75,000 payments on OCR equipment. Annual recurring savings of $528,000 are projected for the three disbursing centers at total conversion.

3. The income tax rebate program authorized under the Tax Reduction Act of 1975, Public Law 94–12, required additional workload during the latter part of fiscal 1975. The disbursing offices issued, enclosed, and mailed more than 54.6 million rebate checks during May and June 1975. The May portion, coupled with the issuance of all other payments produced in May 1975, resulted in a total volume of over 106 million items processed—the highest monthly volume in the history of the Division of Disbursement.

4. In June 1975 as a result of section 702 of the Tax Reduction Act of 1975, the disbursing offices issued and mailed 30.3 million special $50 one-time checks to recipients of social security, supplemental security income, and railroad retirement benefits. This payment program was administered by the Department of the Treasury with the

cooperation of the Social Security Administration and the Railroad Retirement Board.

5. Third-generation computer systems continued to provide the necessary capacity for meeting yearly increases in check production volumes and to more fully develop and efficiently maintain a computerized rapid check claims research system. One tape drive was added to each of the two IBM S/360 computers at the Philadelphia office and an additional card reader punch was procured for use on the punch/print S/360 to increase processing capacity at that office.

6. Additional agencies have automated, or are considering automating, their accounts payable by submitting magnetic tapes to disbursing offices for the issuance of vendor and miscellaneous payments. Computer-generated cards which accompany many of the checks provide the recipients with a permanent record of the purpose of the payment. Use of this card notice eliminates the time-consuming manual processing of large quantities and various sizes of paper notices by the agencies and the disbursing offices, and reduces the number of inquiries concerning the purpose of payments.

The following table is a comparison of the workload for fiscal years 1974 and 1975.

Classification	Volume 1974	Volume 1975
Operations financed by appropriated funds:		
Checks:		
Social security benefits	324,627,344	340,024,721
Supplemental security income program	25,862,546	50,683,926
Veterans benefits	78,928,491	85,069,062
Income tax refunds	66,009,233	[1] 122,751,650
Veterans national service life insurance dividends program	2,870,965	4,248,518
Other	65,116,179	[2] 100,754,343
Savings bonds	7,643,271	7,918,396
Adjustments and transfers	299,164	340,109
	571,357,193	711,790,725
Operations financed by reimbursements:		
Railroad Retirement Board	13,968,671	13,767,833
Bureau of the Public Debt (General Electric Co. bond program)	1,409,201	1,463,114
Total workload—reimbursable items	15,377,872	15,230,947
Total workload	586,735,065	727,021,672

[1] Includes 54,612,071 tax rebates.
[2] Includes 30,291,958 special $50 payments.

Settling check claims.—During fiscal 1975, the Division of Check Claims processed 1.2 million requests to stop payment on Government checks. This resulted in 501,295 paid-check claims acted upon, including 72,479 referred to the U.S. Secret Service for investigation because of forgery, alteration, counterfeiting, or fraudulent issuance and negotiation. Reclamation was requested from those having liability to the United States on 102,481 checks.

During the year, 54,533 paid-check claims resulted in settlement checks to payees totaling $12.4 million; 4,332 claims resulted in settlement checks to endorsers totaling $1.8 million; and 24,662 claims resulted in payments to other agencies of $4.9 million for death and nonentitlement cases. In addition, 249,472 substitute checks valued at $152.4 million were authorized to replace checks that were lost, stolen, destroyed, or not received.

The project to further automate check claims operations using third-generation computers is continuing. Programs have been implemented to extend the retention in the computer system of locater numbers of paid checks needed to settle check claims. The locater number is necessary to retrieve the check from the Federal Records Center. This greatly reduces the volume of locater numbers obtained through the use of microfilm equipment. The processing of claims involving supplemental security income checks has been expedited by automatically generating a substitute check issue tape.

Government-wide accounting

Government accounting systems.—In July 1974, a project team was organized for the purpose of developing a unified Treasury accounting and financial reporting system replacing the two separate systems maintained by the former Office of the Treasurer, U.S., and Bureau of Accounts. The overall project, known as accounting information management system, is comprised of multiple subsystems and modules. A management information system designed to track employee man-hours and related costs for all staff projects was introduced in fiscal 1975 and will be further refined and expanded next year. A preliminary analysis of the current central accounting and financial reporting system, in process for 6 months, will result in eventual conversion of the master file from a second-generation tape-oriented system to a third-generation on-line disc storage system. An electronic funds transfer subsystem is in process which will result in earlier availability of cash into the Treasury account. Additional side benefits of improved cash management and reduction in paperwork will be derived from the electronic funds transfer system. A deposit-in-transit systems study, begun in January 1974, has resulted in a new system for reconciling deposit-in-transit differences and a new certificate of deposit form designed for automated processing. The use of the new system and the new form is scheduled to begin in September 1975, on a test basis, utilizing a major Federal agency for the pilot application. Upon evaluation of the test results, use of the system will be gradually expanded Government-wide.

The simplified intragovernmental billing and collection system was expanded in fiscal 1975 to include penalty mail usage charges by the U.S. Postal Service. These charges are billed monthly in advance based on the annual estimates of anticipated penalty mail usage provided to the Postal Service by the agencies.

The revised Daily Statement of the United States Treasury went into effect July 1974. It reflects current day activity based on telephone and wire reports from the Federal Reserve System and internal Treasury sources. The statement has been fully functional, providing more timely and detailed information, better suited to its users.

Treasury special agent accounts maintained for the redemption of securities and related payments of interest for Federal National Mortgage Association, Federal home loan banks, Federal Home Loan Mortgage Corporation, Federal intermediate credit banks, Federal land banks, and banks for cooperatives were eliminated, effective October 1, 1974.

A project was started during the year to eliminate all remaining funded checking accounts of the various Government agencies. All such accounts will become unfunded, effective July 1, 1975.

Pursuant to Public Law 93–340 and Executive Order 11863, both enacted in fiscal 1975, the Secretary of the Treasury entered into agreements with 36 eligible cities for the withholding of city income or employment taxes from the pay of Federal employees who are subject to the tax and whose regular place of Federal employment is within such a city. Regulations were published in the Federal Register governing the withholding of city income and employment taxes from the pay of Federal employees.

On December 31, 1974, after 41 years, it became legal for U.S. citizens to buy, sell, and hold gold. Treasury through the General Services Administration conducted two auctions on January 6, 1975, and June 30, 1975, selling 756,862 and 499,500 ounces of gold, respectively. These sales of gold earned Treasury profits of $154.8 million. To accomplish these sales, the Bureau of Government Financial Operations in cooperation with the Bureau of the Mint and the General Services Administration coordinated internal procedures to assure proper payment, delivery, and financial accounting and reporting.

A project to accelerate the availability of outlay data at the appropriation level was begun during the year. In cooperation with the Department of Defense, a monthly reporting system was developed which utilizes computer-generated magnetic tape in lieu of hard copy accounting reports. This new system was implemented in May 1975 and provides Treasury with actual data at the appropriation level for the Department of Defense about 2 weeks earlier than in the past.

Assets and liabilities in the account of the U.S. Treasury.—Table 53 in the Statistical Appendix shows the balances at the close of fiscal years 1974 and 1975 of those assets and liabilities comprising the account of the U.S. Treasury. The assets and liabilities in this account include the cash accounts reported as the "operating balance" in the Daily Statement of the United States Treasury. Other assets included in the account of the U.S. Treasury are gold bullion, coin, coinage metal, paper currency, deposits in Federal Reserve banks, and deposits in commercial banks designated as Government depositaries. Balances mentioned herein may differ from those in table 53 in the Statistical Appendix which is on a final accounting basis.

Treasury's gold balance was $11,566.8 million at the beginning of the year and $11,619.9 million at yearend. Inasmuch as deliveries of the gold auctioned on June 30 are being made in fiscal 1976, no reduction in gold is herein reflected. The average accepted bid price in the January 6 auction was $165.67 per ounce and in the June 30 auction $165.05 per ounce.

Stocks of coinage metal stood at $418.3 million at the beginning of fiscal 1975 and $402.1 million as the year ended. Such stocks included silver, copper, nickel, zinc, and alloys of these metals which are not yet in the form of finished coins.

The number of depositaries of each type and their balances on June 30, 1975, are shown in the following table:

Depositaries [1]	No. of accounts	Balance June 30, 1975
Federal Reserve banks and branches	36	[2] $6,141,528,180
Other depositaries reporting directly to the Treasury:		
Special demand accounts	9	343,490,000
Other:		
Domestic	19	3,902,150
Foreign [3]	44	8,932,902
Depositaries reporting through Federal Reserve banks:		
General	2,062	149,083,278
Special (Treasury tax and loan accounts)	13,722	1,474,813,777
Total	15,892	8,121,750,287

[1] Includes only depositaries having balances with the U.S. Treasury June 30, 1975. Excludes those designated to furnish official checking account facilities or other services to Government officers but not authorized to maintain accounts with the Treasury. Banks designated as general depositaries are frequently also special depositaries, hence the total number of accounts exceeds the number of banks involved.
[2] Includes checks for $368,691,579 in process of collection.
[3] Principally branches of U.S. banks and of the American Express International Banking Corp.

Government officers deposit moneys which they have collected to the credit of the U.S. Treasury. Such deposits may be made with the Bureau of Government Financial Operations in Washington, D.C., or at Federal Reserve banks, or at designated Government depositaries, domestic or foreign. Certain taxes are also deposited directly by the employers or manufacturers who withhold or pay them. All payments are withdrawn from the U.S. Treasury account.

Cash deposits and withdrawals affecting the Treasury's operating balance are summarized in the following table for fiscal years 1974 and 1975.

Deposits, withdrawals, and balances in the U.S. Treasury account

[In millions of dollars]

	1974	1975
Operating balance at beginning of fiscal year	12,571	9,158
Cash deposits:		
Gross tax collections (selected)	264,919	291,746
Public debt receipts	282,334	388,251
Gas and oil lease sale proceeds	5,218	3,252
Other	238,142	271,155
Total cash deposits	790,613	954,404
Cash withdrawals:		
Public debt redemptions	289,116	348,116
Letter of credit transactions:		
Medicare	10,169	13,294
HEW grants	14,164	16,424
Unemployment insurance	5,131	11,915
Other (includes refunds and 1975 rebates)	475,444	566,224
Total cash withdrawals	794,024	955,973
Operating balance at close of fiscal year	9,158	7,589

Investments.—The Secretary of the Treasury, under specific provisions of law, is responsible for investing various Government trust funds. The Department also furnishes investment services for other funds of Government agencies. At the end of fiscal 1975, Government trust funds and accounts held public debt securities (including special securities issued for purchase by the major trust funds as authorized by law), Government agency securities, and securities of privately owned Government-sponsored enterprises. During fiscal 1975, a new special issue was developed that is identical in every respect (except transferability) to Treasury marketable securities and is issued to Government accounts in lieu of marketable issues. See the Statistical Appendix for table showing the investment holdings by Government agencies and accounts.

Servicing securities for Federal agencies and Government-sponsored enterprises.—In accordance with agreements between the Secretary of the Treasury and the enterprises listed below, the U.S. Treasury acts as special agent for the payment of principal and interest on their securities. A comparison of these payments during fiscal years 1974 and 1975 follows:

Payment made for—	1974		1975	
	Principal redeemed	Interest paid	Principal redeemed	Interest paid
Banks for cooperatives [1]	$5,229,635,000	$204,238,026	$1,400,630,000	$53,839,038
District of Columbia Armory Board		818,034		859,026
Export-Import Bank of the United States	150,602,154	140,490,556	300,870,000	186,211,694
Farmers Home Administration			199,955,867	90,690,783
Federal home loan banks [1]	4,103,878,000	923,016,339	1,326,501,000	295,544,152
Federal Home Loan Mortgage Corporation [1]	151,100,000	110,278,500	199,250,000	43,196,446
Federal Housing Administration	61,651,400	19,989,382	56,951,650	24,715,056
Federal intermediate credit banks [1]	7,213,820,000	438,828,191	2,152,690,000	181,085,918
Federal land banks [1]	2,618,733,400	618,795,279	326,750,000	158,367,379
Federal National Mortgage Association [1]	3,407,723,000	1,135,304,787	549,516,000	578,727,154
Government National Mortgage Association	111,070,000	166,775,664	109,545,000	168,902,025
Student Loan Marketing Association	250,000,000		150,000,000	
Tennessee Valley Authority	1,158,941,000		621,069,000	2,207
U.S. Postal Service		17,199,533		20,158,175
Washington Metropolitan Area Transit Authority		38,363,609		57,899,919
Others	187,525	6,087	73,500	69,936
Total	24,457,341,479	3,814,103,985	7,393,802,017	1,860,268,909

[1] Servicing of these accounts was transferred to the Federal Reserve Bank of New York on Oct. 1, 1974.

Issuing and redeeming paper currency.—The Treasury is required by law (31 U.S.C. 404) to issue U.S. notes in amounts equal to those redeemed. In order to comply with this requirement in the most economical manner, U.S. notes are issued only in the $100 denomination in the Washington, D.C., area. In the course of trade, they also appear in other areas of the country. U.S. notes represent only a very small percentage of the paper currency in circulation.

Federal Reserve notes constitute over 99 percent of the total amount of currency. The Bureau of Engraving and Printing prints these notes, holds them in a reserve vault for the account of the Comptroller of the Currency, and ships them to Federal Reserve banks as needed. The Bureau of Government Financial Operations accounts for Federal Reserve notes from the time they are delivered by the Bureau of Engraving and Printing until redeemed and destroyed.

The Bureau also retires unfit paper currency of all types received locally and from Government officers abroad, and handles all claims involving burned or mutilated currency. During fiscal 1975, payments totaling $6.9 million were made to 52,045 such claimants.

A comparison of the amounts of paper currency of all classes, issued, redeemed, and outstanding during fiscal years 1974 and 1975 follows:

	Fiscal year 1974		Fiscal year 1975	
	Pieces	Amount	Pieces	Amount
Outstanding July 1	6,258,373,459	$64,266,738,143	6,475,292,881	$70,100,055,363
Issues during year	2,940,621,243	21,174,514,100	3,062,447,218	22,478,293,800
Redemptions during year	2,723,701,821	15,341,196,880	2,729,613,999	14,967,262,406
Outstanding June 30	6,475,292,881	70,100,055,363	6,808,126,100	77,611,086,757

Details of the issues and redemptions for fiscal 1975 and of the amounts outstanding at the end of the year are given by class of currency and by denomination in a table in the Statistical Appendix. Other tables in that volume give further information on the stock and circulation of money in the United States.

Data processing.—During the year, 782 million Treasury checks were paid and reconciled by the electronic check payment and reconciliation system. These checks were issued worldwide by all civilian and military disbursing officers.

The automated central accounting system embraces all cash financial operations of the Government. This is the only system which brings together all of the cash transactions of the Federal Government. The system is the data base for Federal budget results published in the Monthly Statement of Receipts and Outlays of the U.S. Government, and in the annual Combined Statement of Receipts, Expenditures and Balances of the U.S. Government.

The Division of Data Processing provided computer service to other agencies in addition to the Bureau's needs. One of such services was converting to magnetic tape 44 million Federal tax deposits for the Internal Revenue Service.

Banking and cash management

Federal depositary system.—The types of depositary services provided and the number of depositaries for each of the authorized services as of June 30, 1974 and 1975, are shown in the following table:

Type of service provided by depositaries	1974	1975
Receive deposits from taxpayers and purchasers of public debt securities for credit in Treasury tax and loan accounts	13,601	13,722
Receive deposits from Government officers for credit in Treasury's general accounts	979	949
Maintain checking accounts for Government disbursing officers and for quasi-public funds	7,369	6,636
Furnish bank drafts to Government officers in exchange for collections	1,200	1,023
Maintain State unemployment compensation benefit payment and clearing accounts	47	43
Operate limited banking facilities:		
In the United States and its outlying areas	209	192
In foreign areas	241	227

Cash services.—In December 1974, an incoming funds transfer system was installed in Division of Cash Services. This system is a direct on-line hookup with the Federal Reserve Bank of New York and was implemented to interconnect a receiving and sending terminal at Treasury with the FRB New York Sigma 5 communication system. This system provides Treasury and Federal Reserve banks with the following: Treasury funds transfers from or to on-line member banks are processed automatically without manual intervention; funds transfers are completed in minutes; the funds transfer network is a dedicated private circuit; the system has a focal point within Treasury for the initiation or receipt of all wire transfers of funds involving Treasury accounts; and the system provides faster availability of funds. Since December, 4,897 wires totaling more than $4.6 billion were received through this system.

Government officers during the year deposited 3.5 million commercial checks, drafts, money orders, etc., with the Division of Cash Services in Washington for collection.

The volume of over-the-counter transactions rose to 218,921, about 13 percent greater than fiscal 1974, due in large part to the tax rebate and $50 social security checks, and an increase in public assistance and unemployment checks.

Banks in the Washington metropolitan area order currency and coin to meet their daily needs: 95.6 million pieces of currency and 691.5 million coins were provided during the year—a 9.7-percent increase when compared with fiscal 1974.

Methods of destroying unfit currency.—The Treasury continued during fiscal 1975 to press its efforts to find ecologically cleaner methods of destroying currency which is no longer fit for circulation. A total of about 3,000 tons of unfit currency are destroyed every year by methods tested and approved by the Treasury. Destruction takes place at 35 Federal Reserve offices around the country and at the Treasury in Washington.

Incineration is used at 30 locations which account for 84 percent of the volume. Although incineration effectively destroys the currency, the equipment has to be very carefully controlled and correctly operated to keep its emissions within limits permitted by locally applicable air quality standards. Consequently, the Treasury has also for several years been looking in other directions for currency destruction equipment, and has tested and approved the installation at six locations of pulverizers which grind the currency to a fibrous residue or to very fine particles.

During fiscal 1975, currency destruction tests were made on equipment made by six different manufacturers. Three incinerators and three grinders were tested. Of these, the Treasury approved one incinerator and two pulverizers for use in destroying currency. At the present time, two manufacturers of incinerators and three manufacturers of pulverizers are authorized to supply equipment for this purpose.

Foreign currency management.—The Foreign Currency Staff initiated a new funding concept that will minimize local currency bank balances sufficient only to meet the disbursing officers' immediate needs, minimize losses due to rate devaluations, and delay drawdowns on the Treasury's general account. Results will be interest savings to the U.S. Government and a favorable impact on the U.S. balance of payments.

This new procedure was fully implemented in Latin America in May 1975. The balances in the disbursing officers' operating accounts have been reduced by approximately $15 million which will result in annual interest savings of about $1.2 million. This funding method will be expanded throughout Europe, Asia, and Africa in the period immediately ahead.

Processing Federal tax deposits.—Under provisions of Treasury Department Circular No. 1079, tax withholders and certain taxpayers are supplied with partially punched cards which they forward to their banks with their tax payments. The cards are then routed to Federal Reserve banks which complete the punching and forward them to the Treasury in Washington. The Bureau of Government Financial Operations enters the data from the cards on magnetic tapes which are furnished to the Internal Revenue Service for reconciliation with taxpayers' returns. This procedure obviates any handling of tax remittances in the Department and expedites the crediting of tax payments in the Treasury's account.

The types of tax payments which are collected in this manner include withheld individual income and social security taxes, corporation income taxes, certain excise taxes, railroad retirement taxes, and Federal unemployment taxes. Collections received under this procedure in fiscal 1975 totaled $233,847.5 million and required the processing of 44.4 million cards, compared with $203,002.9 million collected and 42.4 million cards processed in the previous year. The following table shows the volume of deposits processed by Federal Reserve banks for fiscal years 1960–75.

Fiscal year	Individual income and social security taxes	Railroad retirement taxes	Federal excise taxes	Corporate income taxes	Unemployment taxes	Total
1960	9,469,057	10,625	598,881			10,078,563
1961	9,908,068	10,724	618,971			10,537,763
1962	10,477,119	10,262	610,026			11,097,407
1963	11,161,897	9,937	619,519			11,791,353
1964	11,729,243	9,911	633,437			12,372,591
1965	12,012,385	9,859	644,753			12,666,997
1966	12,518,436	9,986	259,952			12,788,374
1967	15,007,304	10,551	236,538	22,783		15,277,176
1968	17,412,921	14,596	233,083	394,792		18,055,392
1969	23,939,080	12,479	272,048	1,297,052		25,520,659
1970	26,612,484	11,622	296,487	1,235,452	192,905	28,348,950
1971	28,714,587	12,367	323,730	1,249,034	956,201	31,255,919
1972	32,336,751	15,080	364,556	1,309,668	1,409,527	35,435,582
1973	34,606,495	11,202	398,624	1,495,260	1,978,266	38,489,847
1974	37,755,332	10,360	452,796	1,803,689	2,340,052	42,362,229
1975	39,634,697	10,072	451,981	1,944,280	2,363,091	44,404,121

NOTE.—Comparable data for 1944–59 will be found in the 1962 Annual Report, p. 141.

Paying grants through letters of credit.—Treasury Department Circular No. 1075, first published May 28, 1964, established a procedure to preclude withdrawals from the Treasury any sooner than necessary in cases where Federal programs are financed by grants or other payments to State or local governments or to educational or other institutions. Under this procedure, Government departments and agencies issue letters of credit to Federal Reserve banks which permit grantees

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to make withdrawals from the account of the Treasury of the United States as they need funds to accomplish the object for which a grant has been awarded.

By the close of fiscal 1975, 118 Government agency accounting stations were making disbursements through letters of credit. During the year, the Bureau of Government Financial Operations processed 116,426 withdrawal transactions aggregating $46,685 million, compared with 81,408 transactions totaling $38,640 million in fiscal 1974.

In addition, the test of the letter of credit-Treasury RDO system which was first introduced in fiscal 1974 with two agencies has been expanded to include six agencies. In this system agencies issue letters of credit to Treasury regional disbursing offices where payments are made by Treasury check upon receipt of requests from grantees. The requests consist of brief status of funds reports which enable the agencies and the Treasury to review, on a more current basis, each grantee's need for funds.

Operations planning and research

The Operations Planning and Research staff is continuing its systems developmental activities in a number of fiscal functions, including the following major systems revisions:

(1) Implementation of the program for paying recipients of recurring Federal payments by credit to their accounts in financial organizations has begun. Under the program, which is optional for the check recipient, payments will first be accomplished with individual checks mailed to the financial organizations designated by the recipients and, subsequently, by means of electronic funds transfer to the organizations. The program was made available, on a pilot basis, to recipients of social security payments in Georgia and Florida in November 1974 and April 1975, respectively. Nationwide implementation of the program for this class of payments will be completed in October 1975. Current plans provide for the conversion of all of these check payments to a nationwide electronic funds transfer system by December 1976. During calendar 1976, recurring payments made by other administrative agencies will be brought into the system.

(2) The joint efforts of Operations Planning and Research and Federal Reserve personnel to develop a check truncation system have progressed to the point of evaluating proposals by vendors for the equipment necessary to accomplish the task. Under this system, the flow of paid Treasury checks will stop at the level of the Federal Reserve banks. Magnetic tape and microfilm records will be substituted for the hundreds of millions of checks now shipped by the Federal Reserve banks to the Treasury for further processing, including final payment and reconciliation. A pilot test of the check truncation system is targeted for March 1976 and the beginning of full system implementation for September 1976.

Miscellaneous fiscal activities

Auditing.—During fiscal 1975, the Audit Staff conducted 59 financial, compliance, and operational audits of the various Bureau activities covering matters ranging from small imprest funds to the accounting for several multibillion-dollar Federal trust funds. Included were onsite audits at various disbursing centers throughout the United States. Also, management surveys and operational reviews in selected areas were performed at several disbursing centers. In addition, reviews were made of operations pertaining to canceling, verifying, and destroying unfit paper currency at all Federal Reserve banks and branches.

The Comptroller of the Bureau represented the United States on an external Audit Committee which was charged with the responsibility of performing an independent financial audit of the International Monetary Fund. In addition to serving as the U.S. representative, the Comptroller also served as chairman of the Committee.

The Audit Staff also completed the annual examination of the financial statements and related supporting data of surety companies holding Certificates of Authority as acceptable sureties on bonds running in favor of the United States (6 U.S.C. 8). Certificates are renewable each July 1 and a list of approved companies (Department Circular 570, Revised) is published annually in the Federal Register for information of Federal bond-approving officers and persons required to give bonds to the United States. As of June 30, 1975, a total of 280 companies held certificates.

Loans by the Treasury.—The Bureau administers loan agreements with those corporations and agencies that have authority to borrow from the Treasury. See the Statistical Appendix for tables showing the status of Treasury loans to Government corporations and agencies as of June 30, 1975.

Defense Production Act.—Loans outstanding were reduced from $1.9 million to $58,000 during fiscal 1975. Further transfers of $1.3 million were made to the account of the General Services Administration from the net earnings accumulated since inception of the program, bringing the total of these transfers to $36.4 million. A total of $2.0 million has been deposited into miscellaneous receipts under the authority of Public Law 93-426, dated September 30, 1974.

Liquidation of Reconstruction Finance Corporation assets.—The Secretary of the Treasury's responsibilities in the liquidation of RFC assets relate to completing the liquidation of business loans and securities with individual balances of $250,000 or more as of June 30, 1957, and securities of and loans to railroads and financial institutions. Net income and proceeds of liquidation amounting to $60 million have been paid into Treasury as miscellaneous receipts since July 1, 1957. Total unliquidated assets as of June 30, 1975, had a gross book value of $3 million.

Liquidation of Postal Savings System.—Effective July 1, 1967, pursuant to the act of March 28, 1966 (39 U.S.C. 5225-5229), the unpaid deposits of the Postal Savings System are required to be transferred to the Secretary of the Treasury for liquidation purposes. As of June 30, 1970, a total amount of $65 million representing principal and accrued interest on deposits had been transferred for payment of depositor accounts. All deposits are held in trust by the Secretary pending proper application for payment. Through fiscal 1975, payments totaling $57.7 million had been made including $396,591 during fiscal 1975, leaving a balance of $6.1 million, excluding interest, to be liquidated.

Public Law 92–117, approved August 13, 1971 (31 U.S.C. 725 note), provided for the periodic pro rata distribution among the 50 States, the District of Columbia, Puerto Rico, the Virgin Islands, and Guam of the available amounts of unclaimed Postal Savings deposits. A distribution of unclaimed Postal Savings System funds was not made to the States and other jurisdictions for fiscal 1975 due to the increased amount of payments being made to rightful owners. Payments totaling $6.0 million have been made in prior years to the States and other jurisdictions.

Government losses in shipment.—Claims totaling $212,362 were paid from the fund established by the Government Losses in Shipment Act, as amended (40 U.S.C. 721–729). Details of operations under this act are shown in the Statistical Appendix.

Donations and contributions.—During the year, the Bureau of Government Financial Operations received "conscience fund" contributions totaling $229,757 and other unconditional donations totaling $220,874. Other Government agencies received conscience fund contributions and unconditional donations amounting to $19,786 and $50,263, respectively. Conditional gifts to further the defense effort amounted to $781. Gifts of money and the proceeds of real or personal property donated in fiscal 1975 for reducing the public debt amounted to $295,058.

Foreign indebtedness

World War I.—The Governments of Finland and Greece made payments during fiscal year 1975 of $352,185 and $328,898, respectively. For status of World War I indebtedness to the United States, see the Statistical Appendix.

Credit to the United Kingdom.—The Government of the United Kingdom made a principal payment of $69.9 million and an interest payment of $60.3 million on December 31, 1974, under the Financial Aid Agreement of December 6, 1945, as amended March 6, 1957. The interest payment included $10.9 million representing interest on principal and interest installments previously deferred. Through June 30, 1975, cumulative payments totaled $2,380.1 million, of which $1,321.0 million was interest. A principal balance of $2,629.0 million remains outstanding; interest installments of $319.9 million which have been deferred by agreement also were outstanding at the fiscal yearend.

Indonesia, consolidation of debts.—The Government of the Republic of Indonesia made payments in fiscal 1975 of $3,048,680 in principal and $579,165 in interest on deferred principal installments in accordance with the Indonesian Bilateral Agreement of March 16, 1971. The normal payment of interest on principal is not due until June 11, 1985.

Payment of claims against foreign governments.—The 15th installment of $2 million was received from the Polish Government under the agreement of July 16, 1960, and pro rata payments on each unpaid award were authorized.

The third installment of $4,524,000 was received from the Hungarian Government under the agreement of March 6, 1973. The third installment was greater than the minimum installment of $945,000 because 6 percent of the dollar proceeds of imports into the United States from Hungary for the 12 months ending on December 31, 1974, exceeded the minimum installment by $3,579,000, thereby raising the annual installment from $945,000 to $4,524,000. Before any payment can be made on the Hungarian awards, the Foreign Claims Settlement Commission will have to adjudicate and certify new awards.

The Department of the Treasury received an amount of $4,750,000 for deposit into the War Claims Fund for payment on awards certified under the War Claims Act of 1948, as amended. A distribution of $24,000 or the balance of the award, whichever was less, was made.

Administration

Facilities management.—Significant strides have been made to accommodate the consolidation of activities and relocation of personnel resulting from the merger of the Treasurer's Office and Bureau of Accounts, through installation of space-saving partitioning and equipment and application of office excellence concepts at the Engraving and Printing Annex, GAO Building, Liberty Loan Building, Main Treasury, Treasury Annex, and Vermont Building.

Personnel administration.—The integration of all former Treasurer of the U.S. and Bureau of Accounts positions into the new Bureau of Government Financial Operations was accomplished through a series of classification team reviews. The teams assisted management in revising their position structure to meet the objectives of the merger, conducted desk audits where necessary to assist in determining the placement of functions, and revised and processed over 1,000 position descriptions. During this effort, an authorized position list showing all positions authorized for use in the new Bureau, Fair Labor Standards Act status, and position restrictions was developed. The list also identifies all career ladders and their target positions and shows bridge and crossover positions identified for use in support of the new formal upward mobility program.

A new procedure has been devised for meeting the annual Whitten Amendment supervisory review of positions. A form was developed to facilitate documentation by supervisors and employees of the results of the review and will be used as the basis for scheduling position maintenance reviews.

Union activity has centered in the Division of Disbursement with four regional disbursing centers (Austin, Birmingham, Philadelphia, and Washington, D.C.) dealing with certified exclusive unions. Birmingham has a contract with AFGE Local 2890 through March 1977; preliminary negotiations on ground rules are underway between Austin and the NFFE 1745; and Philadelphia and the AFGE Local 678 have exchanged proposals preparatory to negotiations on the contract itself. Austin has been charged by the union with four unfair labor practice complaints none of which has been affirmed by the administrative investigations of the U.S. Department of Labor or the Federal Labor Relations Council. Bureau policy and procedures are being developed to promote effective and cooperative labor-management relations throughout the Bureau.

A troubled-employee program has been developed for employees whose performance has been adversely affected as a direct result of drug abuse or alcoholism. Counseling and treatment are to be furnished the employee if he/she agrees to it.

Ongoing training has been provided in typing and clerical skills, and in the professional, supervisory, and management areas, as well as special effort programs including pre-upward-mobility programs in remedial reading and general equivalency degree coaching, a 2-week residential management development program, and two short residential working-meetings for top management.

Emphasis has been placed on special recruitment and placement programs. Summer hires, including needy youth, and appointments under merit staffing plans totaled 227. Special programs included: Campus recruitment in support of the EEO concept in 23 colleges located in New York, Pennsylvania, Maryland, Texas, New Mexico, and D.C. for professional accountant trainees; working out an affirmative action plan for employment of the handicapped, and carrying out the recruitment and placement of handicapped persons; and a stay-in-school program providing part-time year-round work for 11 needy students.

The innovative check-wrapping system recently installed in the Philadelphia Disbursing Center (with more to follow at other disbursing centers) will require a readjustment of personnel formerly performing many of the duties which are now automated. Personnel has assisted with the promulgation of qualification standards and guides to the application of standards covering the new positions.

Bureau of the Public Debt

The Bureau of the Public Debt is charged with the administrative functions arising from the Treasury's debt management activities. These functions extend to transactions in the security issues of the United States, and of the Government agencies for which the Treasury acts as agent. The Bureau prepares the offering circulars and instructions relating to each offering of public debt securities, and directs the handling of subscriptions and making of allotments; prepares regulations governing public debt securities and conducts or directs all transactions thereof; supervises the public debt activities of fiscal agents and agencies authorized to issue and pay savings bonds; orders, stores, and distributes all public debt securities; audits and records retired securities and interest coupons; maintains individual accounts with owners of registered securities and authorizes the issuance of checks in payment of interest thereon; processes claims on account of lost, stolen, destroyed, or mutilated securities; maintains accounting control over public debt financial and security transactions, security accountability, and interest costs; and prepares public debt statements. The Bureau's principal office and headquarters is in Washington, D.C. An office is also maintained in Parkersburg, W. Va., where most Bureau operations related to U.S. savings bonds and U.S. savings notes are handled.

Management improvement

The consolidation of the Bureau's Chicago and Parkersburg, W. Va., field offices was completed in January 1975. Designated as the "Savings Bond Operations Office," the installation is located in a new building in Parkersburg specifically constructed to house Public Debt field operations. The consolidation has eliminated duplication and overlapping in service functions; promoted more effective utilization of personnel and equipment by consolidating data processing functions; and reduced the time required to process security transactions and correspondence, thus improving the quality of service to savings bond owners.

The Federal Reserve banks are now processing prepayments on sales of public debt securities under a system whereby deposits are made directly to the Treasury account. Previously, deposits were made to Federal Reserve bank accounts and transferred at a later date to the Treasury account. Projections indicate that an estimated interest savings of $1.4 million annually will be realized because of the earlier availability of the deposits for use by the Treasury.

Ten additional issuing agents are now reporting series E savings bonds sales on magnetic tape in lieu of registration stubs. This eliminates key encoding of information from stubs in the Bureau and will provide an estimated savings of approximately $53,000 for fiscal 1975. Forty-one issuing agents are currently participating in this issues-on-tape program.

The Federal Reserve Bank of Atlanta is currently transmitting daily accounting information on issues and redemptions of marketable and agency securities to the Bureau, via mail, on magnetic tape rather than hard copy. This program eliminates additional key encoding in the Bureau and provides information for the completion of accounting reports on a more timely basis. Plans are to expand the program to incorporate other banks and eventually to transmit the information electronically, rather than physically ship the tapes.

To expedite final proofreading of the semiannual bond redemption value tables prior to mailing, a program to computer match tapes of savings bond redemption values compiled by the Bureau offices in Washington and Parkersburg has been implemented. Previously, this information had to be matched manually because of differences in tape formats. Under the new program, only the differences are printed out for reconciliation.

As the result of a study to increase efficiency in paying agent mailing operations performed by the Bureau, address information maintained in Washington on address plates for the semiannual mailing of redemption value tables was merged with address information maintained in Parkersburg on magnetic tape for fee payment purposes. The maintenance and utilization of a single address file for both purposes is anticipated to result in an annual cost savings of approximately $11,000.

The Bureau's Washington office has investigated alternative methods of destroying security items other than by incineration. Plans have been developed for the installation of a paper disintegrator which will eliminate air pollution and reduce personnel costs.

Improvements to the registered accounts system have enabled the Bureau to expedite operations in the maintenance and servicing of accounts of owners of registered Treasury and designated agency securities. Programs to automate investment series accounts, convert depositary and REA bonds to book-entry form, and redesign the system for maintaining accounts for securities of the State and local government series have been implemented.

A feasibility study conducted within the Bureau's Washington office determined that automation of the securities audit and numerical records functions of the retired securities activity was operationally desirable. The study found that existing manual operations accomplished their purposes but that there was no way of improving the timeliness and accuracy of information on a manual basis without adding more personnel and more controls. As the result of this study, a full-scale automation project was initiated to design, develop, and implement an automated retired securities system in the Washington office. Projections indicate that the system will be operational by fiscal 1977 and that a net operational savings of approximately $164,000 annually in personnel and equipment costs will result.

Significant improvements have been made in the performance level of Bureau ADP programs and functions which have promoted more effective utilization of computer hardware and technical personnel and resulted in reduced operating costs and an increase in overall operating efficiency. Improvements include the redesign of the U.S. savings bonds and coupon audit systems; development of increased processing capability of the securities on-line inscription system; modification of the computerized claims system; and preparation of a request for proposal for replacement of the five separate computer configurations in Parkersburg. An increased workload experienced by the Bureau in the ADP operations area also necessitated improvements in the management of computer facilities and resources, resulting in the procurement of a key-to-disk data entry system with eight key stations and the addition of five key stations to existing equipment in the Washington office.

Federal Reserve banks have been authorized to pay past due interest on interim certificates submitted for exchange transactions after the first interest payment date. This procedure eliminates shipping of certificates to the Bureau for processing and provides customers with immediate service at the banks.

The following organizational changes were made within the Washington office to maximize work efficiency and improve personnel utilization: (1) Abolishment of one operating section and functional realignment within the Registered Accounts Branch due to implementation of the automated registered accounts system; (2) reorganization of the Principal Accounts Branch eliminating duplication of effort and recurring conflicts in processing daily and monthend accounting reports; (3) functional and organizational restructuring within the Division of Management Services to increase responsiveness in program and administrative activities; and (4) realignment of ADP functions and responsibilities to provide the Bureau with the type of management and staffing necessary to meet its requirements in ADP and computer-related telecommunications areas.

Bureau operations

During the year, approximately 180,000 individual accounts covering publicly held registered securities other than savings bonds, savings notes, individual retirement bonds, and retirement plan bonds were opened, and about 70,000 were closed. This increased the number of open accounts to 383,174 covering registered securities in the principal amount of $10 billion. There were 640,943 interest checks with a value of $508 million issued during the year.

Redeemed and canceled securities other than savings bonds, savings notes, and retirement plan bonds received for audit included 6,637,011 bearer securities and 339,510 registered securities. Coupons totaling 13,612,073 were received.

During the year, 62,793 registration stubs of retirement plan bonds, 5,399 registration stubs of individual retirement bonds, and 13,468 retirement plan bonds were received for audit.

A summary of the public debt operations handled by the Bureau appears on pages 15–27 of this report and in the Statistical Appendix.

U.S. savings bonds.—The issuance and retirement of savings bonds result in a heavy administrative burden for the Bureau of the Public Debt, including auditing and classifying all sales and redemptions; establishing and maintaining registration and status records for all bonds; servicing requests from bond owners and others for information; and adjudicating claims for lost, stolen, and destroyed bonds.

Detailed information on sales, accrued discount, and redemptions of savings bonds will be found in the Statistical Appendix.

There were 149 million stubs or records on magnetic tape and microfilm representing the issuance of series E savings bonds received for registration, making a grand total of 3,938 million, including reissues, received through June 30, 1975. All registration stubs of series E bonds are microfilmed, audited, and destroyed after required permanent record data are prepared by an EDP system in the Parkersburg office.

Of the estimated 120.0 million series A–E savings bonds and savings notes redeemed and charged to the Treasury during the year, 116.6 million were redeemed by authorized paying agents. For these redemptions the agents were reimbursed quarterly at the rate of 15 cents each for the first 1,000 bonds and notes paid and 10 cents each for all over the first 1,000 for a total of $15,131,088 and an average of 12.98 cents per bond and note.

Interest checks issued on current income-type savings bonds (series H) during the year totaled 4,209,039 with a value of $467 million. New accounts established for series H bonds totaled 126,761 while accounts closed totaled 124,947.

Applications received during the year for the issue of duplicates of savings bonds and savings notes lost, stolen, or destroyed after receipt by the registered owner or his agent totaled 58,579. In 33,557 of such cases the issuance of duplicate bonds was authorized. In addition, 15,723 applications for relief were received in cases where the original bonds were reported as not being received after having been mailed to the registered owner or his agent.

OFFICE OF FOREIGN ASSETS CONTROL

The Office of Foreign Assets Control administers five sets of regulations which implement the Department of the Treasury's freezing controls. The Foreign Assets Control Regulations and the Cuban Assets Control Regulations prohibit, unless licensed, all trade and financial transactions with North Korea, North Vietnam, South Vietnam, Cambodia, and Cuba and their nationals. South Vietnam and Cambodia were added to the schedule of blocked countries under the Foreign Assets Control Regulations following the takeover of these countries by Communist forces in April 1975. These regulations also block assets in the United States of the above-named countries and their nationals.

Under general licenses contained in the Foreign Assets Control Regulations, all transactions with the People's Republic of China are now authorized except transactions abroad by foreign firms, owned or controlled by Americans, involving shipment to the People's Republic of China of internationally controlled strategic merchandise unless the transaction is appropriately licensed under the Transaction Control Regulations (see below). Also, transactions in Chinese assets blocked in the United States as of May 6, 1971, remain prohibited.

The Transaction Control Regulations supplement the export controls exercised by the Department of Commerce over direct exports from the United States to Eastern Europe and the U.S.S.R. These regulations prohibit, unless licensed, the purchase or sale or the arranging of the purchase or sale of strategic merchandise located outside the United States for ultimate delivery to Communist countries of Eastern Europe, the U.S.S.R., the People's Republic of China, North Korea, North Vietnam, South Vietnam, and Cambodia. The prohibitions apply not only to domestic American companies, but also to foreign firms owned or controlled by persons within the United States. A general license permits sales of these commodities to the listed countries other than North Korea, North Vietnam, South Vietnam, and Cambodia provided shipment is made from and licensed by a COCOM-member country. (COCOM is a NATO entity.)

The Office also administers controls on assets remaining blocked under the World War II Foreign Funds Control Regulations. These controls continue to apply to blocked assets of Czechoslovakia, Estonia, Latvia, Lithuania, East Germany, and nationals thereof who were, on December 7, 1945, in Czechoslovakia, Estonia, Latvia, or Lithuania or, on December 31, 1946, in East Germany.

Finally, the Office administers the Rhodesian Sanctions Regulations, controlling transactions with Rhodesia and its nationals. The regulations implement United Nations Resolutions calling upon member countries to impose mandatory sanctions on Southern Rhodesia. An exception to the prohibition against imports of merchandise of Southern Rhodesian origin is authorized by general license for certain strategic and critical materials, pursuant to section 503 of the Military Procurement Act of 1971.

Under the Foreign Assets Control Regulations and the Transaction Control Regulations, the number of specific license applications received during fiscal 1975 (including applications reopened) was 582. During the year, a total of 278 applications were acted on.

Applications for licenses and requests for reconsideration under the Cuban Assets Control Regulations totaled 395. During the year, 397 applications were acted on.

During the same period, 875 applications (including applications reopened) were received under the Rhodesian Sanctions Regulations;

866 applications were acted upon. Comparable figures under the Foreign Funds Control Regulations for this period were 25 (including reopened) received and 26 acted on.

Certain broad categories of transactions are authorized by general licenses set forth in the regulations, and such transactions may be engaged in by interested parties without the need for securing specific licenses.

During fiscal 1975, there was no criminal case action by the Department of Justice involving violations of the regulations administered by this Office. Criminal court fines totaling $6,000 were collected as a result of criminal convictions reported previously. Civil penalties amounted to $518,705, and the total value of merchandise under seizure at the end of the fiscal year amounted to $244,882. There were no forfeitures of merchandise during the fiscal year.

INTERNAL REVENUE SERVICE [1]

The Internal Revenue Service administers the internal revenue laws embodied in the Internal Revenue Code (26 U.S.C.) and certain other statutes, including the Employee Retirement Income Security Act of 1974 (Public Law 93–406, 88 Stat. 829).

Receipts, refunds, and returns filed

Gross revenue collections in fiscal 1975 rose to a record high of $293.8 billion, an increase of $24.9 billion or 9.2 percent over 1974, in spite of such counteracting influences as the economic slowdown and various provisions of the Tax Reduction Act of 1975.

Individual and corporation income taxes accounted for over two-thirds of all tax receipts. Individual income taxes amounted to $156.4 billion, an increase of $13.5 billion (9.4 percent) over the 1974 level. Corporation income taxes totaled $45.7 billion, up $4.0 billion (9.6 percent) over the previous year.

Employment taxes (social security, unemployment, and railroad retirement), the second largest source of revenue, totaled $70.1 billion, a rise of $8.0 billion or 13.0 percent over 1974. The increase in employment tax collections in 1975 did not equal the 19-percent growth rate of the 2 previous years mainly because of smaller increases in the social security tax rate and the maximum amount of earnings subject to tax.

Excise taxes, levied on a variety of products, services, and activities, declined slightly. Receipts from these taxes totaled $16.8 billion, dipping $0.3 billion (1.5 percent), reflecting the continued phasing out of the telephone excise tax, elimination of the interest equalization tax, and an overall net reduction in receipts from auto and energy-related excise taxes.

[1] Additional information will be found in the separate Annual Report of the Commissioner of Internal Revenue.

During fiscal 1975, 67.8 million regular refund checks were issued. This was 3.1 percent more than the 65.8 million refund checks issued during fiscal 1974. The refunds amounted to $32.2 billion, 14.2 percent more than 1974's $28.2 billion. In addition to regular refunds, rebates of 1974 individual income taxes, as provided by the Tax Reduction Act of 1975, totaled $7.9 billion. Some 54.7 million checks were issued for the rebate alone and 9.1 million checks combined the rebate with a regular refund.

In 1975, more than 125 million returns of all types were received and processed by IRS service centers, compared with nearly 122 million in 1974. Individual and fiduciary returns totaled 85.5 million, compared with 83.0 million in 1974. Over 22 million individuals, 27 percent of all individual filers, used the short form 1040A. Perhaps influenced in part by the economy, taxpayers filed earlier this year. Anticipating taxpayers' need for a prompt refund, the Service responded by processing returns faster than any year in history.

Assisting and informing taxpayers

Taxpayer service.—The IRS recognizes its obligation to help taxpayers compute their tax liabilities and file timely and accurate returns. Each year the Service provides assistance to millions of taxpayers by answering their questions and helping them complete their returns.

During fiscal 1975, the Service received over 40 million written, telephone, and walk-in inquiries. While taxpayers were encouraged to prepare their own returns, IRS personnel prepared returns for those who needed and requested such assistance. Walk-in taxpayer service was offered in over 750 permanent offices and nearly 300 temporary locations. Centralized toll-free telephone service was offered for the second consecutive year in all 58 districts. The actual number of answering sites was reduced from 135 in 1974 to 85 in 1975, improving the quality and depth of assistance to taxpayers at each location.

In July 1974, Taxpayer Service was reorganized at the district level, separating this function from enforcement activities. Collection and Taxpayer Service functions now have equal organizational status. This organizational realignment provides for year-round managers who can give closer attention to the program, identify and correct problem areas, and improve the quality of the program.

The number of permanent taxpayer service representatives was increased this year from about 1,900 to over 2,300 and their professional training was expanded.

Special efforts were made in 1975 to meet the needs of the elderly and low-income taxpayers unable to visit IRS offices by providing them with income tax assistance in their own neighborhoods. Over 73,000 low-income individuals and almost 26,000 elderly taxpayers were served under this outreach program in 1975.

A total of 148 IRS offices provided assistance to taxpayers in Spanish, and 154 offices provided assistance in other foreign languages. For taxpayers unable to call or visit an IRS office during normal business hours, 550 offices were open at times outside of normal business hours.

About 800,000 taxpayers received assistance under the volunteer income tax assistance program in 1975. The Service trained more than 23,000 volunteers who provided free assistance to the elderly, Spanish-speaking, low-income, and other taxpayers in their communities.

To reinforce information provided taxpayers during direct contact and to assure nationwide consistency in the application of the tax laws, the Service also distributed approximately 90 different free IRS publications dealing with special tax problems such as reporting the sale of a personal residence or computing the value of donated property.

In 1975, free distribution of Publication 17, Your Federal Income Tax, and Publication 334, Tax Guide for Small Business, was inaugurated. Distribution reports for 1975 show that 1.5 million copies of Publication 17 and 0.6 million copies of Publication 334 were distributed to taxpayers at no charge.

IDRS operations.—The integrated data retrieval system (IDRS), which links all district and area offices and Puerto Rico through video terminals to computer files at the IRS service centers, processed an average of 1.8 million inquiries per service center each month during the last half of fiscal 1975.

To cope with the rapid growth in use of the IDRS since it was made fully operational nationwide in 1974, the Service has installed larger computers and related components with faster processing capabilities at all 10 IRS service centers. For example, the IDRS can now report on a taxpayer's refund status and on rebates, which accounted for voluminous taxpayer contacts in 1975.

This increased IDRS capability will also provide a better method of controlling information concerning the number of audits being conducted and their disposition. The new method is named the "audit information management system" (AIMS) and will be installed and operating on a pilot basis in fiscal 1976 and is scheduled to be operating nationwide in fiscal 1977.

Informing taxpayers through the mass media.—The IRS continued to use the Nation's mass media to provide tax information to the public. In fiscal 1975, over 17,000 radio and TV stations, daily and weekly newspapers, and magazines received material prepared by IRS to inform and assist taxpayers. Service personnel participated in 6,500 interviews, answered more than 18,000 media inquiries, and made 5,500 talks to citizen groups.

Nearly 8,800 news releases were issued to the media. These releases covered such topics as services available to taxpayers, appeal rights, correct filing of returns, checkoff for the Presidential campaign fund, tax advice for disaster victims, and the tax rebate program. Some of the releases were translated into Spanish for use in areas where it is widely spoken as a second language. Tax question-and-answer columns were written for nationwide distribution to weekly newspapers and magazines.

The Service also produced and distributed to field offices a 28-minute color film on audit and appeals procedures. This IRS film was shown on 393 occasions by TV outlets and 2,670 occasions by civic associations and educational groups from January through June of 1975.

Tax forms and publications [1]

Tax forms.—The successful 1975 filing period may be attributed partly to the fact that, although improvements were made in the 1974 individual income tax forms, the basic forms design remained substantially unchanged so that taxpayers could use their 1973 forms as

[1] A complete listing of taxpayer publications can be found in the separate Annual Report of the Commissioner of Internal Revenue.

a guide in preparing their 1974 returns. Returns were more completely and accurately prepared with fewer taxpayer errors this year.

Among the changes on this year's return was the addition of a "no" box for the 1976 Presidential election campaign fund checkoff allowing taxpayers to check "yes" or "no" regarding their desire to contribute to the fund. Participation in the checkoff election increased sharply during the 1975 filing period. Designations totaled $19.8 million or 24.2 percent of returns processed, compared with 13.6 percent the previous year.

Schedule B (Form 1040) was reintroduced for the reporting of dividends and interest. Many taxpayers and practitioners found the reinstatement of this schedule helpful in correctly reporting such income.

Lines were added on schedule A to itemize deductions for taxes, interest, and miscellaneous expenses, and additional space was also provided on schedule D for listing capital gains and losses.

Over 2.6 million tax packages sent to farmers and fishermen were printed on recycled paper as a cost reduction and environmental experiment. Public reaction was generally favorable.

The Tax Reduction Act of 1975 required the IRS to revise a number of major forms and to develop new forms to reflect the changes made by the act, such as the housing credit.

New publications developed for the public in 1975 included: Publication 587, Tax Information on Operating a Business in Your Home; Publication 588, Tax Information on Condominiums and Cooperative Apartments; Publication 589, Tax Information on Subchapter S Corporations; and Publication 590, Tax Information on Individual Retirement Savings Programs.

These publications, along with additional tax forms, were available to the individual taxpayer at IRS offices across the country on a walk-in basis. Many banks and post offices also cooperated in making certain IRS forms available to taxpayers. As another option, the taxpayer was able to order forms or publications in writing or by telephone. Over 4.4 million such orders were filled during the first part of 1975. In addition, 79 million individual income tax packages were mailed to taxpayers in advance of the filing period.

Communications with taxpayers.—During 1975, the IRS improvement of form letters, computer notices, and other form-type taxpayer communications continued to be a major objective. A special unit of writer-editors now reviews all such standard communications to humanize them and make sure they are clear and understandable to the average taxpayer. National Office units and field offices reviewed a total of 2,069 forms during the year, and were able to eliminate 553 of them as duplicative or unnecessary.

The Service continues to emphasize making all taxpayers aware of their rights under the tax laws and providing complete and courteous responses to taxpayer inquiries.

Tax rulings and technical advice

The Service's tax ruling program consists of letter rulings and published revenue rulings.

A letter ruling is a written statement issued to a taxpayer by the National Office interpreting and applying the tax laws to a specific set of facts. Such a ruling provides advice concerning the tax effects of a proposed transaction so that the taxpayer may structure the transaction to comply with the tax laws, thus resolving issues in advance and avoiding future controversy. Letter rulings are not precedents and may not be relied upon by other taxpayers.

A revenue ruling is an interpretation of the tax laws issued by the National Office and published in the Internal Revenue Bulletin for the information and guidance of taxpayers, practitioners, and IRS personnel. Most revenue rulings are based on letter rulings which have the potential of setting precedents or have such broad applicability that general guidance should be offered to people in similar situations.

Technical advice is advice or guidance as to the interpretation and proper application of the tax laws to a specific set of facts. It is furnished by the National Office at the request of a district office in connection with the audit of a taxpayer's return or claim for refund or credit. Frequently, the district director's request is made in response to the suggestion of the taxpayer that technical advice be sought.

Requests for tax rulings and technical advice (closings), fiscal 1975

Subject	Total	Taxpayers requests	Field requests
Total	24,236	23,596	640
Administrative provisions	42	30	12
Changes in accounting methods	4,987	4,987	
Changes in accounting periods	9,880	9,880	
Earnings and profits determinations	719	719	
Employment and self-employment taxes	556	490	66
Engineering questions	240	163	77
Estate and gift taxes	506	429	77
Excise taxes	310	229	81
Individual income tax matters	2,691	2,574	117
Corporation tax matters	4,305	4,095	210

Accounting methods activities.—During fiscal 1975, a sudden increase was experienced in requests for rulings regarding accounting methods. The increase occurred principally in two areas.

First, many taxpayers requested permission to adopt or readopt the last in, first out (LIFO) method of inventorying their goods. The LIFO method softens the impact of inflationary trends on prices paid for goods and, in effect, reduces or defers taxpayers' current profits and taxes. The increase in requests for permission to adopt the LIFO method is expected to continue until the present inflationary spiral levels off or reverses.

Second, there were increases in the number of requests by manufacturers to change to the full absorption method for inventory valuation. This activity was primarily a result of the promulgation in 1973 of section 1.471-11 of the Income Tax Regulations, which provided a transition period for manufacturers to report the tax impact of a change to the full absorption method for inventory valuation.

Internal Revenue Bulletin.—The weekly Internal Revenue Bulletin is the authoritative publication of the Commissioner for announcing official rulings and procedures of the Service and for publishing Treasury decisions, Executive orders, tax treaties, legislation, court decisions, and other items of general interest. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins. Copies of the weekly and semiannual issues are distributed within the Service and are made available to the public by the Superintendent of Documents on a single copy or subscription basis.

During fiscal 1975, the Bulletin included 576 revenue rulings, 66 revenue procedures, 27 public laws relating to Internal Revenue matters and 31 committee reports, 3 Executive orders, 42 Treasury decisions containing new or amended regulations, 19 delegation orders, 3 Treasury Department orders, 9 court decisions, 33 notices of suspension and disbarment from practice before the Service, and 181 announcements of general interest.

The Bulletin Index-Digest System, revised as of December 31, 1974, provides a rapid and comprehensive means of researching material published in the Internal Revenue Bulletin after 1952. The major part of the system consists of digests of Bulletin items arranged under headings that facilitate a topical approach to a search for items on a specific issue. With the aid of finding lists, the researcher can locate items by Code section or number.

Tax credit for purchase of residence.—Under the Tax Reduction Act of 1975, new Code section 44 provides for a tax credit to taxpayers purchasing a new residence under certain conditions. Since this provision had no counterpart in previous tax law, the Service promptly issued a Technical Information Release summarizing the provisions and the Service's interpretation of section 44. From April to June, the National Office Technical organization received over 150 written requests for information in addition to 10–30 telephone calls per day.

"Sick pay exclusion" clarified.—Prior to April 1974, the Service took the position that the sick pay exclusion under section 105(d) of the Code was applicable to disability pension payments only until the employee reached optional retirement age rather than mandatory retirement age. Optional retirement age was deemed to be the earliest age indicated in the pension plan at which the taxpayer could retire without the employer's consent and still receive retirement benefits based on service up to retirement computed at the full interest rate in the plan. After a number of adverse court decisions, the IRS announced in Technical Information Release 1283, on April 9, 1974, that taxpayers retired on disability prior to the mandatory retirement age could apply the sick pay exclusion to their disability payments.

During fiscal 1975, the Service received over 150 requests for rulings and information on specific plans that included the sick pay exclusion. Tax Regulations implementing the new procedures and superseding prior regulations were published in the Federal Register on April 14, 1975.

Estate and gift taxes.—During fiscal 1975, requests for estate and gift tax charitable deduction letter rulings and technical advice increased as the Estate Tax Regulations implementing the Tax Reform Act of 1969 became final on July 10, 1974.

The IRS provided computer solutions to over 400 complex mathematical problems involving estate and gift tax returns. This program provides field personnel with accurate computations within 24 hours of receipt of the request for assistance. Prior to the computerized program, manual computations by estate and gift tax attorneys in IRS field offices often required several days to complete.

Under the computerized program, field personnel received mathematical solutions reflecting nationwide consistency in the legal interpretations on which the computations are based. Moreover, the amount of time field personnel devote to the mathematical aspects of estate tax cases has been reduced and taxpayers' representatives receive interpretations which are comprehensive, consistent, and accurate.

Employee plans and exempt organizations

To administer the Employee Retirement Income Security Act of 1974 (ERISA), the IRS established on December 2, 1974, an Office of Employee Plans and Exempt Organizations headed by an Assistant Commissioner, the first such position created by statute. The purpose of ERISA is not to raise revenue, but rather to protect the retirement income security of some 30 million American workers. It also required major changes in the private pension field. Its impact has been compared to the original Social Security Act of 1935. Not since the Tax Reform Act of 1969 had there been such changes in the Federal taxing provisions.

The new office is responsible for carrying out the regulatory responsibilities assigned to the Service with respect to employee benefit plans as well as the Service's responsibilities with respect to tax-exempt organizations. In the National Office, the new structure consists of Employee Plans, Exempt Organizations, and Actuarial Divisions. It was created by a transfer of functions from the Audit and Technical organizations. Field staff are located in 7 regional offices, 19 key districts, and 39 associate districts.

Employee plans.—Regulations have been developed to administer employee plans in accordance with the new law. Major emphasis has been placed on those regulations most urgently needed by taxpayers. In April 1975, Service officials testified before the Subcommittee on Labor Standards regarding actions taken to implement ERISA.

To ensure that taxpayers receive consistent information on rulings and are not required to make duplicate reports, the IRS established liaison with the Department of Labor and the Pension Benefit Guaranty Corporation through a policy committee, an ERISA coordination board, and a joint interagency regulations drafting group.

From September 2, 1974, to the end of fiscal 1975, 12 regulations, 10 revenue rulings, 7 revenue procedures, 6 delegation orders, 22 technical information releases, 12 forms, 6 news releases, and 1 publication were issued in the employee plans area. Factsheets on the most common questions and answers were also developed for taxpayer assistance personnel.

The Employee Retirement Income Security Act requires the conformance of all new pension benefit plans, and will require the modification of approximately 500,000 existing plans.

In 1975, the Service devoted an average of 555 field professional positions to carrying out its regulatory responsibility in the employee benefit plans area. This responsibility is met by issuing advance determination letters regarding the qualification of pension, profit-sharing, and other employee benefit plans and by conducting an examination program to determine whether plans continue to qualify in operation and to verify the appropriateness of deductions for plan contributions. The number of determination letters issued with respect to corporate pension and profit-sharing plans during 1975 was 70,818, a decrease of 17.7 percent from 1974. The decrease is attributed to the passage of ERISA and the fact that the IRS was in the process of developing regulations under the new law.

Preparations have been made for a case inventory control and management information reports system with computer terminals in all key districts and certain associate districts. This will enable the IRS to control applications for approval of plans and plan amendments.

Exempt organizations.—During 1975, the Service received 42,411 applications and reapplications from organizations seeking a determination of their tax-exempt status or seeking a determination of the effect of organizational or operational change on their status. The Service issued 34,203 determinations and ruling letters. In addition, 400 technical advice memoranda were issued. The Service devoted an average of 495 field professional positions to the examination of returns of 22,168 exempt organizations.

Also, 1 regulation, 50 revenue rulings, 8 forms, 4 news releases, and 2 publications relating to EO were issued in 1975. Question-and-answer sheets were also prepared for taxpayer service use on exempt organizations.

A taxpayer compliance measurement program covering the examination of private foundations, public charities, and social welfare organizations was initiated in 1975. The program is designed to identify patterns and characteristics of compliance and noncompliance of the exempt organizations being studied.

The number of active entities recorded on the exempt organizations master file increased from 673,000 in 1974 to 692,000 in 1975. As of July 1, 1975, the file was redesigned to include additional data from returns to provide information to the Congress, the charitable community, and the Service.

Actuarial.—In 1975, the Service devoted 17 average positions to reviewing actuarial determination, interpreting and clarifying provisions under ERISA, and overseeing the enrollment of actuaries to practice before the IRS.

The Joint Board for the Enrollment of Actuaries, which was established by ERISA, developed final regulations for enrollment which provide for examinations of applicants in all 58 districts in a manner similar to the examination for enrollment to practice before the IRS. Enrollment on the basis of professional standing and experience is also provided.

Ensuring compliance

The IRS audits tax returns in order to help ensure the highest possible degree of voluntary compliance with the tax laws. While audit activity is the primary method that the IRS uses to encourage voluntary compliance, every return is subject to scrutiny by IRS employees and computers. When a return is received in one of the 10 IRS service centers, it is first checked manually for completeness, accuracy, and certain obvious errors such as the claiming of a partial exemption or duplicate deductions. Then the service center's computers check the accuracy of the taxpayer's arithmetic and pick up other errors which may escape manual detection such as the failure to reduce medical deductions by 3 percent of adjusted gross income.

Returns selection.—The method used by the IRS in selecting returns for audit is a computer program of mathematical formulae—the discriminant function system—which measures the probability of tax error in each return. Returns identified by the system as having the highest probability of error are then reviewed manually, and those confirmed as having the highest error rate potential are selected for audit. Since the discriminant function system was introduced, the IRS has reduced the number of taxpayers (all categories) contacted whose audit would result in no tax change from 41 percent in 1969 to 23 percent in 1975.

In 1975, the Service began using the discriminant function system for the selection of partnership returns. In 1976, taxpayer compliance data will be accumulated to develop a selection basis for fiduciary returns, and the filing and reporting characteristics identified will then be used to develop formulae for fiduciary returns.

Results of audit activity.—Tax returns audited in 1975 reached 2.4 million. This is an increase of 190,000 returns or 9 percent over a year ago. Included in the total examinations are 2,265,425 returns examined by district audit divisions and 112,550 returns examined by service centers. Examinations conducted by revenue agents under field audit techniques rose to 726,257 returns, an increase of 37,200 returns over 1974 and those conducted by tax auditors under office audit procedures numbered 1,651,718 returns, an increase of 152,911 returns. Audit coverage was 2.55 percent of returns filed compared with the 2.39-percent coverage achieved in 1974.

The Service's examination program produced $5.3 billion in additional tax and penalties recommended. While recommendations exceeded $5 billion for the third straight year, they were somewhat below a year ago. This was attributed mainly to a fall-off in unusually large cases ($100,000 and over), which were down nearly 600 returns and $779.6 million.

During fiscal 1975, assessments totaled $4.5 billion, including $3.8 billion in assessed tax and penalties and $0.7 billion in interest. In fiscal 1974, assessments amounted to $3.7 billion, of which $3.1 billion represented tax and penalties and $0.6 billion represented interest.

Four out of every five returns examined were individual and fiduciary. These returns produced $1.4 billion in additional tax and penalties recommended. Corporate returns comprised 6.5 percent of total examinations, but accounted for $2.9 billion in the additional tax and penalties recommended. Estate and gift tax examinations resulted in $626 million of total additional tax and penalties recommended, and excise and employment tax returns accounted for $303 million.

Examiners also look for indications that taxpayers have overstated, as well as understated, their tax liability. In 1975, Service examinations disclosed overassessments on 122,399 returns, accounting for refunds of $302.8 million.

Service center examinations.—The IRS service center review program began in 1972, and is generally limited to the verification or resolution of issues which can be satisfactorily handled by service center correspondence with the taxpayer. More than 1,329,000 returns were checked in service centers in 1975, an 86-percent increase over 1974.

Over half of these returns involved obviously unallowable items such as medical expenses unreduced by the 1-percent and 3-percent limitations. More than 952,000 returns with unallowable items were corrected in 1975, compared with approximately 406,000 for 1974.

The service centers also conducted correspondence examinations of returns selected under district office criteria involving such issues as charitable contributions or interest payments. A total of 112,550 of these returns were examined during 1975, a 40-percent increase over 1974.

Appeals process.—The IRS encourages resolution of tax disputes through an administrative appeals system rather than litigation. If taxpayers disagree with a proposed change to their tax liability, they may avail themselves of the administrative appeals system before resorting to court litigation. The appeals system is designed to give taxpayers a prompt, independent review of their case with a minimum of inconvenience, expense, and delay in disposing of contested tax cases.

Within the system, there are two levels of appeal, (1) the conference staff in the Audit Division of the District Director's office and (2) the Appellate Division in the Regional Commissioner's office. For the initial appeal conference, a taxpayer may choose either the district conference staff or the regional appellate staff. Opportunities for appeal conference are provided at 58 district offices and 36 regional appellate offices nationwide. As needed, conferences are also provided at other IRS locations by circuit-riding conferees at a place and time more convenient to the taxpayer.

In a majority of cases, the taxpayers and district or regional conferees reach a mutual basis for resolving their tax disputes. Consequently, very few cases go to trial. In the past 10 years, 97 percent of all disputed cases were closed without trial. District conference staffs reached agreement with the taxpayer in about 75 percent of the cases they considered. In 1975, the appeals function disposed of 54,945 cases by agreement; the Tax Court tried 967 cases; and the U.S. district courts and Court of Claims tried 376 cases.

District settlements.—Since April 1974, district conference staffs have utilized the authority granted to them to settle cases with a disputed tax liability of $2,500 or less. As a result, the percentage of agreed cases closed by the district conference staffs has significantly increased. About 25 percent of all cases where settlement authority could be exercised have in fact been settled. The results have been favorable to the taxpayers in terms of time, convenience, and expense as well as to the IRS in terms reducing the number of cases going to the regional appellate office or to the Small Case Division of the U.S. Tax Court.

Appellate workload.—Cases considered in the appeals process cover a wide range of issues, and involve additional taxes or claims for refund ranging from very small amounts to millions of dollars. They consist of individual and corporation income tax, estate tax, gift tax, excise tax, employment tax, and offers in compromise. Deficiency cases can also be considered before a petition for a hearing is filed in the Tax Court (nondocketed cases) and after the petition has been filed (docketed cases). Nondocketed cases make up about 64 percent of the appellate workload. In 1975, 74 percent of the nondocketed cases closed by appellate offices were closed by agreement with the taxpayer.

The remaining 36 percent of the appellate workload consists of docketed cases in which settlement negotiations continue in the appellate offices after the filing of a petition. In 1975, approximately 89 percent of the docketed cases completed by the appellate offices were closed by agreement with the taxpayer.

Tax fraud investigations.—The Intelligence Division enforces the criminal provisions of the tax laws by investigating areas of potential noncompliance to deter suspected tax law violators and to identify complex and significant tax fraud schemes.

Investigations conducted by IRS special agents involve the evasion of income, excise, estate, and gift taxes, failure to file returns, failure to remit trust funds (withheld income and social security taxes), as well as the filing of false withholding exemption certificates, false claims for refunds, and the preparation of false returns for others.

During 1975, the Intelligence Division completed 8,731 investigations and recommended prosecution of 2,760 taxpayers. Grand juries indicted or courts filed informations on 1,495 taxpayers. Prosecution was successfully completed in 1,219 cases. In 1,046 cases, taxpayers entered guilty pleas and in 173 cases, taxpayers were convicted after trial. Acquittals and dismissals totaled 83 and 168, respectively. Of those pleading guilty or convicted after trial, 485 or 40.3 percent received jail sentences, compared with 42 percent last year.

Collecting delinquent accounts.—In 1975, the Service collected $2.8 billion in delinquent taxes, an increase of $292 million over 1974.

The Service also undertook, during 1975, a thorough reappraisal of delinquent tax collection practices. The goal was to make the delinquent tax collection process more clearly understood by the taxpaying public. To accomplish this goal, a major program, "The Collection Initiatives," was implemented and its changes are now showing results.

Some of the changes recommended or presently implemented include: (1) The use of postdated checks to cover the terms of an installment-payment agreement for the greater convenience of taxpayers and the IRS; (2) the substitution of a personal contact for one of four written notices to explain the seriousness of tax delinquency and to help the taxpayer avoid drastic enforcement action, such as levy or seizure; (3) greater supervisory review before the property of a delinquent taxpayer is seized.

An increasing number of business taxpayers have failed to deposit and pay over the money they withhold from their employees' salaries. Instead, these trust fund taxes are improperly used as working capital or otherwise diverted.

As a possible answer to this abuse and the general problem of taxpayers using the Government's money rather than borrowing through legitimate means, the Service was successful in obtaining legislation, Public Law 93–625, which raised to 9 percent the interest rate on tax delinquencies. This rate will be adjusted periodically to reflect the prevailing prime rate charged by the major banks. The IRS is also vigorously pursuing civil and criminal sanctions against noncompliant business taxpayers.

International activities

Technical assistance to foreign countries.—The IRS Tax Administration Advisory staff assigns tax advisers, upon request, to developing countries to help them modernize their tax administration systems.

During 1975, 35 IRS employees performed such overseas assignments. Full-time advisers were assigned to eight countries—Bolivia, Colombia, Guatemala, Paraguay, Uruguay, Trinidad & Tobago, Vietnam, and Liberia. Short-term assistance in specific functions was provided to the Governments of Guyana, El Salvador, and Ethiopia while broad tax administration surveys were conducted for the Governments of Egypt and Portugal.

Tax officials from foreign countries visit IRS facilities for observation, to discuss problems in tax administration, or for training purposes. During 1975, 284 officials from 69 countries made such visits. Nearly 4,000 officials from 118 countries have visited the IRS during the past 13 years.

The Commissioner of Internal Revenue is a member of the Inter-American Center of Tax Administrators (CIAT), which has representation from 26 countries of the Western Hemisphere. The purpose of CIAT is to improve tax administration within the Western Hemisphere through the cooperative efforts of member countries. The Commissioner led the U.S. delegation at the ninth annual CIAT assembly in Ottawa, Canada, in June 1975.

Tax administration abroad.—The IRS also maintains a system of permanent foreign posts to help coordinate its domestic and foreign tax programs. Revenue Service representatives at these stations are involved in compliance and taxpayer assistance activities, with emphasis on cooperative contacts with foreign tax agencies.

The five new posts authorized in 1974 are now fully operational. They are located in the U.S. embassies or consulates in the following cities: Canberra, Australia; Caracas, Venezuela; Johannesburg, South Africa; Kuala Lumpur, Malaysia; and Teheran, Iran. These posts are in addition to those already established in Bonn, London, Manila, Mexico City, Ottawa, Paris, Rome, São Paulo, and Tokyo.

The Office of International Operations conducted its annual overseas taxpayer assistance program in 1975 for the 22d consecutive year. A taxpayer service representative was detailed to each of the OIO foreign offices to counsel taxpayers during the extended overseas filing period of January through June. Also, circuit-riding TSR's covered an additional 105 cities in 59 countries.

These specially trained representatives gave information and guidance to approximately 93,000 taxpayers overseas during the first 6 months of 1975, an alltime record in number of taxpayers assisted. In addition, instruction was provided members of the armed services at foreign bases, who, in turn, were able to help other military personnel prepare their returns.

Compliance program.—In 1975, the Service continued its overseas audit program to encourage a level of compliance among Americans abroad which will compare more favorably with the high degree of voluntary compliance in the United States. Under this program, revenue agents and tax auditors are detailed on 6-month tours to the Service's foreign offices to conduct both field and office audits, working together with the Revenue Service representatives.

Exchange of information.—Effective administration of U.S. tax laws as to multinational conglomerates and other U.S. taxpayers engaged in international operations has required increased cooperation under our tax treaties. The IRS has continued to fulfill its reciprocal obligations specified in the treaties and has encouraged the appropriate use of the mutual exchange of information provisions.

Federal-State cooperation

Aid to State tax authorities.—Under the Intergovernmental Personnel Act, IRS employees have helped State tax authorities improve their programs and contributed to increased cooperation between the IRS and State tax authorities. In fiscal 1975, the IRS provided almost 160 weeks of training assistance to 17 State and local governments. State revenue employees received training in special agent, revenue agent, and income tax law courses. IRS instructor training courses have enabled New York State and the city of Philadelphia governments to develop training courses which will meet the future needs of their tax department employees.

Planning activities

Planning activities of the Service during 1975 concentrated on the design and testing of improved automation systems, analysis of pending legislation, and statistical compilation and projection of tax return data. Long-range planning of workloads and resources and measurement of progress in meeting program objectives continued as central features of planning activities.

Optical character recognition.—Recent technological advances in optical character recognition (OCR) development indicate that OCR will probably be more economical than manual transcription. The Service is making efforts to acquire OCR equipment to test this hypothesis in two areas: (1) Converting to magnetic tape the data reported by taxpayers on information returns such as payments of wages, dividends and interest, or adjustments to income, and (2) conversion of data recorded on Federal tax deposit forms and other forms with print characteristics controlled by Service preparation such as internal management documents, management information data, and others.

Automatic document numbering.—Every year the Service processes millions of paper documents, many of which are manually numbered to facilitate control. The Service now plans to conduct a test of automatic document numbering machines in one service center. These machines are expected to be capable of automatically feeding, numbering, and sequentially stacking tax returns as received from taxpayers, and therefore have the potential to eliminate current manual numbering activity, and to expedite the flow of returns processing. Subsequent tests will determine the feasibility of computer-controlled numbering.

Remittance processing system.—Successful tests were made with a prototype computerized system to expedite clearance and deposit of tax remittances. Combined remittance data input, numbering and preparation of accounting documents are performed in a single operation. The system will reduce processing costs, accelerate remittance posting to account status and tax data bases, and provide a "fact of filing" indicator for account status operations. A pilot system for all remittance processing activity at one service center is planned for late 1976.

Technical reference information.—Testing was successfully completed on a technical reference information system. Under the control of a large-scale computer, the system applies computer techniques to help resolve legal research problems of the IRS. Researchers query the system, which contains the current Internal Revenue Code and Regulations, revenue rulings since 1954, and selected tax cases from the various courts, via interactive video terminals for material relevant to various tax issues. Fifteen video terminals are currently installed in large IRS offices and gradual expansion to other offices is planned.

Advisory groups

Commissioner's advisory group.—In January 1975, the Commissioner named 14 prominent accountants, attorneys, business executives, educators, and public interest representatives to serve as his advisory group for 1975. The group met with the Commissioner twice before the fiscal year ended to provide him and his staff with useful views and criticism of IRS operations so that the Service could do a better job of serving the public. Members of the group are selected on the basis of suggestions by professional organizations in the tax field, IRS officials around the country, and other groups and individuals in tax administration. Members of the Commissioner's advisory group serve for 1 calendar year without compensation.

Art advisory panel.—Since 1968, a 12-member panel of art experts, including museum directors, scholars, and art dealers, has helped the Service determine the correct value of works of art donated to charity or included in taxable gifts or estates. In its 7 years of operation, the panel has reviewed more than $145 million worth of art and has recommended valuation adjustments of over $35 million. At the three meetings held during fiscal 1975, the panel reviewed works of art valued in tax returns at approximately $27 million and recommended substantial adjustments in approximately 60 percent of the cases.

Small business advisory committee.—As a step towards recognizing and dealing with the particular tax problems of small businessmen, the Service announced the organization of a new small business advisory committee. The committee will hold its first meeting in the fall of 1975.

Internal inspection programs

Management reviews.—The Internal Audit Division independently reviews and reports on Service operations to determine whether they are being carried out efficiently, effectively, and in accordance with laws and regulations. These reports are used by management to make changes in programs and procedures. The Division also assists in the investigation of irregularities involving employees and those who attempt to corrupt employees.

Management actions resulting from internal audits have helped improve taxpayer service, increase operating efficiency, strengthen internal controls, and foster a climate of integrity. While many of these improvements do not result directly in monetary savings, in areas where monetary measurement is possible, savings and additional revenue from these actions in fiscal 1975 are estimated at $32 million.

Security and integrity programs.—The Internal Security Division conducts personnel background investigations of IRS job applicants and investigates complaints against IRS employees regarding misconduct and irregularities, including criminal matters. Investigations also are made of persons outside the IRS who attempt to bribe or otherwise corrupt Service employees, or who threaten or assault employees.

The Division investigates the unauthorized disclosure of Federal tax information and disclosure or use of information by preparers of returns, and investigates charges against tax practitioners. In addition, the Division conducts special investigations and inquiries as required by the Commissioner and the Office of the Secretary of the Treasury.

A total of 18,265 investigations were completed during fiscal 1975. Of the major case categories, there were 11,104 background investigations, 2,719 complaints against IRS employees, 238 bribery or attempted bribery cases, 619 assaults and threats on IRS employees, and 179 investigations of unauthorized disclosure of Federal tax information. Investigations resulted in the indictment of 140 individuals and conviction of 76 defendants during fiscal 1975. These investigations also resulted in administrative disciplinary actions such as separations, suspensions, reprimands, warnings, or demotions of 1,126 employees.

Management and administration

Cost reduction and management improvement.—With active support and involvement of executives and managers at all levels, the Service in 1975 placed high priority on and carried out numerous projects aimed at reducing costs and improving the efficiency of operations. While it is not feasible to assemble and report the savings from all cost reduction actions, the known results of several major cost reduction initiatives in overhead support operations indicate that savings of approximately $20 million (some of a cost avoidance nature) will be realized.

For example, estimated savings in space and property utilization of over $400,000 were reported in 1975, and savings of over $3.0 million are projected in 1976 as a result of actions to reduce office space expansion; repair and refinish existing furniture when economically sound; use multiple occupancy work stations where more than one worker can efficiently occupy one work station; verify actual IRS-occupied square footage against measurement and billing records; and review assigned quality ratings and classifications of IRS space.

In the telecommunications area, an intensive cost reduction campaign resulted in better use of telecommunications facilities and innovative approaches toward providing effective telecommunications at lower cost. This campaign has reduced the cost of toll-free taxpayer service, Federal Telecommunications Systems (FTS), and local and long-distance telephone calls in 1975 by $1.1 million. Savings of $6 million are projected for next year.

Several programs of effective mail management have produced savings in 1975 of nearly $3.9 million.

Records disposal during calendar 1974 resulted in the release of space and equipment valued at $2,047,000. A total of 126,953 cubic feet of records were destroyed, and 265,580 cubic feet of records were retired to Federal Records Centers.

The Service's reports curtailment project, which in 1974 yielded annualized savings of $2.4 million, was carried into 1975 and produced additional savings of $700,000 through elimination of further unessential reports and the streamlining of others.

Total tangible savings of $1,246,100 from suggestions and special achievements were realized in 1975, slightly exceeding incentive awards program savings reported in 1974 for which the Service received the Secretary's Award for Cost Reduction and Management Improvement.

Safety programs.—With a rate of 1.9 disabling employee injuries per million man-hours worked in calendar 1974—down from a rate of 2.0 in 1973—the Service continues to rank as one of the top Federal agencies in the area of health and safety.

Service personnel drove 127.6 million miles in 1975 with only 812 accidents for a low accident frequency rate of 6.4 accidents for every million miles driven.

Executive personnel.—The Service experienced a severe shortage of executive staff this year because of the large number of senior-level officials who retired in 1974 and the $36,000 ceiling on executive salaries. Nevertheless, the Service met its obligation to fill these positions by training 19 employees in one executive development class in fiscal 1975.

Other special efforts used by the IRS to train midlevel and top-level employees and minimize the amount of time senior officials are away from their duty stations were: (1) Development of "Technical Guidelines for Executives"—a ready desk reference providing current, concise, and accurate interpretation and clarifications of those complex portions of the Internal Revenue Code and Manual needed in the executive's day-to-day activities; (2) communications via video tapes—a means for the Commissioner and other headquarters officials to directly communicate their views, official policy, and new procedures on an "in person" basis without the field executive having to travel to executive conferences; and (3) reduction in instructor time—reducing by almost 50 percent the time and number of executives needed to serve as instructors in improved midlevel training courses which accomplish in 2½ weeks what formerly took 4 weeks.

"*Blue ribbon program.*"—In recognition of increased emphasis upon providing quality assistance to taxpayers, the Service developed a taxpayer service blue ribbon program during 1975 which will go into effect at the beginning of 1976. The program establishes a new occupation for taxpayer service with expanded duties and responsibilities, higher level qualification requirements, an improved grade structure, and more comprehensive training. To implement the new occupation, IRS developed new position descriptions, an amendment to the qualifications standard, and incumbent selection and screening criteria.

During 1975, a special effort was also made to improve the effectiveness of taxpayer relations. All new and some incumbent employees who have direct dealings with the public attended taxpayer relations training, which covered interpersonal communications, communicating to taxpayers their rights and responsibilities, and dealing with threats, assaults, and potential assault situations.

Revenue agent training.—In 1975, almost 1,000 revenue agents received formal classroom training in individual and corporate income tax laws, taxpayer relations, and auditing techniques before they were assigned auditing duties.

The IRS-designed revenue agent training program was evaluated by the American Council on Education in March and found to be of such high quality that the Council has recommended to colleges and universities the granting of 6 postgraduate credit hours to Service employees who successfully complete the training program and who subsequently enroll in universities to pursue a masters degree in tax law.

The revenue agent training program has been revised to reduce the classroom portion of training from 14½ weeks to 12 weeks without a resultant loss in the quality or effectiveness of instruction. Under the restructured training arrangement, a new revenue agent will be able to examine various tax returns with minimum supervision after only 25 weeks of classroom and on-the-job training instead of 32 weeks. It is estimated that 1,200 agents will be trained next year with salary savings of $1.2 million and per diem savings of $360,000 projected.

This year, another 44 experienced revenue agents were selected and trained for computer audit specialist positions. Over 110 Service employees are now qualified to perform the complex auditing duties required by today's sophisticated computer-prepared tax returns.

Paraprofessional positions.—By the end of 1975, over 1,000 paraprofessional positions had been established and filled in the Audit, Collection, and Intelligence Divisions. These positions, at grades GS–4 through GS–7, perform work that would otherwise be done by professional and technical employees at grades GS–9 and above. This program has resulted in savings of over $4.5 million plus improved utilization of the higher level skills, knowledge, and abilities of the professional and technical work force.

Labor-management activities.—In early February, the IRS concluded a 2-year collective-bargaining agreement with the National Treasury Employees Union (NTEU), covering 2,200 employees in the headquarters office. It provides for bilateral union-management decisionmaking in personnel policies and practices, such as promotions and performance evaluations.

At year's end, the IRS and NTEU were involved in the process of negotiating a new multicenter agreement covering 29,000 employees in the Data Center, National Computer Center, and in 9 out of the 10 service centers. In total, the National Office agreement, the multicenter agreement, and the multidistrict and multiregional agreements, which were negotiated in 1974, cover over 62,000 IRS employees.

The collective-bargaining agreements concluded between the IRS and employee unions renewed the need for training of managers and supporting staff people in their responsibilities under the agreements.

Orientation sessions were held in all regions for firstline and middle managers; three executive seminars in union relations were held for field and National Office officials. Training was also conducted for personnel officers to assist them in advising managers on union relations matters.

More specialized courses in grievance handling and arbitration have been developed and will be used in Service-wide training next year.

Equal employment opportunity.—The Service has moved steadily to increase equal employment opportunity and to ensure upward mobility opportunities for all employees. While total IRS yearend employment increased by 13.6 percent between 1974 and 1975, minority employment during the same period increased by 19.6 percent. This included a 36-percent increase in the employment of Spanish-speaking Americans.

On December 14, 1974, IRS officially recognized 1975 as "International Women's Year," and programs and activities were planned throughout the Service to focus attention on the potential and accomplishments of IRS women. During the year, Ms. Anita Alpern was appointed Assistant Commissioner (Planning and Research), making her the first career woman in IRS and the Department of the Treasury to reach grade GS-18.

The IRS formalized its upward mobility program in August 1974. The program provides training and advancement opportunities for employees in grades GS 1-7 and equivalent to enhance their career potential and ultimate usefulness to the Service. While the program was not fully implemented until late in the year, approximately 800 employees actively participated in training under the program.

Employment of the handicapped.—The IRS has continued to increase its employment of the handicapped in all occupations. By the end of calendar 1974, there were 1,629 handicapped persons employed by the IRS. Of this number, 107 were blind individuals working as taxpayer service representatives in IRS districts and as tax examiners in the service centers.

Every year, IRS focuses attention on the valuable contributions of IRS handicapped employees and their ability to perform top-level work by presenting an IRS Outstanding Handicapped Employee of the Year Award. This year, Charles E. Johnson, computer operator at the Andover service center, received the award.

BUREAU OF THE MINT [1]

The Mint became an operating bureau of the Department of the Treasury in 1873, pursuant to the Coinage Act of 1873 (31 U.S.C. 251). All U.S. coins are produced at Mint installations. The Bureau of the Mint distributes coins to and among the Federal Reserve banks and branches, which in turn release them to commercial banks. In addition, the Mint maintains physical custody of Treasury monetary stocks of gold and silver, handles various deposit transactions, including inter-Mint transfers of bullion, and refines and processes gold and silver bullion.

During fiscal 1975, functions performed by the Mint on a reimbursable basis included the manufacture and sale of numismatic Eisenhower dollars (through December 1974), proof coin sets and uncirculated coin sets, medals of a national character, the Bicentennial 40-percent silver proof and uncirculated coin sets, and medals commemorating the Bicentennial, including America's First Medals in

[1] Additional information is contained in the separate Annual Report of the Director of the Mint.

pewter and the ARBA medals; and, as scheduling permitted, the manufacture of foreign coinage.

The headquarters of the Bureau of the Mint is located in Washington, D.C. The operations necessary for the conduct of Mint business are performed at seven field facilities. Mints are situated in Philadelphia, Pa., and Denver, Colo.; assay offices in New York, N.Y., and San Francisco, Calif.;[2] and bullion depositories in Fort Knox, Ky. (for gold) and West Point, N.Y.[3] (for silver). The Old Mint, San Francisco, contains the Mint Data Center, the Mint Museum, and the Special Coinage and Medals Division.

The advantages of the decentralization of the Mint's Internal Audit Staff during fiscal 1974 were underscored in fiscal 1975 by improved results in the wider range of areas audited and more frequent reviews in established areas. During the year, a resident auditor was assigned to New York to service both the New York Assay Office and the West Point Bullion Depository.

An audit of the gold stored at the U.S. Bullion Depository, Fort Knox, Ky., was performed beginning in September 1974. The Committee included Treasury auditors from the Office of the Secretary, the U.S. Customs Service, and the Bureau of Government Financial Operations, as well as the Bureau of the Mint. Auditors from the General Accounting Office (GAO) also participated. Audit procedures and guidelines developed by auditors from the Mint and GAO were designed to determine the reliability of the recorded values stored at the Depository. The final GAO audit report, which was submitted to the Congress, concluded that the gold stored at the Fort Knox Depository agreed with the records of the Depository.

The Mint security program provides continuous protection of all employees and assets under the jurisdiction of the Bureau of the Mint. This is accomplished through the operations of the Mint Security Force, protective electronic and mechanical alarm systems, vaults and sophisticated locking devices, security surveys and internal inspections, and a personnel security clearance program.

On September 23, 1974, an extraordinary security exercise took place at the U.S. Bullion Depository, Fort Knox, Ky. A congressional delegation and more than 100 news media representatives visited the gold vault to verify the existence of the U.S. gold reserves maintained in the facility. Extensive security measures were utilized inasmuch as the occurrence marked a rare change in the customary "no visitor" policy.

During fiscal 1975, a new police-type basic training school was initiated in cooperation with Treasury's Consolidated Federal Law Enforcement Training Center with 52 Mint security officers completing the 5-week course.

Extensive security devices, including closed-circuit video equipment and special doors, were installed at the Mint Museum in San Francisco in preparation for the public display of the multimillion-dollar exhibit of gold bars. In October 1974 the gold was moved to the museum exhibit area under armed escort.

The Bureau of the Mint deposited $668,196,653 into the general fund of the Treasury during fiscal 1975. Seigniorage on U.S. coins accounted for $626,372,785 of this deposit.

[2] The U.S. Assay Office, San Francisco, also operates as a mint.

[3] The West Point Depository was activated as a coin production facility during fiscal 1975.

Bureau of the Mint operations, fiscal years 1974 and 1975

Selected items	Fiscal years 1974	Fiscal years 1975
Newly minted U.S. coins issued:[1]		
1 dollar	31,000,000	56,267,000
50 cents	178,609,834	308,164,000
25 cents	524,356,064	674,344,000
10 cents	836,906,500	913,980,000
5 cents	629,791,200	756,960,000
1 cent	8,247,873,600	9,886,662,200
Total	10,448,537,198	12,596,377,200
Inventories of coins in Mints, June 30	580,600,000	1,292,300,000
Electrolytic refinery production:		
Gold—fine ounces	2,009,278.452	451,210.518
Silver—fine ounces	3,045,404.87	4,643,895.42
Balances in Mint, June 30:		
Gold bullion—fine ounces	267,007,454	266,700,077
Silver bullion—fine ounces	45,017,170	43,819,864

[1] For general circulation only.

Domestic coinage

U.S. mints during fiscal 1975 manufactured cupronickel-clad dollars, half dollars, quarter dollars, and dimes, cupronickel 5-cent pieces, and 1-cent pieces composed of 95 percent copper, 5 percent zinc for general circulation.

The Philadelphia Mint produced 6,464,997,000 coins; the Denver Mint 5,710,432,210 pieces; the newly activated coinage facility at the West Point Depository 833,347,027 1-cent coins; and the San Francisco Assay Office 368,883,510 coins for general use. The 13,377,659,747 domestic coins produced for general circulation exceeded the previous record established during fiscal 1974 by approximately 2.940 billion coins.

U.S. coins manufactured, fiscal year 1975

Denomination	General circulation: Number of pieces	General circulation: Face value	Numismatic[1]: Number of pieces	Numismatic[1]: Face value	Total coinage: Number of pieces	Total coinage: Face value
1 dollar:						
Cupronickel	70,529,710	$70,529,710.00	1,330,943	$1,330,943.00	71,860,653	$71,860,653.00
Silver-clad			[2] 3,207,295	3,207,295.00	3,207,295	3,207,295.00
50 cents:						
Cupronickel	407,663,100	203,831,550.00	1,330,943	665,471.50	408,994,043	204,497,021.50
Silver-clad			[3] 1,172	586.00	1,172	586.00
25 cents:						
Cupronickel	1,013,819,100	253,454,775.00	1,330,943	332,735.75	1,015,150,043	253,787,510.75
Silver-clad			[3] 1,172	293.00	1,172	293.00
10 cents	951,215,688	95,121,568.80	1,330,943	133,094.30	952,546,631	95,254,663.10
5 cents	929,607,100	46,480,355.00	1,330,943	66,547.15	930,938,043	46,546,902.15
1 cent	10,004,825,049	100,048,250.49	1,330,943	13,309.43	10,006,155,992	100,061,559.92
Total	[4] 13,377,659,747	769,466,209.29	11,195,297	5,750,275.13	13,388,855,044	775,216,484.42

[1] All numismatic coins were manufactured at the U.S. Assay Office at San Francisco and included 1,330,909 proof sets dated 1974, 34 proof sets of the 1975 variety (dollar, half dollar, and quarter dollar dated 1776–1976; all other denominations dated 1975), 602 Bicentennial proof sets, and 570 Bicentennial uncirculated sets.

[2] Consists of 1,900,052 1974-dated uncirculated Eisenhower dollars, 1,306,071 1974-dated proof Eisenhower dollars, and 602 proof and 570 uncirculated dollars for inclusion in Bicentennial coin sets.

[3] Consists of 602 proof coins and 570 uncirculated coins for inclusion in Bicentennial coin sets.

[4] Includes 22,792,710 Bicentennial dollars, 200,674,000 Bicentennial half dollars, and 28,196,000 Bicentennial quarter dollars.

NOTE.—All dollars, half dollars, quarter dollars, and dimes for general circulation are three-layer composite coins—outer cladding 75 percent copper, 25 percent nickel, bonded to a core of pure copper. Proof coins for inclusion in the 1974- and 1975-dated sets are of the same metallic composition as those for general circulation. Numismatic Eisenhower dollars and coins for inclusion in Bicentennial proof and uncirculated coin sets are three-layer composite coins with an outer cladding 800 parts silver, 200 parts copper, bonded to a core approximately 209 parts silver, 791 parts copper.

During the third quarter of the fiscal year, production of the Bicentennial dollar, 50-cent, and 25-cent pieces was begun. These coins, to be distributed after July 4, 1975 (Public Law 93–127), have newly designed reverses to commemorate the Bicentennial and obverses bearing the dates "1776–1976." By fiscal yearend, about 23 million of the dollar coins, 201 million of the 50-cent coins, and 28 million of the 25-cent coins for general issue had been produced.

The Bureau of the Mint shipped approximately 12.596 billion coins to the Federal Reserve banks and branches and the Treasury. This total included almost 118 million Bicentennial coins for release after July 4, 1975. Due largely to preparation for the Bicentennial coin distribution, Mint coin balances at fiscal yearend exceeded those of June 30, 1974, by about 713 million coins.

Foreign coinage

The Bureau of the Mint is authorized to produce coinage for foreign governments on a reimbursable basis, provided that the manufacture of such coins does not interfere with coinage required for the United States. During fiscal 1975, Mint installations produced coinage for Haiti, Liberia, Nepal, Panama, the Philippines, and Taiwan. A total of 240,146,337 foreign coins were manufactured.

Production

During fiscal 1975, the Mint exceeded previous annual domestic coin production by 28 percent and achieved new daily and monthly production records. The West Point Depository began manufacturing 1-cent coins on July 29, 1974. By fiscal yearend that facility had reached a daily rate of more than 7 million coins.

New production equipment delivered to the Philadelphia Mint during the fiscal year included 12 four-strike coin presses and 4 improved-type upset mills.

The Mint standard coinage die and coin press tooling program was fully implemented during the fiscal year, resulting in major economies in die manufacturing, coin press tooling fabrication, and inventory systems, as well as capability for interchange between coinage facilities. Parameters for the standardization of blanking die sets were developed this year.

Technology

The Bureau of the Mint's Laboratory in Washington continued to provide technical expertise on the authenticity of U.S. coins. During the fiscal year, laboratory examinations of 2,680 questioned coins relative to 196 cases were performed by the Mint.

Public services

Liaison with Federal Reserve.—The Bureau of the Mint continued its close liaison with the Federal Reserve in determining coin requirements. Demand for coins, as measured by the net outflow from Federal Reserve banks to commercial banks, increased to approximately 11.469 billion coins. Coin balances at the Federal Reserve banks on June 30, 1975, totaled approximately 2.892 billion pieces, an increase of 63 percent over 1974.

Special coinage and medals.—The Mint continued, as part of the Department of the Treasury's observance of the Bicentennial of the American Revolution, to reproduce in antique-finished pewter the first

10 medals authorized by America's Continental Congress. Orders were accepted during fiscal 1975 for the second and third units, representing four pewter medals. The second unit medals included Gen. Anthony Wayne and Col. François Louis DeFleury; approximately 162,000 of each were sold. The third unit sales totaled approximately 212,000 each of Maj. Henry Lee and Gen. Daniel Morgan medals.

Early in fiscal 1975, the third medal authorized by Public Law 92–228 of February 15, 1972, was released. In addition to the 511,000 medals sold as part of the American Revolution Bicentennial Administration's Philatelic Numismatic Commemorative package (consisting of the ARBA medal and a block of four commemorative postage stamps, postmarked July 4, 1974, Philadelphia, Pa.), 187,980 bronze "unique" package and 150,215 silver "unique" package medals dated 1974 of the same design were released in individual self-standing cases.

The 40-percent silver proof and uncirculated 3-coin Bicentennial sets, containing a dollar, 50-cent, and 25-cent coin, were offered to the public at premium prices. Brochures describing these coins, with newly designed reverses (a Liberty Bell and Moon combination on the dollar, Independence Hall on the 50-cent piece, and a colonial drummer on the 25-cent coin) and the date "1776–1976" on the obverses, were distributed via the Mint's mailing list as well as through the commercial banking community, congressional offices, the U.S. Postal Service, and various other agencies. Distribution of these numismatic coin sets, authorized by Public Law 93–127 of October 18, 1973, was scheduled to begin after July 4, 1975, and extend through calendar year 1976.

The segment of the Department of the Treasury's Bicentennial observance whereby the Mint manufactures medals of historic customhouses was continued during fiscal 1975. Four additional customhouses designated as national landmarks were dedicated during the year. Bronze "list" medals in the 1⁵⁄₁₆-inch size were issued in conjunction with the following ceremonies: New Orleans, La., September 1, 1974; Galveston, Tex., October 3, 1974; Galena, Ill., May 18, 1975; and Providence, R.I., June 12, 1975.

The Eisenhower silver dollar program, the manufacture and sale of 40 percent silver clad proof and uncirculated dollar coins to the public at premium prices, was continued through December 1974. None of these coins will be issued as numismatic items during calendar 1975, because of the Bicentennial coin programs.

As is customary, the Mint offered sets of proof coins to the public. These sets included one coin of every U.S. denomination from the dollar through the penny.

During fiscal 1975, medals in recognition of the San Francisco Cable Car, the Statehood of Colorado, and Jim Thorpe were struck under the authority of congressional legislation. These medals will continue to be struck until December 31, 1975, the expiration date of the legislation, and delivered by the Mint to the sponsoring organizations for sale to the general public. In addition, the Mint continued to manufacture and sell bronze national "list" medals in both the traditional 3-inch size and the 1⁵⁄₁₆-inch size. Mint sales areas are located at the Main Treasury Building, Washington, D.C.; the Philadelphia Mint; the Denver Mint; and the Old Mint, San Francisco.

Administration

On December 19, 1974, the first nationwide labor agreement between the Bureau of the Mint and the American Federation of Government Employees was signed. The 2-year agreement covers all professional and nonprofessional employees, excluding guards, supervisors, and management and confidential employees at the Office of the Director and at all field activities. Supplemental agreements covering the unique characteristics of the major field offices were being negotiated at fiscal yearend.

A contract was awarded to a private research organization to provide the Mint with a comprehensive review of U.S. coinage requirements through 1990. The report is scheduled for completion during fiscal 1976.

OFFICE OF REVENUE SHARING [1]

The Office of Revenue Sharing is a part of the Office of the Secretary of the Treasury. By June 30, 1975, the Office of Revenue Sharing employed 81 professional and support staff. In addition, 10 persons are assigned by the General Counsel of the Department of the Treasury to handle the Office of Revenue Sharing's legal work. All personnel, including the legal staff assigned by the General Counsel, are located in offices at 2401 E Street, NW., Washington, D.C.

Allocation and distribution of funds

During fiscal 1975, the following units of American general-purpose government were eligible to receive general revenue sharing funds: the 50 States and the District of Columbia, 3,047 counties, 18,783 cities, 16,934 towns and townships, and 357 Indian tribes and Alaskan native villages. During the year, $6.1 billion was paid, which brought to $18.9 billion the amount shared with States and local governments since the inception of the general revenue sharing program in 1972.

Title I of the State and Local Fiscal Assistance Act of 1972 (31 U.S.C. 1221–1263), which established the general revenue sharing program, authorizes the Treasury to distribute $30.2 billion over a 5-year period that ends December 1976 to all units of American general-purpose government as defined by the Bureau of the Census, and to Indian tribes and Alaskan native villages. The funds are to be distributed within seven periods of time specified in the law known as entitlement periods.

Revenue sharing allocation formulas contained in the law use data relating to the population, per capita income, tax effort, and intergovernmental transfers of each recipient unit of State and local government. These data are supplied primarily by the Bureau of the Census.

[1] Additional information is contained in the separate Annual Report of the Office of Revenue Sharing, Mar. 1, 1975.

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In February, the Office of Revenue Sharing invites each recipient unit of government to review its own data elements as provided by the Bureau of the Census. An opportunity is provided for changes to be made, where recipients can substantiate challenges to the Census Bureau's data. During fiscal 1975, the Office of Revenue Sharing processed 2,400 data challenges, of which 500 resulted in revisions.

In April, the revised data were used to allocate funds for the sixth entitlement period (equivalent to Federal fiscal year 1976).

Revenue sharing payments are issued at regular quarterly intervals in October, January, April, and July.

Audit and compliance system

During fiscal 1975, major steps were taken to strengthen the Office of Revenue Sharing's capability to assure compliance by recipient governments with all provisions of revenue sharing law.

Cooperative agreements were concluded with the State audit agencies of 44 States, through which State auditors are extending their own audits or reviews of privately conducted audits of State agencies and local governments to include information required by the Office of Revenue Sharing. In performing this task, the States will use standards put forward by the Office of Revenue Sharing in its publication "Audit Guide and Standards for Revenue Sharing Recipients."

Cooperative working arrangements began to be developed with other Federal agencies. In October 1974, an agreement was concluded with the Equal Employment Opportunity Commission through which confidential employment data collected from public employers has been made available to the Office of Revenue Sharing. These data can be retrieved by the Office of Revenue Sharing for units of government against which complaints of discrimination in employment involving revenue sharing funds have been filed. The Office of Revenue Sharing and EEOC have undertaken jointly to prepare a "Guidebook on Equal Employment for Public Employers," due to be completed in the summer of 1975.

A memorandum of agreement signed with the Office for Civil Rights of the Department of Health, Education, and Welfare in May 1975 established procedures to be used in cooperative civil rights compliance efforts with the Office of Revenue Sharing.

The Office of Revenue Sharing also has an understanding with the Office of the Assistant Secretary for Equal Opportunity of the Department of Housing and Urban Development which provides for exchange of information and cooperation in investigation of complaints of infringement on individuals' civil rights.

A series of agreements began to be executed with State civil rights agencies. By June 30, agreements had been concluded with agencies in the States of Maryland, Connecticut, South Dakota, and Minnesota and more were in various stages of development. These agreements provide, generally, that State human rights agencies will extend their ongoing monitoring and enforcement activities to include reviews of compliance and civil rights provisions of revenue sharing law.

The Office of Revenue Sharing expects to conclude agreements with all of the State human rights agencies recognized for deferral purposes by EEOC.

In addition to reports received from State audit agencies, Office of Revenue Sharing staff are conducting random audits as another way to measure compliance with revenue sharing law.

During fiscal 1975, the Office of Revenue Sharing received 507 complaints of noncompliance with revenue sharing law of which 178 were resolved and the remainder are in various stages of investigation.

Legal issues

During the fiscal year, the Chief Counsel was involved in the initiation or defense of 16 legal actions. The legal issues in those suits involved civil rights, the applicability of the National Environmental Policy Act and the Uniform Relocation Assistance Act to the expenditure of revenue sharing funds, the interpretation of Indian treaties, and the determination of data factors for the revenue sharing allocation formulas.

On April 28, 1975, the Office of Legal Counsel of the Department of Justice supported the view of the Office of Revenue Sharing by rendering the opinion that the Hatch Act, administered by the Civil Service Commission, was not applicable to employees of State and local governments paid with revenue sharing funds.

The promulgation of regulations continues to be an active area. The revenue sharing regulations were amended on November 15, 1974, to implement an amendment to the revenue sharing law by the Disaster Relief Act of 1974. In January 1975, proposed nondiscrimination regulations were published for comment. Those regulations would clarify the withholding authority of the Secretary of the Treasury in cases where a Federal court or a Federal administrative law judge has made a finding that a recipient government has failed to comply with the nondiscrimination provisions of the State and Local Fiscal Assistance Act of 1972.

The most significant court decision in the area of civil rights was the case of *Robinson et al.* v. *Shultz et al.* (U.S.D.C. for D.C.), which was initiated in 1974. During the year, the District Court for the District of Columbia denied plaintiffs' motion to require the Secretary to promulgate regulations to defer the payment of revenue sharing funds pending the outcome of an administrative hearing. In denying the motion, the court held that the Office of Revenue Sharing's referral of a case to the Attorney General fulfilled the statutory duty of the Secretary until such time as noncompliance was determined by the courts.

In November 1974, the U.S. District Court for the Northern District of Illinois, in an action brought by the United States against Chicago, enjoined the city from continuing certain discriminatory employment practices in its police department. Thereafter, the District Court for the District of Columbia directed the Office of Revenue Sharing to withhold further revenue sharing funds to Chicago. The District of Columbia case was subsequently consolidated with the complaint filed in the Northern District of Illinois by the United States (and others) against Chicago. The motion of the city of Chicago to vacate or modify the order of the District Court for the District of Columbia was denied.

In March 1975, a supplement to the digest of letter rulings on general revenue sharing (covering the period October 1, 1973, to September 30, 1974) was published for the guidance of recipient governments and their counsel.

The Chief Counsel drafted the administration's proposed bill to extend and revise title I of the State and Local Fiscal Assistance Act of 1972. The draft bill was submitted to the Congress with a Presidential message in April 1975.

Renewal of general revenue sharing

The President's proposal for renewal of general revenue sharing was developed by a task force comprised of representatives of Treasury, OMB, and the President's Domestic Council, after careful study and consultation with other Federal agencies.

The key elements of the President's bill, before the Senate as S. 1625 and the House of Representatives as H.R. 6558, are as follows:

1. General revenue sharing would be extended for an additional 5¾ years, through September 1982. The current stairstep increase in the total amount of money to be distributed would continue at the rate of $150 million per year. Accordingly, the proposal requests $39.85 billion plus a noncontiguous States (Alaska and Hawaii) appropriation of $27.5 million.
2. The allocation formula would remain as it now is, except that the present maximum constraint of 145 percent of the average statewide local per capita allocation would be increased to 175 percent at the rate of 6 percentage points per year.
3. The present strong antidiscrimination requirement of revenue sharing law would be retained; but the Secretary's enforcement powers would be clarified: The Secretary would expressly be authorized to withhold all funds or that portion used in a discriminatory program or activity, to require repayment, and to terminate the eligibility of a government to receive one or more payments.
4. The proposal would give to the Secretary of the Treasury full discretion to determine the form and content of use reports required of recipient governments by revenue sharing law and to authorize alternative methods to publicize the reports.
5. To strengthen public participation in local decisionmaking regarding uses of shared revenues, recipient governments would be required to assure the Secretary that the public has had access to a public hearing or other appropriate means of participation.
6. The Secretary of the Treasury would be required to review the program and report his recommendations to Congress 2 years before the new expiration date.

Uses of funds

The law requires that each recipient unit of government periodically report to the Office of Revenue Sharing the amounts of money that have been spent in certain broad areas of activity.

The latest of the actual use reports, filed by September 1, 1974, showed that approximately $6.7 billion in shared revenues were spent by States and local governments between July 1, 1973, and June 30, 1974. Of each dollar spent—

- 23 cents was used in support of *public safety* by paying operating costs of police and fire departments, providing crime prevention and drug rehabilitation programs, in traffic safety, and through the purchase of equipment.

- 21 cents was devoted to public *education.* Of this amount, most was spent by State governments as assistance for primary and secondary education at the local level. State governments spent 52 percent of their revenue sharing receipts in the field of education.
- 15 cents paid for improvements in *public transportation* services and facilities such as mass transit systems, highways, bridges, and traffic control systems. Some revenue sharing money spent for public transportation has been used to subsidize mass transit fares, to provide free or subsidized transportation for the elderly, and to construct special sidewalk intersection ramps for the handicapped.
- 10 cents was devoted to *multipurpose/general government* expenses involving, for example, general planning and central administrative services.
- 7 cents was spent in support of *health,* to provide medical equipment and facilities and to pay operating costs of ongoing health programs.
- 7 cents paid expenses involved in *environmental protection/conservation* efforts including, for example, soil, water and air pollution control and sanitation services.
- 5 cents provided *recreation* facilities and services.
- 4 cents went directly into *social services for the poor or aged.* It is important to note that some money listed as spent in other categories may be considered to have been used to provide social services for the poor or aged, as well. Public transportation expenditures to subsidize intracity transportation for the elderly are an example of this.
- 2 cents was spent in *financial administration* to help meet local costs associated with tax collections, accounting, debt management, and other, related matters.
- 1 cent provided materials, publications, improvements and general support for *public libraries.*
- 1 cent used in the field of *housing and community development* supported housing and redevelopment projects.
- Less than 1 cent was spent in *corrections* by State governments where increasing awareness of the importance of rehabilitation has generated new efforts related to work release and related programs.
- Less than 1 cent was devoted by recipient governments to promote *economic development.*
- Less than 1 cent paid for *social development* programs and services not included in categories listed above. Community centers may be considered a typical expense in this category.
- 4 cents provided *other services* that represent innovative ways to meet particular needs of individual communities.

Categorization of reported uses is the responsibility of State and local chief executives. Although use reports filed with the Office of Revenue Sharing provide a useful indication of the direct impacts of revenue sharing dollars on the activities of recipient units of government, the data cannot and do not measure the indirect effects and the ultimate impact of shared revenues on the total spectrum of services provided at the State and local levels of government.

The Revenue Sharing organization

The Office of Revenue Sharing staff is organized into eight functional units, as follows:

Administration.—Manages personnel, budget, central services, and other internal administration of the Office.

Program Planning and Coordination.—Coordinates special research projects at the request of the Director; manages the program planning system.

Data and Demography Division.—Responsible for acquisition of current and accurate data used to compute allocations of funds; conducts data improvement program.

Systems and Operations Division.—Computes allocations of funds; writes payment vouchers; does all associated accounting; issues and processes required reports; produces computer-generated communications and publications.

Compliance Division.—Responsible for assuring compliance with the law by all recipient governments; makes or coordinates audits and investigations of recipients; undertakes cooperative compliance programs with other Federal agencies, State governments, and national associations of civil rights, women's rights and governmental organizations.

Intergovernmental Relations Division.—Provides technical advice and assistance to State and local governments; maintains liaison with public interest groups.

Public Affairs.—Provides information about general revenue sharing to the public, the media, citizens groups, other Federal agencies, research groups, and the Congress.

Chief Counsel.—Interprets the law; issues opinion letters, prepares regulations; represents the Office of Revenue Sharing in all legal matters concerning the general revenue sharing program.

UNITED STATES CUSTOMS SERVICE

The mission of the U.S. Customs Service is to assess, collect, and protect import duties and taxes; to enforce customs and related laws against the smuggling of contraband; and to control carriers, persons, and articles entering or departing the United States by enforcing the Tariff Act of 1930 and numerous other statutes and regulations which govern international traffic and trade.

To accomplish this mission, the Customs Service performs the following:

1. Examination and clearance of carriers, persons, and merchandise consistent with the requirements for the proper assessment and collec-

tion of customs duties, taxes, fees, fines and penalties, and compliance with the customs laws and regulations applying to international commerce.

2. Detection and investigation of illegal activities so as to apprehend violators and reduce, prevent, and deter violations of laws and regulations enforced by Customs.

3. Detection and prevention of all forms of smuggling and other practices designed to gain illicit entry into the United States of prohibited articles, narcotics, drugs, and all types of contraband.

4. As the principal border enforcement agency, the administration and enforcement of over 400 laws and regulations of over 40 Government agencies relative to international traffic and trade.

5. The most effective application of resources to carry out the total Customs mission, consistent with efficiency in Government and economy and service to the public.

In fiscal 1975 Customs cleared over 246 million persons arriving in the United States. More than 75 million cars, trucks, and buses crossed the country's borders; 123,000 ships and 353,000 aircraft were cleared. This involved making 77 million baggage examinations and processing 12 million customs declarations.

There were 47.6 million foreign mail parcels processed, requiring over 2 million informal mail entries. In all, Customs collected a record $4.5 billion in duties and taxes and processed $100 billion worth of imported goods, which required over 3 million formal entries (those over $250 in value).

The Customs enforcement mission also registered gains. There were over 21,000 drug seizures. The estimated "street value" of drugs and narcotics confiscated was over $678 million. Seizures included 717 pounds of cocaine, 19.3 million units of polydrugs, and 207.6 tons of marijuana. There were 103 pounds of heroin seized during fiscal 1975—an increase of 35 percent. In addition, neutrality violations—smuggling arms out of the United States to other countries—rose from 315 cases to 674 cases in fiscal 1975.

Enforcement

Integrated interdiction

During fiscal 1975, the further development of the integrated interdiction program resulted in increased interdiction of narcotic and other dangerous drugs and other illegal smuggling attempts along the Nation's borders and at ports of entry in the United States. This success resulted in large part from the development and use of sophisticated electronic information and communications systems, modern detection devices, improved processing methods, and the expansion of land, sea, and air Customs units.

To detect border intrusion between ports of entry particularly along the Mexican border, a sensor system was deployed. During fiscal 1975, 175 Phase III sensors were procured from the Army; efforts were initiated to develop a repeater to increase the range from which the sensor can be monitored; and these sensors/repeaters were interfaced with the radio communications system. Customs also started inctalling closed-circuit television systems to cover pedestrian, passenger, and baggage areas within land border stations and airports.

These systems will help detect illegal activities and will also serve as deterrents to physical attacks on customs officers and as sources of evidence for future investigations and court actions.

The following are some significant cases during fiscal 1975:

In January 1975, the largest cocaine seizure recorded at Los Angeles was made when a customs officer found 30.9 pounds of cocaine concealed in false top and bottom suitcases and in a hollow fishing pole section. On January 23 at the San Francisco Airport, 12 pounds of heroin were discovered by a customs officer in the false bottom of a shipment of chinaware.

On May 16, 1975, a Miami customs officer discovered 46.2 pounds of cocaine in unclaimed baggage aboard an incoming flight from South America. On the same day, a customs officer in San Luis, Ariz., found 15.7 pounds of cocaine hidden in a compartment within a vehicle gas tank. The combined value of the two seizures approached $14 million.

The single largest marijuana seizure made by customs officers during fiscal 1975 on the U.S./Mexican border, involving both air and land units, resulted in the seizure of 37,785 pounds of marijuana and 2 trucks, and the arrest of 4 persons. This seizure occurred on September 19, 1974, and was the largest seizure of marijuana on record on the Southwest border. While on air patrol near Lochiel, Ariz., a customs crew observed two trucks just south of the international boundary in Mexico, hidden in a grove of trees. They maintained aerial surveillance while Customs land units moved into position along the border. At about 11:30 p.m. sensors signaled an illegal border intrusion and enabled the land units to track and detain the intruding vehicles.

Customs air and sea units.—The number of aircraft assigned to interdiction now exceeds 50 and the number of boats approaches the same figure. Efforts were initiated in fiscal 1975 to develop an advanced lightweight radar which can track low-flying aircraft, boats, and ground activities. Customs completed a lease-purchase agreement on a high-speed, twin-engined jet aircraft that will be modified to accommodate the advanced radar, as well as forward looking infrared sensors and special purpose avionics equipment.

Customs officers using Customs aircraft seized or participated in the seizure of a total of 46 aircraft during fiscal 1975. Typical cases were:

On September 22, 1974, Customs aircraft intercepted an Aero Commander inbound from Jamaica and followed it to Clewiston, Fla., where it landed. A Customs search revealed 578 pounds of marijuana, 6 pounds of cocaine, and 14 pounds of hashish; over $1,700 was seized and 2 persons were arrested.

On November 7, 1974, a suspect Beech Queen Air was tracked by an air support unit as it flew from Tucson International Airport into Mexico. The aircraft later returned on approximately the same course northward and was observed landing in the desert northwest of Eloy, Ariz., where it was met by two camper trucks. One of the Customs aircraft landed behind the suspect aircraft and stopped it, along with one of the trucks. A Customs helicopter pursued and stopped the second camper. Seized with the aircraft and 2 trucks were 1,465 pounds of marijuana; 5 arrests were made.

On December 6, 1974, before daylight, Customs aircraft observed an aircraft with its lights off crossing the border into Mexico. The aircraft later reentered the United States and was followed to a dirt road north of Buckeye, Ariz., where it landed and met with a Dodge van. The aircraft then departed in a northwesterly direction. The Customs air support unit vectored a Customs ground unit into the area where the Dodge van and 1,100 pounds of marijuana were seized and one arrest was made. On December 7 the suspect aircraft was located in Reno, Nev., and placed under seizure.

On June 6, 1975, customs officers at Tucson seized 1,200 pounds of marijuana, 1 aircraft, and 1 vehicle at Turf Paradise Airstrip, Ariz. The seizure resulted from a ground radar detection of the smugglers' aircraft and interception by sensor-equipped Customs aircraft.

Typical interceptions by Customs marine support units were:

Awareness of a distinctive pattern and route followed by vessels engaged in smuggling in the San Diego area led Customs to position a marine unit offshore to observe any smuggling attempts. On May 2, 1975, when a suspect vessel was sighted, the Customs unit followed and radioed ahead to a land patrol unit. When the smugglers' vessel landed at a secluded location, the Customs marine and land units were on the spot to apprehend the smugglers. Customs intercepted 482 pounds of marijuana, seized a vehicle and trailer, and arrested 2 persons.

On June 15, 1975, using two boats, customs officers in the Miami area arrested five persons and seized 6,400 pounds of marijuana, 8.3 ounces of cocaine (combined value of $2.3 million), one 36-foot boat, two 12-foot Boston whalers, one 40-foot houseboat, and four vehicles. This successful interdiction resulted from extended surveillance of the suspect vessel as it approached Miami from the direction of Bimini. The Customs boats followed the suspect vessel into the Intracoastal Waterway and up a creek leading to a local marina at North Miami Beach. During the predawn hours, customs officers observed the suspect vessel moor to a houseboat. When bulky sacks suspected of containing marijuana were off-loaded, the customs officers closed in.

Detector dogs.—First used extensively by Customs in 1970, detector dogs, which have the ability to detect marijuana, hashish, cocaine, and heroin, amassed a highly successful detection record while screening over 15 million units of mail, cargo, and arriving carriers. During fiscal 1975, the number of trained teams (dog and handlers) increased to 105 and a modern training center was opened at Front Royal, Va. Detector dog teams contributed directly to the seizure of nearly 40,000 pounds of marijuana, 1,900 pounds of hashish, 39 pounds of cocaine, 19 pounds of heroin, and 1.5 million units of dangerous drugs.

Typical of the seizures made by the teams was a narcotic alert by detector dog "Tammer" at the Port of San Luis on April 4, 1975, in the rocker panel of an automobile. The panel was opened and customs officers discovered over 5 pounds of heroin and one-half pound of cocaine.

Cargo security

Pursuant to Executive Order 11836, dated January 29, 1975, which emphasized that "Theft of cargo has emerged during this decade as a serious threat to the reliability, efficiency, and integrity of the Nation's commerce," Customs operated a cargo theft prevention program consisting of the following areas:

Public awareness.—The public awareness project presented cargo security miniseminars to transportation industry management, insurance underwriters, and law enforcement personnel to demonstrate that cargo theft and pilferage could be prevented by a few basic security procedures. As a result, industries and firms invested over $9 million in making such improvements. Additionally, thousands of cargo theft prevention posters and pamphlets were distributed throughout the Nation. Customs personnel were kept abreast of current developments through the quarterly publication The Cargo Security and Control Bulletin.

Imported merchandise quantity control (IMQC) program.—The IMQC program was established in 1972 to upgrade the quality of inward manifests and provide a uniform system for accounting for imported merchandise. In August 1974, a revised edition of the IMQC Manual was issued to the field, carriers, and importing community. To insure uniform interpretation of the new manual, familiarization presentations were made in 18 major cities.

Customs program against cargo crime.—Designed to reduce cargo crime at airports and seaports, this program has seven major objectives: Arrests, apprehensions, seizures, establishment of deterrent factors, gathering intelligence, identification of local problem areas, and followup accountability both in-house and industrywide.

Theft information system.—The theft information system is designed to provide data related to cargo crimes which will permit the most cost-effective allocations of customs manpower and equipment to Customs program against cargo crime.

High-security warehouses.—In cooperation with the Bureau of Alcohol, Tobacco and Firearms, the Customs Service undertook to upgrade the security of warehouses that handle imported automatic weapons. Based upon a Customs evaluation of a warehouse's security, ATF will either approve or deny the importer a permit. As a spinoff from this program, specifications and amendments to the regulations are being drafted to provide for a high-security warehouse for high-risk cargo.

Project Weight.—Designed to aid customs officers in the detection of overages, fraudulent weights, and large-volume shipments of controlled substances, Project Weight utilized portable scales to weigh "empty" and full containers on a random or preselected basis.

High-security seal.—The Service began the process of adopting the first approved high-security seal in Customs history. With the dramatic rise in cargo thefts in the last decade, the seal has gained added importance as an accountability and control device. Five hundred seals were sent to Customs field offices for a test of their effectiveness. At yearend, with 85 percent of the test complete, only one of the seals had been violated.

Containerized program.—The Customs Service estimates that $40 million in revenue is lost each year through false manifesting (underreporting) of containerized cargo. To combat this loss, a program was instituted at 48 ports in February 1975 to conduct 100 percent examinations of 2 percent of the house-to-house and pier-to-house movements arriving by vessel. The following statistics for March and April 1975 attest to the success of the program:

	March	April
Falsely manifested cargo:		
Additional revenue	$6, 992	$4, 443
Penalties assessed	195, 988	310, 806
Penalties collected	7, 801	4, 898
Return on $1 expended	3. 68	4. 38
Unmanifested cargo:		
Number of containers	457	324
Value of merchandise	$892, 677	$1, 513, 095
Duties and taxes	$101, 408	$100, 890

During fiscal 1975, Customs opened 1,494 cargo theft cases and closed 1,281, which resulted in 232 arrests, 85 convictions, 215 seizures valued at $958,857, and 36 penalties totaling $78,949.

The following are selected cases:

On November 26, 1974, a truck containing approximately 2,500 French-made men's suits valued at $360,000 was hijacked after departing Kennedy International Airport. Customs officers subsequently arrested five individuals involved in the hijacking and recovered suits valued at $94,000. Participating with Customs in the arrests and recovery of the merchandise were the FBI, New Jersey State Police, U.S. Postal Inspectors, and the New Jersey Organized Crime Force.

Customs was notified on December 25, 1974, by the Broward, Fla., Sheriff's Office that, as the result of an anonymous phone call, six men unloading liquor from two containers and placing it into two motel rooms in Pompano, Fla., had been arrested. Preliminary investigation by Customs and the FBI disclosed that the two containers were in-bond shipments and part of a theft involving three additional containers. The FBI handled the theft investigation of the two containers and the subsequent arrests. On December 26, 1974, the Pembrook Park Police received an anonymous phone call with information that the three additional containers were in the vicinity of a warehouse complex. Subsequent investigation by Customs identified the anonymous caller, who was interviewed. As a result, two containers of whiskey, and one container of plastic sheeting valued at $200,000 were recovered and a seizure effected for violation of 18 U.S.C. 549.

On April 30, 1975, two persons were arrested in possession of 441 items of stereo sound equipment valued at $97,000 which was part of a container shipment stolen from Customs custody on March 16, 1975. The stolen items had been stored in an unused warehouse in Fall River, Maine. One of the suspects was on bond for his part in an attempt to smuggle $516,000 in stolen securities into the United States at Atlanta, Ga., on April 19, 1974. Prosecution for currency and smuggling violations in Atlanta is being withheld pending completion of an FBI case regarding possession of stolen property.

A suspect was arrested on June 11, 1975, by Customs in Los Angeles, Calif., based upon an arrest warrant issued by the U.S. District Court, Northeastern District of Illinois, Eastern District (Chicago), which alleged the individual's involvement with the theft of 700 cases of whiskey from Norfolk & Western Railroad on February 28, 1975. Investigation continues and more arrests are expected. To date, 70 cases of Scotch have been recovered, 5 persons arrested, and 1 trailer and 2 vehicles (one of which was a 24-foot motor home) seized.

Investigations, fraud and smuggling

During fiscal 1975, Customs opened 28,279 investigative cases, closed 24,508 cases, and ended the fiscal year with a backlog of 16,926 open and pending cases. Largely through fraud investigations, Customs recovered $21,003,000 in unpaid duties, plus penalties assessed at an average rate of three times the duties, for a total revenue return of $84,012,000. This represents a 42-percent increase over fiscal 1973.

Case backlog.—The investigative case backlog increased 28 percent—from 13,213 at the beginning of the year to 16,926 at the end. Fraud cases dominate the backlog with 7,644 cases, comprising 45.1 percent of the total. The problem is attributable to increased complexity and sophistication in the types of cases being worked and increased demands on existing investigative manpower to respond to significant arrests and seizures at over 300 ports of entry, producing a situation where investigators are forced continually to react to pressure to clean up old cases (consisting primarily of referrals) rather than initiating new lines of investigation.

Fraud program.—Customs antifraud program was highly cost-effective and a deterrent against fraud activities throughout the multinational importer community. A number of major investigations were highlighted by a key oil investigation handled in cooperation with the Federal Energy Administration:

The ongoing oil investigations continued to have priority, with over 30 positions assigned almost full time.

An electronics firm pleaded guilty to 15 counts of a Federal Maritime Administration law. The case, which concerned customs entries, was concluded with a fine of $75,000 assessed against the company. Still pending is a separate issue involving a loss of revenue of $125,000 with a forfeiture value of $54,000.

At San Diego, an individual was found guilty of attempting to bribe a customs officer. The individual had been the subject of numerous other Customs investigations. Still pending are civil cases involving a loss of revenue of $400,000 and goods with a forfeiture value of more than $2 million.

General smuggling.—Customs personnel specially trained in initiating investigations concerning the smuggling of arts and artifacts from other countries made several significant seizures in this area. A task force effort was initiated to combat commercial bird smuggling, with the expectation that this effort will largely eliminate the threat of Newcastle disease being introduced into the poultry population of the United States.

General investigations highlights were:

On July 4, 1974, Customs personnel in Los Angeles concluded a 9-week surveillance by arresting three Mexicans (one a Jalisco, Mexico, police officer) and seizing 34 firearms, 1,500 rounds of ammunition, and 2 vehicles as they attempted to export same at Los Angeles International Airport.

On July 17, 1974, Customs personnel in Newark arrested 3 persons for negotiating with an undercover agent for the sale of 35,000 assorted weapons stored in Europe. During the investigation, $125,000 in "flash money" was shown to the conspirators. This case was worked jointly with the Bureau of Alcohol, Tobacco and Firearms.

On August 23, 1974, a customs officer acting undercover as a Mexican "guerrilla" received at Laredo from 2 persons, 10 rifles, 3 handguns, and various types of ammunition. A car and truck were also seized, ending a 3-week investigation.

Customs personnel continue to remain active in seizures of illegally imported commodities such as sugar and fertilizer. For example, in February at Brownsville, Tex., Customs seized 4,417 metric tons of undeclared anhydrous ammonia (fertilizer), valued at $3 million.

Customs furnished the Dallas County district attorney's office intelligence resulting in the arrest of five individuals and the recovery of three stolen paintings and a wood carving alleged to have been made by Leonardo da Vinci. The value of the items recovered was claimed to be over $1 million.

Customs seized 705 long tons of submarine netting as an outgrowth of an export licensing investigation. The total value of the netting was $1,075,000. In addition, 12 barges used in conveying the submarine netting were seized with a value of $960,000.

Customs seized $20,000 worth of Laetrile tablets and liquid, as an outgrowth of an April 11 arrest and seizure at San Ysidro involving 300 glass vials and 2,000 tablets of Laetrile smuggled from Mexico.

Neutrality Act violations

Customs undertook a wide-scale program to combat the illegal movement of weapons to Mexico and South America. Discussions with Mexican and South American officials led to an intensified intelligence effort and an increase in seizures and arrests in the West and Southwest. Organized crime elements were connected with a large amount of the traffic.

CPO homicide investigation

The investigation into the deaths of 2 customs patrol officers was brought to a conclusion by the indictment and arrest of 20 persons. Twenty-eight customs officers from 11 offices, with the cooperation of Drug Enforcement Administration and ATF personnel and State and local authorities, conducted a 4-month investigation which led to the indictments and arrests. The investigation involved three conspiracies within one large conspiracy to smuggle controlled substances from Mexico into the United States.

Enforcement support systems and equipment

Customs operated several enforcement support systems involving the use of modern computer, communications, and information technology:

Treasury enforcement communications system (TECS).—TECS, with a data base of over 350,000 records and over 500 terminals, was improved and expanded in fiscal 1975. A new B7700 computer was installed in the San Diego computer facility and work was begun to convert all ongoing systems to the new computer; 100 new terminals were installed at preclearance airports and Kennedy International Airport; and a telecommunications study was completed which, when implemented, will improve performance and result in long-range reduction in telecommunications cost. Also, added to the TECS data base were the license tag numbers of wanted persons in the FBI's National Crime Information Center data base. Finally, interface with the national law enforcement and telecommunications system was completed, thereby enabling Customs to obtain from State and local law enforcement agencies drivers' licenses and license-tag information.

Communications.—Long-range plans call for a sector radio communications system to provide for substantially complete coverage along the entire perimeter of the United States. This system is intended to enable Customs personnel to communicate with each other and with the Radio Control Center during interdiction, investigation, and inspection operations.

During fiscal 1975, the sector radio control system was extended approximately 500 miles along the Gulf Coast to complete coverage of the southern perimeter from San Francisco to Charleston, S.C.

Implementation was begun on two new sectors: The Mid-Atlantic sector, from Charleston, S.C., to New York; and the Northeast sector, from Bridgeport, Conn., to Buffalo, N.Y. Both of these sectors will provide support to Customs operations impacted by the Canadian Olympics and the Bicentennial activities. In addition, zone communications networks were initiated in New York, Detroit, Los Angeles, and Miami to provide local radio communications in support of interdiction, investigation, and inspection operations.

Enforcement communications were enhanced by the establishment of a complete communications center at the new Customs headquarters this year. This center will provide 24-hour administrative teletype, facsimile, secure teletype, and secure voice service from Customs headquarters to regions, districts, and selected ports. In addition, the Customs administrative teletype system was designed and implementation was nearly completed. This system, scheduled for operation on August 1, 1975, will enable Customs users to communicate between Customs headquarters, all regions, and selected districts and ports throughout the continental United States. The system will be utilized to transmit quota data to headquarters in support of the Trade Act of 1974.

Customs enforcement information system.—As customs officers perform their enforcement or investigative functions, they collect a wide spectrum of enforcement information. To make this information available to all customs officers with "need to know," a central file system with microfiche capabilities and an automated index in TECS was established in fiscal 1975. In addition, a number of special purpose systems were initiated or implemented: (1) The Customs law enforcement activities reporting system, which provides statistical information on arrests and seizures performed by customs officers; (2) the vessel violation profile system, which gives customs officers nationwide access through TECS to vessel-related violation information; and (3) a private aircraft inspection reporting system, which provides a customs officer with information helping him to determine the illegal penetration of U.S. borders.

Regulatory audit

A Regulatory Audit Division was established during the year to bring Customs processing of imported merchandise in line with the development of modern business practices. The systemized review by auditors trained to scrutinize the records of importing and exporting firms permitted a more selective initial processing of transactions and resulted in cost savings and the facilitation of the movement of goods.

Military predeparture inspection program

Under a joint agreement signed by the Department of Defense and the U.S. Customs Service, six customs advisers were assigned to overseas locations from which large numbers of military personnel and dependents depart for return to the United States. These advisers train military personnel who assist in predeparture clearance. Between April 26 and May 30 of this year, military customs inspectors under the supervision of U.S. Customs advisers also processed over 60,000 U.S.-bound Vietnamese refugees at Guam and Subic Bay, the Philippines.

International conferences

Customs played an important role in the full range of Customs Cooperation Council programs, which highlighted enforcement and the facilitation of international trade. Chairing the Finance Committee and the second meeting of the Working Party on Customs Enforcement, as well as sending delegations to the plenary council meeting and all committee and working party meetings, Customs not only contributed to individual programs but also influenced the overall direction of the Council.

Responding to initiatives by U.S. and Australian Customs, the Council stepped up its enforcement activities as the awareness of national customs administrations of enforcement problems heightened. The Council adopted a new "Recommendation on the Pooling of Information"; decided to begin work on a multilateral convention on mutual customs administrative support; and sponsored a successful narcotics detector dog seminar. The Council continued to take part in the work of other international organizations dealing with enforcement, and U.S. Customs represented the Council at the 26th session of the U.N. Commission on Narcotic Drugs.

Customs played an active role in the Council's continuing program to facilitate international trade. This included development of three new technical annexes to the International Convention on the Simplification and Harmonization of Customs Procedures and stepped-up work on the development of an international harmonized commodity description and coding system.

Customs also participated in significant projects of other international organizations in the field of facilitation. Principal among these was the U.N. Economic Commission for Europe's development of a revised text of the 1959 TIR Convention, which will be considered at a review conference in November 1975. This convention makes possible the expeditious transit of cargo across borders and through customs territory by means of a carnet and an international guarantee system. The revision will update the convention in the light of technological advances during the past decade in the transportation of cargo.

At the bilateral level, the American-German Mutual Customs Assistance Agreement entered into force June 13, 1975. It provides for an expanded range of cooperative effort in the enforcement of customs laws and regulations. Work on a similar agreement with the Government of Austria has begun, and the possibility of negotiating an agreement has been proposed to the Government of Mexico.

Cabinet Committee on International Narcotics Control (CCINC).—The principal objective of the CCINC program is to interdict the flow of narcotics before it reaches the United States. Through the enforcement training of foreign officials, U.S. Customs has a significant role in implementing this objective. During fiscal 1975, Customs trained more than 1,300 foreign officials representing some 40 countries. Directors General of Customs from Afghanistan, Bolivia, Colombia, and Singapore came to the United States to observe interdiction techniques. More than 90 foreign officials received middle-management training in narcotics interdiction in the United States, and over 1,200 line officers were trained in their own countries, which included West Germany, France, Bulgaria, Colombia, Thailand, the Philippines, and Nepal.

Modernization

Customs modernization and simplification bill.—This legislative package is a consolidation of various proposals to modernize and simplify Customs procedures. It would amend sections 315(d), 321(a)(i), 484, 498(a)(4), 499, 505, 508–511, and 526 of the Tariff Act of 1930, and the Tariff Schedules (19 U.S.C. 1202), and eliminate certain provisions which are considered archaic.

The bill was transmitted to the Congress in May. In June, at a special White House convocation, the Commissioner and other Customs officials briefed industry associations and other interested members of the public sector on the importance of the bill. To continue the above program, Customs has prepared a supplemental legislative package which contains proposals to change other sections of customs law.

Automated merchandise processing system (AMPS).—AMPS is a system for automating the control of merchandise entering the United States, the collection of duties, and the enforcement of import regulations. The increased workload on Customs due to the continued growth of foreign trade has taxed to the limits the present manual merchandise processing system. AMPS will not only satisfy the increased workload requirement but will also provide many additional benefits, including the use of modern business techniques in dealing with importers and brokers, i.e., single periodic payment for several entries of merchandise filed nationwide and monthly statements of account; standardization of port procedures; speeding the clearance of merchandise; increasing the effectiveness and efficiency of entry and air cargo manifest processing; and providing a ready access to entry and management information.

The first phase of the AMPS entry processing system—the early implementation system (EIS)—became fully operational in the Port of Philadelphia on January 27, 1975. EIS is composed of immediate delivery control, entry screening, and collection processing. A similar system is also being implemented in the Chicago Seaport. In early fiscal 1976, EIS will be installed at Chicago's O'Hare Airport and the Port of Baltimore. Later in fiscal 1976 additional liquidation and collection functions, improved on-line immediate delivery control functions, and improved quota control capabilities will be added. The enhanced system will then be implemented at JFK Airport, New York Seaport, and Newark, and, in fiscal 1977, in Baltimore and Chicago, with completion of nationwide implementation by fiscal 1981.

Additionally, an AMPS manifest clearance system frees the customs officer from the clerical task of clearing cargo manifests, as well as centralizing this function. The AMPS seaport manifest clearance system, currently operational in Houston, San Francisco, and Baltimore, will be implemented in additional ports during fiscal 1976. An automated airport manifest clearance system is now in development and will be implemented in the larger airports in fiscal 1976.

Duty assessment by account (DABA).—The duty assessment by account approach involves the processing of import transactions by importer account rather than by port of arrival. Participation of importing firms is voluntary but their interest in the advantages to them shows that a high proportion will employ this form of processing. The system, as currently planned, utilizes business records and normal accounts to verify classification, appraisement, and quantity of imports rather than the shipment-by-shipment method now employed. Based upon the level of importer participation, substantial savings for the Government may result.

Investigative program analysis (IPA).—Numerous changes were made to the IPA, a cost accounting system used by the Customs Service to provide management information on the efforts expended by customs officers on investigative cases. These resulted in the development of better measures of performance achievement and workload. The most notable changes were: (1) Current fiscal year report tracking of all major reporting areas, and (2) a nationwide productivity report yielding certain fraud statistics.

Headquarters consolidation.—The consolidation of Customs activities into the new headquarters location at 1301 Constitution Avenue, NW, was virtually completed. The relocation into one building of employees previously located in several buildings in the Washington area improved both internal efficiency and service to the public.

Customs Service Academy.—The Customs National Training Center relocation was completed April 5, 1975. The center, previously located at Hofstra University in New York, was moved to the Georgetown area of Washington, D.C., and renamed the "U.S. Customs Service Academy."

Border construction authority.—A bill to increase the amount authorized to be expended for Customs and Immigration facilities along the border from $100,000 to $200,000 was enacted as Public Law 93–396 on August 29, 1974. This is the first piece of Customs-proposed legislation to be enacted since 1971.

Trade Policy

Trade Act of 1974.—Over 20 countervailing duty cases were processed by Customs within the new stringent time limits provided under the Trade Act of 1974. Regulations and procedures for dealing with the generalized system of preferences were being developed, looking toward implementation of this major provision of the act later this year. Substantial support was also given for the new round of General Agreement on Tariffs and Trade (GATT) talks for which the act provides.

Antidumping and countervailing duties.—Enactment of the Trade Act of 1974 caused a comprehensive review of the regulations and procedures applicable to antidumping and countervailing duty proceedings. The format and contents of an expanded statement of reasons detailing findings of fact and conclusions of law, to accompany publication in the Federal Register of determinations under the Antidumping Act, were being developed. In addition, as a result of an amendment made by the Trade Act of 1974, to section 516, Tariff Act of 1930, as amended, part 175, Customs Regulations, is being amended to afford to American manufacturers, producers, and wholesalers the right to petition for review of antidumping and countervailing determinations in a manner similar to that currently provided for review of classification and valuation decisions.

Drawback.—An amendment to the Customs Regulations was published in the Federal Register on April 2, 1975, increasing the amount of accelerated payment of drawback claims from 90 percent of a claim to 100 percent. Accelerated payment of drawback claims permits the payment of claims prior to liquidation, with the Government's interest being protected by the claimant filing a bond. The effect of this change will be to increase the working capital of American industry by several million dollars.

Trademarks, copyrights, and patents.—Two hundred twenty-five trademarks, service marks, copyrights or renewals, assignments, and name changes were recorded for import infringement protection during fiscal 1975. Eleven patent surveys were approved. Fees collected for these services totaled $43,000.

South African coal—19 U.S.C. 1307.—American coal-mining interests alleged that a company in the United States was in violation of 19 U.S.C. 1307, which prohibits the importation of articles manufactured or produced by indentured labor under penal sanctions, except where it has been determined that the domestic supply cannot meet demand, by importing low-sulfur coal from South Africa. (The use of low-sulfur coal minimizes emissions of sulfur dioxide from steam power utility stacks.) Customs investigated the charge by studying whether domestic supply can meet the needs and then determining the nature of labor used in mining the coal. Customs concluded that low-sulfur coal was not mined in sufficient quantities in the United States. Customs further concluded that the shipments of coal were not subject to the prohibition of 19 U.S.C. 1307 and that this finding made it unnecessary to consider the question of whether the system of labor under which the coal was mined constituted indentured labor under penal sanctions within the meaning of the statute.

Mutual assistance agreements.—Commissioner Vernon D. Acree participated in a ceremony in Bonn on June 16, 1975, marking the entry into force of the United States-Federal Republic of Germany Mutual Assistance Agreement which had become effective on June 13. On May 1, 1975, the State Department granted Circular 175 authority to negotiate and conclude an executive agreement with Austria providing for mutual assistance between the customs services of the two Governments. These bilateral agreements foster close cooperation between customs services to ensure correct determination of customs duties and more effective prevention and investigation of offenses against customs laws.

Other Activities

Regulatory activities

Internal advice procedure.—Treasury Decision 75–17, published in the Federal Register on January 13, 1975 (40 FR 2453), set forth an internal advice procedure for the use of customs officers, importers, and other interested parties in obtaining advice and rulings from Customs headquarters with respect to current Customs transactions within the technical areas of law interpreted by the Service. This procedure provides for the disposition of issues by the U.S. Customs Service and a formal method for furnishing advice and guidance to field officers in the interpretation and application of laws and regulations.

Administrative rulings.—A proposed revision to the Customs Regulations concerning issuance of administrative rulings relating to prospective transactions was published in the Federal Register on January 13, 1975. The revision will provide a uniform process under which rulings can be requested and issued with respect to transactions for which advance information concerning the dutiable status of merchandise is necessary for business or other reasons.

Prepenalty notice procedures.—Treasury Decision 75–21, effective upon publication in the Federal Register on January 16, 1975 (40 FR 2797), amended subpart A of part 171 of the Customs Regulations by setting forth a new prepenalty notice procedure which introduces an additional element of flexibility in the Customs processing of certain penalty cases. Under this new procedure, the district director will issue a prepenalty notice to a party against whom he contemplates issuing a claim for forfeiture value exceeding $25,000 for violations of section 592, Tariff Act of 1930, as amended (19 U.S.C. 1592). The importer has 30 days in which to file a written reply explaining why the claim for forfeiture value should not be issued. Upon request, the district director may permit an oral presentation of arguments in addition to a written reply. Claims for forfeiture value will be issued when replies have failed to disprove allegations in the prepenalty notice or when no reply is made.

Freedom of information.—The provisions of the amendments to the Freedom of Information Act, Public Law 93–502, effective February 19, 1975, which, among other things, placed statutory time constraints on responding to requests for information in Customs files and records have been implemented. Preliminary instructions have been issued and a draft revision of part 103, Customs Regulations, patterned after Treasury Department regulations, is in preparation.

Fishing.—During fiscal 1975, Customs analyzed and commented on several bills and other agency regulations involving the protection of domestic fishing operations and international fishing conservation programs. Close coordination of the various agencies having interest in this important area is essential to a consistent approach and efficient resolution of the related problems.

Internal audits.—During fiscal 1975, Customs formulated a new approach to the internal audit program which is less regimented and allows more flexibility. A national scope audit on Customs cash collections, as well as a number of other significant audits, were completed during fiscal 1975 utilizing the new approach. Lateral and vertical audits were utilized, as well as local audits and surveys, as a reporting tool for Customs management to judge the effectiveness and progress of priority programs.

Accelerated full field investigations.—In April 1975, Customs was called upon to perform accelerated full field investigations in connection with 346 new positions to be filled by the end of fiscal 1975. An abbreviated full field investigation with a 5-day completion date was instituted and completion of the total investigation within a 30-day limit was prescribed. During May and June, 459 applicants were investigated. During all of fiscal 1975, Customs processed 1,473 full field investigations, 98 of which were found to be derogatory and referred to the principal field officers for determination.

Internal security.—Customs enjoys a high level of integrity. However, during fiscal 1975 Customs opened 479 personnel conduct investigations. For the most part, these investigations served to resolve allegations against employees. Thirteen cases did result in termination of the employee, 35 resigned while under investigations, and 11 cases resulted in convictions for violation of law.

During the year, there were 14 instances where bribery offers were made to customs officers. Five of these were attempts to procure collusion in the smuggling of narcotics into the United States. Cooperation with FBI and Internal Affairs agents in investigations led to the seizure of large amounts of narcotics and the arrest of the conspirators.

Management improvement

During fiscal 1975, Customs continued its support of the management by objectives process. Customs was responsible for one Presidential level objective (modernization and simplification of customs operations and procedures), two Secretarial level objectives (integrated interdiction and automated merchandise processing system), and over 50 Customs level objectives (including an upward mobility program for Customs employees; an increased enforcement communication and information capability to the users of the Treasury enforcement communications system; an intensified and expanded fraud investigations program; and a program to effectively reduce cargo theft and pilferage).

Administrative activities

Upward mobility program.—The groundwork for implementing a formalized upward mobility program within the Customs Service was completed. An announcement to all employees explained the purpose, scope, and goals of the upward mobility program. A skills inventory was conducted by the regions and Service headquarters to identify employees eligible to participate in the program and to determine their counseling needs and the best avenues for their development. Initial counseling services for approximately one-third of the upward mobility population were completed.

Spanish language training program.—The Spanish language training program was very successful, with 293 employees completing the training course at the various class locations. In preparation for the Bicentennial celebration, French language training for customs personnel along the Canadian border is planned.

Equal employment opportunity-Spanish speaking program.—Customs took an active part in all Civil Service Commission and Treasury-sponsored workshops and conferences concerning employment of Spanish-speaking personnel. A full-time program coordinator was appointed at headquarters. Customs liaison with IMAGE, the major organization concerned with the employment of the Spanish-speaking in local, State, and Federal Government, was strengthened by participation in the IMAGE Convention at Kansas City in May.

Bicentennial era activities.—In support of this Nation's Bicentennial, Customs commemorated several customhouses as "historic" and commemorative medals were issued. In connection with the Service's 185th anniversary, headquarters developed a program of celebrations at ports of entry during National Port Week, September 29–October 5, 1974.

Minority bank depositary.—The designation of minority-owned banks as depositaries for customs collections continued as a top priority for the Customs Service. The number of minority banks authorized to act as depositaries for customs collections increased 100 percent, from 7 to 14 banks, in this fiscal year. These depositaries are currently receiving over $90 million in customs deposits a month.

UNITED STATES SAVINGS BONDS DIVISION

The U.S. Savings Bonds Division promotes the sale and retention of U.S. savings bonds. Because the average life of series E and H savings bonds is about twice that of the marketable debt, this form of savings constitutes a long-term underwriting of the Treasury's debt structure, and makes possible the widespread distribution of the national debt through its ownership by a substantial number of small investors.

The program is carried out by a small staff with the active assistance of thousands of volunteers who are leaders in business, labor, finance, and the media. This corps of volunteers assists in the promotion and sale of savings bonds through banks, savings and loan associations, and approximately 40,000 employers cooperating in the operation of the payroll savings plan and over-the-counter sales.

Sales of series E and H savings bonds totaled $6,826 million in fiscal 1975; reported participation in the payroll savings plan as of June 30, 1975, totaled close to 9½ million. There were $65.9 billion in savings bonds and savings notes held at the close of fiscal 1975, over one-fifth of the privately held portion of the public debt. During fiscal 1975, holders of these savings vehicles received over $3½ billion in interest.

U.S. Industrial Payroll Savings Committee

The leader of the 1975 nationwide payroll savings campaign in industry is Gabriel Hauge, chairman of the board, Manufacturers Hanover Trust Co., and Chairman of the U.S. Industrial Payroll Savings Committee. The 1975 campaign was launched in Washington, D.C., on January 16, 1975, with the annual meeting of the Committee being highlighted by a meeting with President Ford at the White House. Serving on the Committee with Mr. Hauge are 12 former chairmen and 48 top executives of the Nation's major corporations.

The members of the U.S. Industrial Payroll Savings Committee conduct top management meetings, urge the chief executives in their areas and industries to conduct payroll savings drives, and set strong examples by the campaigns they conduct in their own companies. Through June, four Committee members had completed their company campaigns and had enrolled over 198,000 employees either as new savers or for increased allotments.

Chairman Hauge has contributed much time and effort to the campaign. He has traveled to 19 cities to address 28 meetings of business and community leaders, helping members of the Committee launch their area and industry campaigns.

On April 16, 1975, Mr. Hauge appeared on the NBC television network "Today" show. Sixty NBC stations also presented their local volunteer leaders to further publicize the campaign. Mr. Hauge provided sales tools for the volunteers and staff workers in the campaign, including a brochure for the top executive and a sound motion picture in color entitled "No Greater Bond." Mr. Hauge produced a newsletter for volunteers to publicize the campaign and also ran a full-page ad featuring the 1975 Committee members with a sketch of each in all editions of the Wall Street Journal on January 21.

The U.S. Industrial Payroll Savings Committee has been the principal force in raising the sales of E bonds in the $25 to $200 denominations to $4.7 billion, more than $2.1 billion higher than in 1962 before the Committee was formed.

Federal campaign

The annual savings bonds campaign for Federal employees was conducted during the spring months. For the first time, the campaigns were staggered over a 3-month period. Many large departments and agencies conducted campaigns in March, others in April, and the Department of Defense, along with some smaller agencies, conducted campaigns in May. The purpose of this was to allow field staff promotional personnel more time to give personal attention to field installations. The Interdepartmental Savings Bonds Committee was again headed by Secretary of Agriculture Earl L. Butz. The Chairman hosted two small luncheons for the major agencies and performed countless other duties which furthered the savings bonds campaign. He requested President Ford to address the Cabinet about the importance of the savings bonds program. This proved to be most successful, resulting in substantially more involvement by Cabinet members and agency heads than in recent years.

The April 9 kickoff rally was more widely attended than in years past. Then-Secretary of the Interior Rogers C. B. Morton was the keynote speaker. He shared the platform with Secretary Butz and Mrs. Francine Neff, Treasurer of the United States and National Director of the Savings Bonds Division. William Conrad, star of the TV series "Cannon," made his appearance as the honorary chairman of the Federal campaign.

The Federal establishment, with a work force of approximately 2½ million civilian employees and over 2 million military personnel, produced sales in excess of $1,075 million in 1974. The campaign resulted in approximately 225,000 new savers and increased allotments. The 1975 campaign was an outstanding success wherein over 330,000 new savers and increased allotments were obtained. Sales should surpass $1,100 million in 1975.

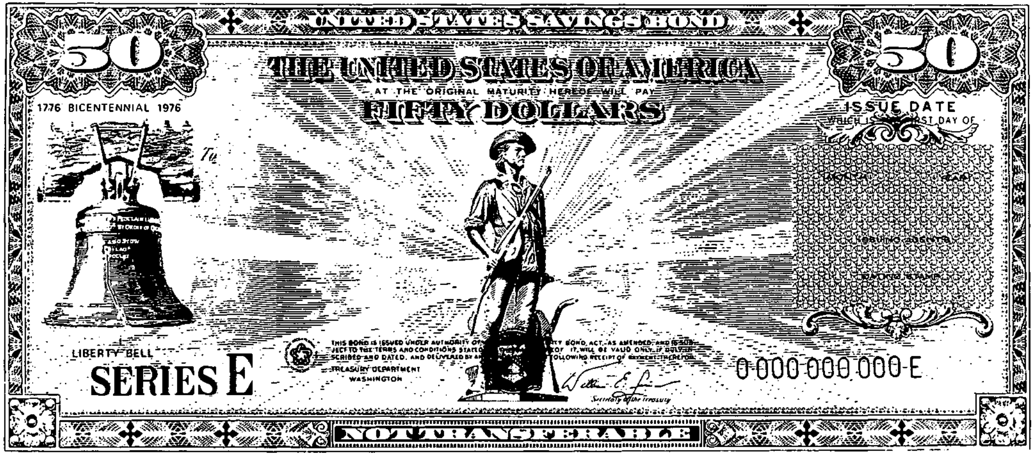
Volunteer activities

The volunteer chairmen of State savings bonds committees and members of the American Bankers Association savings bonds committee met with Treasury officials during their annual conference in Washington, D.C., on December 4 and 5. Sessions were presided over by North Carolina Chairman Bland Worley, vice chairman of the board, Wachovia Corp., and ABA Chairman W. Jarvis Moody, president, American Security and Trust Co. of Washington, D.C. Following the Washington meeting, volunteer meetings were held in the States to plan introductory ceremonies for the Bicentennial-design series E savings bonds and other volunteer activities.

In a May 1, 1975, White House ceremony, President Ford purchased a Bicentennial-design series E savings bond—the first printed—in a ceremony with Secretary Simon, Secretary Butz, Minnesota Volunteer Chairman Clifford C. Sommer, ABA Chairman Moody, and National Director Neff. On that same day, in similar ceremonies throughout the country, State Governors participated in ceremonial sales with their State volunteer chairmen and ABA State coordinators and declared the week of May 5–9 as "Minute Man Week." Reproductions of the Liberty Bell, one of which was presented to each State during the special 1950 savings bonds Independence Drive, formed the background for many of these ceremonies. Throughout "Minute Man Week" savings bonds volunteer county chairmen around the country conducted hundreds of ceremonial sales to city and county officials to introduce the new design bond and open the celebration of the Bicentennial through the savings bonds program.

During the fiscal year, Secretary Simon reappointed 4 volunteer State chairmen and appointed 12 new volunteer State chairmen for 2-year terms.

Nineteen newly elected Governors were appointed by the Secretary to serve along with the incumbent Governors as honorary chairmen for their respective State savings bonds committees. They play an important role by providing leadership for State citizens and employees in each State's savings bonds program.



Bicentennial-design series E savings bond.

Labor support

America's labor unions and their leaders continued their traditional support of savings bonds and the payroll savings plan. George Meany, president of the AFL–CIO, voiced his strong support with the following statement: ". . . as you know, the AFL–CIO has long supported the Savings Bonds Campaign, and we intend to continue that support. I am convinced the labor movement can and will do its part to promote the Savings Bonds Campaign."

Mr. Meany helped publicize the Bicentennial-design series E savings bonds by his purchase of one from National Director Neff. Press material originating from coverage of this event was sent to more than 500 labor publications throughout the United States, resulting in excellent publicity for savings bonds.

Acting in the volunteer capacity of National Labor Chairman for Savings Bonds, Mr. Meany is helping to form a new national labor committee. From the AFL–CIO he has asked Lane Kirkland, secretary-treasurer of the AFL–CIO, Al H. Chesser, president of the United Transportation Union, and Glenn E. Watts, president of the Communications Workers of America, to serve and all have accepted.

On State and local levels, union officials continue to serve as volunteers for the program, involving themselves in payroll savings campaigns in their local communities. The labor press has been of great help by continuing use of savings bonds ads, editorials, and news stories.

Advertising

The public service advertising campaign for saving bonds, conducted in cooperation with the Advertising Council, enjoyed one of its best years in 1974. According to council estimates, the media contributed more than $75 million in space, time, and services, which was just short of 1973's record-breaking total of $76 million. Included in the contributions were 17,500 ads in daily newspapers, the highest total since 1969, and 158,000 lines in national magazines, another record.

The new advertising campaign for 1975 and 1976 is centered around the Nation's Bicentennial, tracing the contribution of citizen financing to the Nation's growth. Created by the Leo Burnett Co., volunteer task-force agency of the council, the theme is "Take Stock in America—200 Years at the Same Location." The campaign began in April in print media and radio, and will be extended to television beginning in the fall.

John Wayne, well-known film star and longtime bond volunteer, contributed his services to a Bicentennial savings bonds film message which is being shown this spring and summer in theaters throughout the country. Production was arranged and contributed by Lew Wasserman, motion picture chairman of the U.S. Industrial Payroll Savings Committee, and Universal Pictures.

In the annual savings bonds awards competition for company communicators—based on payroll savings promotion appearing in company publications in 1974—Henry Bachrach of General Electric Co. was named "Communicator of the Year" and A.T. & T. received the grand award for a total corporate campaign. Members of the national Employee Communications Committee, which held its annual meeting in Washington in March, judged the contest, and awards were presented on June 12 at the conference of the International Association of Business Communicators in New Orleans.

National organizations

The National Organizations Committee, under the Chairmanship of Valerie F. Levitan of Soroptimist International, continued its strong support of the bond program. More than 90,000 individual club units were asked by their national presidents to participate in the "Seven-Point Program" of cooperation, and results to date indicate widespread pickup. The new program for the 1975–76 club year, as recommended by the steering committee, will feature a strong tie-in with the Bicentennial.

Public affairs

The Office of Public Affairs developed a comprehensive package of "Copy Patterns" for use by the media and a special package of news releases, proclamations, and scripts for the introduction of the Bicentennial-design series E bond. Two series of feature articles were launched—"Family Forum" and "Voice of the Volunteer."

A manual of public relations techniques and tactics was prepared and distributed to the field staff, and a leaflet describing the savings bonds "freedom eagle" emblem was given wide distribution.

Charles R. Buxton, editor/publisher, Denver Post, was named Chairman of the National Committee of Newspaper Publishers, succeeding Robert Letts Jones, who retired as president, Copley Newspapers, Inc.

Continuing close collaboration with leading financial writers and editors brought about increased coverage in a number of leading magazines, including U.S. News & World Report and Changing Times, and hundreds of newspapers which carry the columns of Don G. Campbell, John Cunniff, Merle E. Dowd, Leonard Groupe, Sam Shulsky, and others. Scripps-Howard's Robert Dietsch provided detailed chain coverage of the Bicentennial-design E bond.

The cooperative efforts of the Office of Public Affairs led to a feature article on the bond program in Public Relations Journal and a section on savings bonds in Ethyl Digest.

During the course of the year, some 6,250 pieces of correspondence were handled, many inspired directly by publicity items in newspapers and magazines.

EDP program

In the 10 years that the EDP program has been in operation, the system has proved to be a valuable management tool in the area of program planning. The centralized collection and publication of payroll savings statistics relieves the State offices of many hundreds of hours of clerical time and provides a meaningful picture of the payroll savings program which is utilized at the National, regional, and State levels to formulate sales plans each year and to establish payroll savings goals on State, area, and county bases.

At the end of fiscal 1975 the number of reporting units (companies that operate the payroll savings plan) on the EDP tapes was 39,042, which represents 21,566 interstate units (including branches of companies) and 17,476 intrastate companies. Total employment in these companies is shown as 26,970,613. The number of employees signed up to buy savings bonds in these companies is 6,713,235, or 24.9 percent.

Management improvement

On January 20, 1975, a management study was initiated under the auspices of the Office of the Secretary. The study team consisted of two members of the Office of Management and Organization and a representative from the U.S. Savings Bonds Division. The study was completed in May. Its purpose was to assess the organizational structure and function of the Washington, D.C., headquarters of the Division to determine its efficacy for managing the savings bonds sales program. Currently the 33 recommendations made by the study team are under consideration by top management in the Division. Acceptance of a number of these recommendations should lead to a more effective headquarters operation.

Training and staff development

The Division is continuing to recruit and move young persons up through the ranks. Through an American Management Association-prepared course, "Principles of Professional Salesmanship," and on-the-job training assignments, recently graduated college students and persons promoted through the upward mobility program are trained for key sales promotion, managerial, and administrative positions. A program of sales instruction/training—"20-Point System for Guaranteed Sales Success" by Dartnell-Anderson—is used for new promotional employees unable to attend an indoctrination course for 6 to 10 months after entering on duty. This course is also being used as a refresher course for veteran promotional staff members.

A line management training program entitled "How to Improve Individual Manager Performance," prepared by the American Management Association, was continued in fiscal 1975. A management library, publicized quarterly, has been extensively used by all staff members. During fiscal 1975, 5 of 14 persons selected for the executive development program were involved in a planning conference to assist in the development of a national sales program while 5 of the 14 attended courses presented by the Civil Service Commission, Department of Agriculture Graduate School, and Advance Management Research, Inc.

All executive level and supervisory personnel have received introductory level instruction on the implementation and operation of the management by objectives program. This instruction was to further enhance the grasp of management by objectives principles and the installation of the program. As preparation begins for fiscal 1976, understanding and use of the program has greatly improved.

UNITED STATES SECRET SERVICE

The major responsibilities of the U.S. Secret Service are defined in section 3056, title 18, United States Code. The protective responsibilities include protection of the President of the United States; the members of his immediate family; the President-elect; the Vice President or other officer next in the order of succession to the office of President, and the Vice President-elect; the members of the immediate family of the Vice President, unless such protection is declined; the person of a former President and his wife during his lifetime; the person of the widow of a former President until her death or remarriage; minor children of a former President until they reach 16 years of age, unless such protection is declined; the person of a visiting head of a foreign state or foreign government; and, at the direction of the President, other distinguished foreign visitors to the United States and official representatives of the United States performing special missions abroad. In addition, Public Law 90-331 authorizes the U.S. Secret Service to protect major Presidential or Vice Presidential candidates.

The investigative responsibilities are to detect and arrest persons committing any offense against the laws of the United States relating to coins, obligations, and securities of the United States and of foreign governments; and to detect and arrest persons violating certain laws relating to the Federal Deposit Insurance Corporation, Federal land banks, joint-stock land banks, and Federal land bank associations.

Protective responsibilities

During fiscal 1975, the Secret Service provided protection for President and Mrs. Gerald R. Ford and their four children; Vice President and Mrs. Nelson A. Rockefeller and Nelson, Jr.; former President and Mrs. Richard M. Nixon; John Kennedy, Jr.; and former First Ladies, Mrs. Harry S Truman, Mrs. Dwight D. Eisenhower, and Mrs. Lyndon B. Johnson.

In addition, the Secret Service provided protection for Secretary of State Henry A. Kissinger (on a reimbursable basis); Secretary of the Treasury William E. Simon; and Assistant Secretary of the Treasury Gerald L. Parsky (on two special trips abroad). Secretary Kissinger made 10 foreign trips and Secretary Simon, 13. The majority of these trips were extensive, and involved large-scale protective and logistical problems.

During fiscal 1975, the Secret Service provided protection for Speaker of the House Carl Albert during the period that Vice President Rockefeller was being selected and confirmed. On August 13, 1974, protection for Patricia Nixon Cox and Julie Nixon Eisenhower was terminated.

There was an increase in Secret Service protection for visiting heads of state or government from 70 in fiscal 1974 to 103 in fiscal 1975. The total number of foreign dignitaries protected by the Secret Service in fiscal 1975 was 132. The heaviest period of foreign dignitary protective activity occurred between April 15 and May 15, 1975, when 35 received Secret Service protection.

A large increase in Secret Service protective responsibilities is expected in fiscal 1976 and 1977. The Secret Service, by law, will be responsible for the protection of major Presidential and Vice Presidential candidates and nominees. Also, it is anticipated that a large number of foreign heads of state or government will visit the United States for the Bicentennial celebrations, United Nations activities, and the nearby Olympic games in Canada.

On December 27, 1974, Public Law 93–552 was signed by President Ford, amending title 18 of the United States Code, to authorize Secret Service protection of members of the immediate family of the Vice President, unless declined. In addition, this bill designated the former residence of the Chief of Naval Operations, located on the grounds of the U.S. Naval Observatory, as the temporary official residence of the Vice President.

The bill also amended title 3, United States Code, section 202, by authorizing the Executive Protective Service to protect the temporary official residence of the Vice President and grounds in the District of Columbia. In fiscal 1975, the Executive Protective Service provided protection for the White House, buildings housing Presidential offices, and for foreign diplomatic missions of 127 countries at 300 locations in the metropolitan area of the District of Columbia.

Further, EPS protection was afforded, at Presidential directive, on a case-by-case basis, for foreign diplomatic missions located in other areas of the United States. Three cases in point were the annual International Monetary Fund Conference held in Washington, D.C.; the 29th annual General Assembly of the United Nations in New York City; and continual coverage for selected foreign missions to the United Nations in New York City.

Protective intelligence

During fiscal 1975, the Intelligence Division initiated a long-range review of all files to determine which records to convert to the new automated data processing system. Also, the Division was reorganized to better utilize intelligence research specialists. These employees were given more responsibilities and, as a result, special agents formerly performing the duties were available for travel.

The Technical Security Division purchased and installed a Colenta La 130 automatic color film processing machine, greatly reducing the man-hours required for film developing. Also, this Division began the installation of security systems for the new Vice Presidential residence at the Naval Observatory. The program to computerize supply records was also completed.

The Data Systems Division conducted a study to determine the ADP needs for the Secret Service for the next 8 years, which indicated that the present computer equipment was inadequate to handle the projected requirements.

In order to provide an orderly expansion of ADP equipment and programs, an interim upgrading of two central processing units was authorized to meet the increased protective support requirements for 1976. In addition, a minicomputer with associated control terminals and display board was authorized to interface with one of the units, thus permitting more effective determination of agent personnel assignments.

The Technical Development and Planning Division served as consultant to the Architect of the Capitol in connection with the Capitol security system and was in charge of the technical aspects of the system. This 2-year effort culminated in May of 1975 with the manning by the Capitol Police of the centralized control room. The cameras in the video surveillance system located throughout the Capitol and

Senate and House Office Buildings, and the sensors for the security system in the steam and chilled water tunnels supporting the Capitol complex are monitored from the control room. Also included in the system are X-ray units for parcel and briefcase inspection, located at major entrances to the building and in mailrooms.

The Technical Development and Planning Division began work during the year on several significant new developments:

1. A system to provide current information on the available manpower of all field offices will greatly facilitate the formation of special protective details. This system will include a computer-controlled wall display and computerized storage and recall of every agent's present and future work status, special skills, training, and past experience.

2. A mobile X-ray inspection system will facilitate the inspection of baggage and parcels in connection with Secret Service protective responsibilities. The system is built into a Tradesman van and will allow the operator to view a fluoroscopic presentation of the packages. The packages will be moved into and out of position on a conveyor belt, thus allowing rapid inspection.

3. A unit to allow the rapid comparison of gold coins provides a presentation of the coins magnified from 15 to 70 times actual size, either full-view side by side, half-view of each joined, or full-view superimposed.

4. New high-strength steel gates designed in conjunction with personnel from the National Park Service will replace the present gates at all entrances to the White House complex.

5. Both rigid armor and flexible ballistic armor for agents, configured to Division requirements, will be purchased.

In fiscal 1975, the Communications Division expanded the Communications Center facility to meet the rapidly increasing volume of messages and to prepare for increased foreign dignitary and candidate/nominee protective activities in 1976. In addition, radio communications were upgraded in 20 field offices.

The Liaison Division was very active during fiscal 1975, particularly at the U.S. Capitol, the Department of State, and other agencies, regarding the visits of foreign dignitaries and visits of protectees abroad. Also, the Division is working closely with the Office of Protective Forces and the appropriate office on Capitol Hill in preparation for activities at the U.S. Capitol during the 1976 Presidential campaign.

Investigative responsibilities

Counterfeiting.—Counterfeiters in fiscal 1975 produced $48.6 million in counterfeit U.S. currency, up 127 percent over fiscal 1974 and $21 million higher than the previous record established in fiscal 1972.

While losses to the public jumped $1.2 million to a figure of $3.6 million (an increase of 49 percent), the Secret Service seized $45 million, 93 percent of total output, before it could be placed into circulation. This seizure figure represents an increase of 137 percent over the past fiscal year and exceeds the previous high (fiscal 1971) by over $21 million.

Of the $48.6 million in counterfeit currency reported during fiscal 1975, $39.3 million originated with counterfeiting conspiracies initiated during that fiscal year. A total of $37.9 million was seized before it could be passed on the public, and the plant operations responsible for $37.3 million (95 percent) were successfully suppressed by the end of the fiscal year.

The suppression of one such plant operation began during November of 1974 when a person was arrested in Miami for passing a new issue of counterfeit $20 Federal Reserve notes. Pursuing leads resulting from that arrest, agents traced the counterfeits to a legitimate printing firm located in Albany, Ga. One of the firm's owners, its general manager, and the press foreman were arrested and charged with manufacturing the notes. All were later convicted and received prison terms ranging from 3 to 7 years. This conspiracy was responsible for producing over $4.9 million in counterfeit currency. Only $3,180 was successfully passed on the public.

A second counterfeiting conspiracy successfully suppressed during the current fiscal year first came to light in July of 1974 when a Los Angeles doctor was questioned by authorities in Mexico City after passing a single specimen of a new type of counterfeit $50 Federal Reserve note. The doctor claimed he had received the bill when he cashed a check at the Los Angeles airport shortly before departing on his trip. No further counterfeits of the type involved in the Mexico City incident were passed during the next several months, and it was felt that the case would have little significance. In the latter part of November, however, the administrator of a nursing home located in Redlands, Calif., reported he had found a large quantity of counterfeit notes hidden in one of the rooms. Over $3.1 million in counterfeit currency, including a number of the Mexico City notes, were recovered. Several items seized with the counterfeit notes were found to bear the fingerprints of two persons who had been previously arrested by the Secret Service in connection with a different counterfeiting scheme. They admitted printing the counterfeits found in the nursing home and identified the Los Angeles doctor, the nursing home administrator, and a third party as being the financial backers of the operation. All parties have since entered guilty pleas and have received sentences ranging from 3 years' probation to 2 years in prison.

In addition, 25 other counterfeiting operations, each responsible for producing more than $100,000 in counterfeit currency, were suppressed during the current fiscal year.

Month suppressed	Location	Passed on the public	Seized
1974			
July	Miami, Fla.	$9,960	$2,574,100
July	St. Louis, Mo.		214,320
August	Dallas, Tex.	6,470	597,460
October	New Orleans, La.	1,720	612,270
October	Portland, Oreg.	620	418,500
October	Sycamore, Ill.	6,040	466,000
October	Houston, Tex.	16,580	343,770
October	Cerritos, Calif.		8,440,515
October	Beverly, Mass.	80	177,910
November	Bountiful, Utah	1,410	764,900
December	Cedar Rapids, Iowa.	3,700	3,055,920
December	San Antonio, Tex.	84,380	257,800
December	Hatboro, Pa.	2,390	113,080
December	Greeley, Colo.	9,490	159,770
December	Winston-Salem, N.C.		$426,000
December	Lancaster, Calif.	$23,940	294,740
1975			
February	Chattanooga, Tenn.	300	1,678,400
February	Hackensack, N.J.	613,820	3,452,350
March	Los Angeles, Calif.	48,840	153,880
March	Ft. Lauderdale, Fla.	20,200	171,080
April	Boston, Mass.	22,480	100,615
April	Las Vegas, Nev.	980	214,040
May	Salt Lake City, Utah.		5,886,000
May	Naples, Fla.		222,580
June	Roanoke, Va.	62,580	479,920

Check forgery.—During fiscal 1975, the Service received 78,148 checks for investigation, an increase of 21 percent over fiscal 1974. With the Department of the Treasury having issued approximately 780 million checks during fiscal 1975, only 1 of every 10,500 checks paid was referred to this Service for investigation.

Arrests for check forgery offenses increased from a previous record of 5,465 in fiscal 1974 to a new, record high of 6,602 in fiscal 1975. The backlog of pending check cases increased 21 percent, from 35,006 to 42,478. This increase in backlog is due in part to the increase in referrals and to the number of cases pending judicial action.

The significant increase and improvement in the check forgery arrest area may be attributed to the increase in the availability of manpower for assignment to this activity; the continued expansion of the forgery squad system in the field offices; and the priority concentration of the investigative effort in the area of those who forge and negotiate two or more checks. Efforts in identifying check thieves and fences, coupled with the early identification and arrest of multiple forgers before their activities can expand significantly, are the basic deterrents which suppress the volume of cases.

Implementation of the supplemental security income program in January 1974 only slightly increased the number of check forgery cases referred in fiscal 1974; however, during fiscal 1975, the Service experienced a significant increase in the number of forgery referrals involving these checks—an additional 7,500 forged checks. Continued increases in forged-check referrals involving supplemental security income checks are anticipated.

Check forgery referrals occasioned by fraudulent IRS returns submitted to obtain refund checks and by thefts of checks from the Postal Service, major postal facilities (e.g., military bases), disbursing offices, and issuing agencies continued to increase during fiscal 1975. These multiple thefts have resulted in greater fencing activities and additional multiple check forgery cases. The usual countermeasures, including undercover agent action, increased surveillance, and close liaison with other interested agencies, have again proved to be successful in blunting the overall effect of these activities and schemes.

The initial impact of the social security and income tax rebate programs implemented during the last half of fiscal 1975 was reflected in the rate of forged-check referrals to the Service during the last quarter of the year, which rose significantly over the "normal" referral rate of 100 forged checks for every 1 million checks issued. The basic indicators, that is, the number of original checks recovered in the field prior to being cashed, the number of field-originated forgery cases, the increased fencing activities involving checks, and the immediate appearance of the rebate checks in forgery activities, all point to continued increases in the number of forged-check investigations.

In a recent forgery case, the proprietor of a jewelry store was arrested in Philadelphia for participating in a multiple check forgery scheme along with seven other defendants. She accepted forged checks and processed them through her business account from February through June 1973. At least 85 Treasury checks, amounting to over $21,000, were involved. A 56-count indictment was returned from the Federal Grand Jury, Eastern District of Pennsylvania, charging the defendants with forging and uttering U.S. Treasury checks, mail theft, conspiracy, aiding and abetting, and transportation of stolen goods. Seven of the defendants pleaded guilty and the eighth was recommended for the deferred prosecution program, and will be sentenced in the future. On October 7, 1974, the jewelry store owner was given a 5-year suspended sentence, placed on probation for 5 years, and ordered to undergo imprisonment for a period of 90 days and make restitution for $5,165.60. During September and October 1974, the remaining defendants received sentences ranging from probation to 5 years' imprisonment.

Bond forgery.—Bond forgery investigations decreased during fiscal 1975, with 12,645 bond investigations being opened compared with 13,163 in fiscal 1974, 13,849 in fiscal 1973, and 15,905 in fiscal 1972. This decline may be attributed to the increased early identification, arrest, and incarceration of prolific bond forgers. Also, an ever-increasing number of bonds were recovered prior to being forged and redeemed.

Bonds, stolen throughout the country by various schemes, including bank robbery, office and house burglary, and mail theft, repeatedly and rapidly appear in the hands of known fences of stolen securities in large metropolitan areas. Many of those individuals employ part-time forgers, operating on a commission basis, who travel across the country forging and cashing the stolen bonds.

At the end of the fiscal year, there were 681,118 stolen bonds, representing a face value of $46,707,450, entered into the National Crime Information Center (NCIC) by the Secret Service, compared with approximately 600,000 bonds at the end of fiscal 1974. Each of these bonds represents a potential loss to the Government if presented for redemption.

During fiscal 1975, 199 persons were arrested for bond forgery, just under the record established in fiscal 1974, when 210 persons were arrested. Investigation established that many of those arrested have connections with known organized crime figures.

Prior to forgery and redemption, the Secret Service recovered 10,437 stolen bonds with a face value of $990,995, most of which were returned directly to the registered owners.

In August 1972, the New York office commenced one of the largest bond forgery and conspiracy investigations in the Service's history. The New York County district attorney's office notified the New York office that it was investigating a group of individuals involved in a conspiracy to forge and utter stolen U.S. savings bonds and other securities. These bonds related to numerous pending cases in the New York office, and further investigation was coordinated with the district attorney's office.

As a result of confidential information, alerts to banks on specific stolen bonds, inquiry by the banks on other suspicious transactions, and identifications received from banks on suspected forgers, numerous persons were arrested. These, in turn, provided valuable information indicating that stolen bonds were distributed by fences to forgers working on a percentage basis. On November 8, 1973, all of the individuals were arrested with the exception of two who became fugitives. Final disposition of this case did not occur until April 1975. Three of the indicted individuals were placed on probation for 3 years and the remaining individuals received prison terms ranging from 30 months to 5 years. The main fence received two concurrent 5-year terms and a $5,000 fine. Conservative estimates are that 2,500 bonds with a face value of $504,000 were stolen, forged, and redeemed in this case. There was a combined total of 62 State and Federal arrests for 46 defendants. Bonds from more than 40 bond larceny cases that this Service has investigated (i.e., cases involving a minimum of $5,000) appeared in this case, along with bonds from smaller burglaries. Included were bonds taken in post office burglaries, armed robbery of a bank, and mail thefts in many different States.

Identification Branch.—The Identification Branch of the Special Investigations and Security Division, consisting of a Questioned Document Section and a Latent Print Section, serves all field offices by conducting technical examinations of handwriting, handprinting, typewriting, fingerprints, palmprints, striations on counterfeit currency, altered documents, and other types of physical evidence.

During the 12-month period ending May 31, 1975, members of the Identification Branch conducted examinations in 6,846 cases involving 523,498 exhibits. This resulted in the identification of 2,467 suspects and a total of 293 court appearances to furnish expert testimony.

Treasury Security Force

The Treasury Security Force, a uniformed branch of the U.S. Secret Service, protects the Main Treasury complex and participates in providing security to the White House.

During fiscal 1975, the Force expended 3,236 hours in an intensive inservice training program. Forty felony arrests, compared with 36 in fiscal 1974, were made by the Force; most of the arrests were effected in the Cash Room as individuals attempted to cash forged checks valued at $8,000.

Organized crime

The Secret Service provided 17 special agents to 16 organized crime strike forces located throughout the United States. One intelligence research specialist assigned to headquarters coordinated and disseminated organized crime intelligence information to Secret Service field offices.

During fiscal 1975, these agents were involved in 95 organized crime cases, representing 25,739 man-hours. Total man-hours expended in this category by Service personnel exceeded 91,949, or 44.2 man-years.

Training

There were 197,000 man-hours of training conducted by the Office of Training for personnel engaged in investigative, protective, and administrative functions. In addition, 10,000 man-hours of interagency training and 6,000 man-hours of nongovernment training were completed for a total of 213,000 man-hours.

The Secret Service provided all firearms training for students of the Consolidated Federal Law Enforcement Training Center (302 students from the Criminal Investigator School and 641 students from the Police School). In addition, firearms training was provided to 1,074 employees of other agencies as follows: 10 special agents of the Bureau of Alcohol, Tobacco and Firearms, 146 Customs employees, 525 U.S. Park Police Officers, 16 special agents of the U.S. Information

Agency, 89 Internal Revenue Service employees, 26 special agents of the Department of Commerce, 21 U.S. Marshals, 40 U.S. Park Rangers, 12 employees of the Department of Labor, 8 employees of the Department of the Interior, and 181 couriers for the White House Communications Agency. Firearms training was also provided for all the enforcement personnel of the Secret Service.

On January 2, 1975, a Training Resource Center was opened, providing Secret Service employees with self-paced and individualized training programs. The Center also contains materials such as books, magazines, and programmed texts for research and study. Approximately 220 employees enrolled during the first 6 months of operation. With the development of new programs and the acquisition of additional audiovisual equipment, the Center will expand its services to meet a wide variety of training needs of Secret Service employees at all levels.

The management objective of training one-third of the journeyman special agents to act as supervisors on temporary protective assignments for campaign '76 was completed 6½ months early. A total of 356 special agents completed this formal training course.

Two dignitary protective seminars were completed and 21 additional seminars are scheduled for fiscal 1976. Forty command level police officers completed this 2-week program during fiscal 1975. The first week is conducted by the Secret Service and the second by the FBI.

Plans continued to produce models of sites normally encountered on protective assignments for use in training special agents.

Administration

The automated property accounting system designed during fiscal 1974 was installed and placed into operation. All accounting requirements of acquisition cost, depreciation, and disposal of Government capitalized assets are supplied by this system.

During fiscal 1975, a change in cost accumulation of the automated accounting system was designed and approved for fiscal 1976. With this accumulation system, reports, both recurring and projected, will be expedited due to the system's alinement with all phases of the Service.

The Personnel Division established a formalized personnel management assistance program during the past year. Visits were made to 11 field offices, and more limited surveys were performed in other field offices and headquarters divisions, with the purpose of assuring proper classification of positions, effective staffing, and overall sound personnel practices.

A 2-year administrative intern program was initiated in the Office of Administration. This program was designed to provide each intern with a thorough working knowledge of the Secret Service administrative divisions. The first year, each intern will participate in rotating assignments throughout the various administrative divisions. The second year, each intern will receive specialized training in one division as determined by the needs of the Service and the individual interest and performance of the intern. At the conclusion of the 2 years, the interns will receive permanent assignments within the Office of Administration.

Inspection

In fiscal 1975, the effectiveness of the Office of Inspection was enhanced by the assignment of lower graded special agents to relieve the Inspectors and Assistant Inspectors of many administrative functions of the inspection teams and to assist in special investigations. Also, teams inspecting medium to larger offices of the Service were restructured to include supervisors, senior special agents, and key administrative personnel drawn from offices other than the one being inspected. This gave better balance to the teams and permitted more inspections within the year.

Legal counsel

During fiscal 1975, the Office of Legal Counsel drafted memorandums, reports, and legal opinions on the following: Proposed legislation—44; inquiries from other agencies—29; litigation reports for the Department of Justice—20; interpretation of protection laws—21; interpretation of counterfeit laws—18; interpretation of forgery laws—11; petitions for remission of forfeiture of seized equipment—66; administrative tort claims involving employees of the U.S. Secret Service—109; cases involving the reproduction of genuine U.S. and foreign currency—1,083; Training Division projects—31; Secret Service personnel matters—10.

In December 1974, the Secret Service submitted five legislative proposals for consideration by the Secretary of the Treasury. The first of these would amend 18 U.S.C. 871, "Threats against the President and successors to the Presidency," so that, in addition to the protection presently provided concerning threats made against the President and successors to the Presidency, other persons authorized protection by the Secret Service would be covered as to threats made against them.

The second proposal would amend 18 U.S.C. 475, "Imitating obligations or securities; advertisements," to clarify prohibitions against the reproduction of obligations and securities of the United States and foreign governments.

The Service also proposed to amend 18 U.S.C. 495, "Contracts, deeds, and powers of attorney," to add a misdemeanor to the basic felony charge under section 495, which the Secret Service utilizes to investigate and prosecute individuals who utter, publish, and forge Government obligations. In a typical case involving the uttering and forging of a Government check, the penalty, regardless of the amount of the check, is $1,000 fine or imprisonment for 10 years, or both. This proposal would provide that, for forged writings where the face value does not exceed $100, the penalty would be a fine of not more than $100 or imprisonment for not more than 1 year, or both.

Another draft proposal would amend 18 U.S.C. 473 to provide Federal criminal penalties for the theft of Government obligations of a value of $5,000 or more, and Federal criminal penalties for the possession and sale of such obligations, regardless of the value.

Lastly, the Secret Service proposed to amend 18 U.S.C. 3056, "Secret Service powers," to provide statutory authorization for U.S. Secret Service protection of individuals not specified in existing legislation, and to modify, and in some cases eliminate, protection now prescribed.

There are presently 58 lawsuits pending in which the Secret Service is a party. These cases involve, among others, the Federal Tort Claims Act and alleged violations of civil rights stemming from the protective and investigative responsibilities of the Service.

On May 4, 1975, 11 Secret Service agents, including the Director, were voluntarily dismissed from a suit in Charlotte, N.C., which involved alleged violations of civil rights when the plaintiffs were denied entry to a program attended by the President honoring Billy Graham. Similar major lawsuits against the officials of the Secret Service are pending in San Diego and Cleveland.

EXHIBITS

Public Debt Operations, Regulations, and Legislation

Exhibit 1.—Treasury notes

A Treasury circular and supplement covering an auction of Treasury notes for cash with prices established through competitive bidding are reproduced in this exhibit. Circulars pertaining to other note offerings during fiscal 1975 are similar in form and therefore are not reproduced in this report. However, essential details for each offering are summarized in the table in this exhibit, and allotment data for the notes will be shown in table 37 in the Statistical Appendix. During the year there were no offerings in which holders of maturing securities were given preemptive rights to exchange their holdings for new notes.

DEPARTMENT CIRCULAR NO. 13–75. PUBLIC DEBT

DEPARTMENT OF THE TREASURY,
Washington, May 2, 1975.

I. INVITATION FOR TENDERS

1. The Secretary of the Treasury, pursuant to the authority of the Second Liberty Bond Act, as amended, invites tenders on a yield basis for $2,750,000,000, or thereabouts, of notes of the United States, designated Treasury Notes of Series E–1978. The interest rate for the notes will be determined as set forth in Section III, paragraph 3, hereof. Additional amounts of these notes may be issued at the average price of accepted tenders to Government accounts and to Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities. Tenders will be received up to 1:30 p.m., Eastern Daylight Saving time, Tuesday, May 6, 1975, under competitive and noncompetitive bidding, as set forth in Section III hereof. The 6 percent Treasury Notes of Series B–1975 and 5⅞ percent Treasury Notes of Series F–1975, maturing May 15, 1975, will be accepted at par in payment, in whole or in part, to the extent tenders are allotted by the Treasury.

II. DESCRIPTION OF NOTES

1. The notes will be dated May 15, 1975, and will bear interest from that date, payable on a semiannual basis on February 15 and August 15, 1976, and thereafter on February 15 and August 15 in each year until the principal amount becomes payable. They will mature August 15, 1978, and will not be subject to call for redemption prior to maturity.

2. The income derived from the notes is subject to all taxes imposed under the Internal Revenue Code of 1954. The notes are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority.

3. The notes will be acceptable to secure deposits of public moneys. They will not be acceptable in payment of taxes.

4. Bearer notes with interest coupons attached, and notes registered as to principal and interest, will be issued in denominations of $5,000, $10,000, $100,000 and $1,000,000. Book-entry notes will be available to eligible bidders in multiples of those amounts. Interchanges of notes of different denominations and of coupon and registered notes, and the transfer of registered notes will be permitted.

5. The notes will be subject to the general regulations of the Department of the Treasury, now or hereafter prescribed, governing United States notes.

III. TENDERS AND ALLOTMENTS

1. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D.C. 20226, up to the closing hour, 1:30 p.m., Eastern Daylight Saving time, Tuesday, May 6, 1975. Each tender must

state the face amount of notes bid for, which must be $5,000 or a multiple thereof, and the yield desired, except that in the case of noncompetitive tenders the term "noncompetitive" should be used in lieu of a yield. In the case of competitive tenders, the yield must be expressed in terms of an annual yield, with two decimals, e.g., 7.11. Fractions may not be used. Noncompetitive tenders from any one bidder may not exceed $500,000.

2. Commercial banks, which for this purpose are defined as banks accepting demand deposits, and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions with respect to Government securities and borrowings thereon, may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from banking institutions for their own account, Federally-insured savings and loan associations, States, political subdivisions or instrumentalities thereof, public pension and retirement and other public funds, international organizations in which the United States holds membership, foreign central banks and foreign States, dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions with respect to Government securities and borrowings thereon, and Government accounts. Tenders from others must be accompanied by payment (in cash or the notes referred to in Section I which will be accepted at par) of 5 percent of the face amount of notes applied for.

3. Immediately after the closing hour tenders will be opened, following which public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Those submitting competitive tenders will be advised of the acceptance or rejection thereof. In considering the acceptance of tenders, those with the lowest yields will be accepted to the extent required to attain the amount offered. Tenders at the highest accepted yield will be prorated if necessary. After the determination is made as to which tenders are accepted, an interest rate will be established at the nearest ⅛ of 1 percent necessary to make the average accepted price 100.000 or less. That will be the rate of interest that will be paid on all of the notes. Based on such interest rate, the price on each competitive tender allotted will be determined and each successful competitive bidder will be required to pay the price corresponding to the yield bid. Price calculations will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, including the right to accept tenders for more or less than the $2,750,000,000 of notes offered to the public, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for $500,000 or less without stated yield from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive tenders.

IV. PAYMENT FOR AND DELIVERY OF NOTES

1. Settlement for accepted tenders in accordance with the bids must be made or completed on or before May 15, 1975, at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt. Payment must be in cash, notes referred to in Section I (interest coupons dated May 15, 1975, should be detached), in other funds immediately available to the Treasury by May 15, 1975, or by check drawn to the order of the Federal Reserve Bank to which the tender is submitted, or the United States Treasury if the tender is submitted to it, which must be received at such Bank or at the Treasury no later than: (1) Monday, May 12, 1975, if the check is drawn on a bank in the Federal Reserve District of the Bank to which the check is submitted, or the Fifth Federal Reserve District in case of the Treasury, or (2) Friday, May 9, 1975, if the check is drawn on a bank in another district. Checks received after the dates set forth in the preceding sentence will not be accepted unless they are payable at a Federal Reserve Bank. Payment will not be deemed to have been completed where registered notes are requested if the appropriate identifying number as required on tax returns and other documents submitted to the Internal Revenue Service (an individual's social security number or an employer identification number) is not furnished. In every case where full payment is not completed, the payment with

the tender up to 5 percent of the amount of notes allotted shall, upon declaration made by the Secretary of the Treasury in his discretion, be forfeited to the United States. When payment is made with notes, a cash adjustment will be made to or required of the bidder for any difference between the face amount of notes submitted and the amount payable on the notes allotted.

2. Delivery of notes in bearer form will be made on or about May 27, 1975. Purchasers of bearer notes may elect to receive interim certificates on May 15, 1975, which will be exchangeable for the notes when available at any Federal Reserve Bank or Branch or at the Bureau of the Public Debt, Washington, D.C. 20226. The interim certificates must be returned at the risk and expense of the holder.

V. ASSIGNMENT OF REGISTERED NOTES

1. Registered notes tendered as deposits and in payment for notes allotted hereunder are not required to be assigned if the notes are to be registered in the same names and forms as appear in the registrations or assignments of the notes surrendered. Specific instruction for the issuance and delivery of the notes, signed by the owner or his authorized representative, must accompany the notes presented. Otherwise, the notes should be assigned by the registered payees or assignees thereof in accordance with the general regulations governing United States securities, as hereinafter set forth. Notes to be registered in names and forms different from those in the inscriptions or assignments of the notes presented should be assigned to "The Secretary of the Treasury for Treasury Notes of Series E–1978 in the name of (name and taxpayer identifying number)." If notes in coupon form are desired, the assignment should be to "The Secretary of the Treasury for coupon Treasury Notes of Series E–1978 to be delivered to________________." Notes tendered in payment should be surrendered to the Federal Reserve Bank or Branch or to the Bureau of the Public Debt, Washington, D.C. 20226. The notes must be delivered at the expense and risk of the holder.

VI. GENERAL PROVISIONS

1. As fiscal agents of the United States, Federal Reserve Banks are authorized and requested to receive tenders, to make such allotments as may be prescribed by the Secretary of the Treasury, to issue such notices as may be necessary, to receive payment for and make delivery of notes on full-paid tenders allotted, and they may issue interim receipts pending delivery of the definitive notes.

2. The Secretary of the Treasury may at any time, or from time to time, prescribe supplemental or amendatory rules and regulations governing the offering, which will be communicated promptly to the Federal Reserve Banks.

WILLIAM E. SIMON,
Secretary of the Treasury.

SUPPLEMENT TO DEPARTMENT CIRCULAR NO. 13–75. PUBLIC DEBT

DEPARTMENT OF THE TREASURY,
Washington, May 7, 1975.

The Secretary of the Treasury announced on May 6, 1975, that the interest rate on the notes described in Department Circular—Public Debt Series—No. 13–75, dated May 2, 1975, will be 7⅝ percent per annum. Accordingly, the notes are hereby redesignated 7⅝ percent Treasury Notes of Series E–1978. Interest on the notes will be payable at the rate of 7⅝ percent per annum.

DAVID MOSSO,
Deputy Fiscal Assistant Secretary.

Summary of information pertaining to Treasury notes issued during fiscal year 1975

Date of preliminary announcement	Department circular No.	Department circular Date	Concurrent offering circular No.	Treasury notes issued (all auctioned for cash)	Type of auction [1]	Accepted tenders: Average price	Accepted tenders: High price	Accepted tenders: Low price	Minimum denomination	Issue date	Maturity date	Date tenders received	Payment date [2]
1974 July 31	8-74	*1974* Aug. 1	9-74, 10-74	9 percent Series D-1977	Price	101.00	[3] 101.28	100.86	$1,000	*1974* Aug. 15	May 15, 1977	*1974* Aug. 6	*1974* Aug. 15
July 31	9-74	Aug. 1	8-74, 10-74	9 percent Series B-1980	do	101.15	[3] 101.50	101.01	1,000	Aug. 15	Aug. 15, 1980	Aug. 7	Aug. 15
Sept. 16	11-74	Sept. 16		8¼ percent Series J-1976	Yield	99.84	[3] 100.09	99.75	10,000	Sept. 30	Sept. 30, 1976	Sept. 24	Sept. 30
Oct. 15	12-74	Oct. 15		7⅞ percent Series D-1979	do	99.937	[3] 100.349	99.787	1,000	Nov. 6	May 15, 1979	Oct. 23	Nov. 6
Oct. 30	13-74	Oct. 31	14-74, 15-74	7¾ percent Series E-1977	do	99.737	[3] 99.921	99.685	5,000	Nov. 15	Nov. 15, 1977	Nov. 6	Nov. 15
Oct. 30	14-74	Oct. 31	13-74, 15-74	7¾ percent Series B-1981	do	99.628	100.000	99.416	1,000	Nov. 15	Nov. 15, 1981	Nov. 7	Nov. 15
Dec. 13	16-74	Dec. 16		7¼ percent Series K-1976	do	99.872	[3] 100.183	99.781	5,000	Dec. 31	Dec. 31, 1976	Dec. 23	Dec. 31
Dec. 20	18-74	Dec. 23	17-74	7⅞ percent Series D-1979	Price	101.95	102.20	101.80	1,000	Nov. 6[4]	May 15, 1979	Dec. 30	*1975* Jan. 7
Dec. 20	17-74	Dec. 23	18-74	8 percent Series H-1976	do	100.84	[3] 100.91	100.80	5,000	Apr. 9[5]	Mar. 31, 1976	*1975* Jan. 2	Jan. 9
1975 Jan. 22	2-75	*1975* Jan. 23	3-75, 4-75	7⅛ percent Series D-1978	Yield	99.700	[3] 99.814	99.643	1,000	*1975* Feb. 18	May 15, 1978	Jan. 28	Feb. 18
Jan. 22	3-75	Jan. 23	2-75, 4-75	7⅜ percent Series C-1981	do	99.453	[3] 99.881	99.311	1,000	Feb. 18	Feb. 15, 1981	Jan. 29	Feb. 18
Feb. 11	5-75	Feb. 12	6-75	5⅞ percent Series L-1976	do	99.908	99.993	99.852	5,000	Mar. 3	Aug. 31, 1976	Feb. 19	Mar. 3
Feb. 11	6-75	Feb. 12	5-75	6 percent Series F-1977	do	99.834	100.056	99.778	5,000	Mar. 3	Feb. 28, 1977	Feb. 19	Mar. 3
Mar. 4	7-75	Mar. 5	8-75	7¾ percent Series B-1981	Price	101.21	[3] 101.51	101.07	1,000	*1974* Nov. 15[6]	Nov. 15, 1981	Mar. 11	Mar. 19
Mar. 4	8-75	Mar. 5	7-75	6 percent Series M-1976	Yield	99.991	100.082	99.957	5,000	*1975* Mar. 25	May 31, 1976	Mar. 13	Mar. 25
Mar. 12	9-75	Mar. 13	10-75	6½ percent Series G-1977	do	99.982	[3] 100.185	99.815	5,000	Mar. 31	Mar. 31, 1977	Mar. 18	Mar. 31
Mar. 25	11-75	Mar. 26		7⅛ percent Series N-1976	do	99.926	[3] 100.234	99.865	5,000	Apr. 8	Nov. 30, 1976	Apr. 1	Apr. 8
Apr. 9	12-75	Apr. 10		7⅜ percent Series H-1977	do	99.900	[3] 100.009	99.863	5,000	Apr. 30	Apr. 30, 1977	Apr. 15	Apr. 30
May 1	13-75	May 2	14-75, 15-75	7⅝ percent Series E-1978	do	99.717	[3] 100.001	99.604	5,000	May 15	Aug. 15, 1978	May 6	May 15
May 1	14-75	May 2	13-75, 15-75	8 percent Series A-1982	do	100.000	[3] 100.212	99.894	1,000	May 15	May 15, 1982	May 7	May 15
May 8	16-75	May 9		6¾ percent Series I-1977	do	99.794	[3] 99.924	99.683	5,000	May 27	May 31, 1977	May 14	May 27
May 15	17-75	May 16		6½ percent Series O-1976	do	99.947	100.158	99.895	5,000	June 6	Oct. 31, 1976	May 22	June 6
June 11	18-75	June 12		6½ percent Series J-1977	do	99.797	[3] 100.000	99.650	5,000	June 30	June 30, 1977	June 17	June 30

[1] Some issues of notes were auctioned by the "price" method, with the interest rate being announced prior to the auction, and bidders were required to bid a price. Other auctions were held by the "yield" method in which case bidders were required to bid a yield; after tenders were allotted, an interest rate for the notes was established at the nearest ⅛ of 1 percent necessary to make the average accepted price 100.000 or less.

[2] Payment could not be made through Treasury tax and loan accounts for any of the issues.

[3] Relatively small amounts of bids were accepted at a price or prices above the high shown. However, the higher price or prices are not shown in order to prevent an appreciable discontinuity in the range of prices, which would make it misrepresentative.

[4] Interest was payable from Jan. 7, 1975.

[5] Interest was payable from Jan. 9, 1975.

[6] Interest was payable from Mar. 19, 1975.

NOTE.—The maximum amount that could be bid for on a noncompetitive basis for each issue was $500,000.

Exhibit 2.—Treasury bonds

A Treasury circular and supplement covering an auction of Treasury bonds for cash are reproduced in this exhibit. Circulars pertaining to other bond offerings during fiscal 1975 are similar in form and therefore are not reproduced in this report. However, essential details for each offering are summarized in the table in this exhibit, and allotment data for the bonds will be shown in table 38 in the Statistical Appendix. During the year there were no offerings in which holders of maturing securities were given preemptive rights to exchange their holdings for new bonds.

DEPARTMENT CIRCULAR NO. 4–75. PUBLIC DEBT

DEPARTMENT OF THE TREASURY,
Washington, January 23, 1975.

I. INVITATION FOR TENDERS

1. The Secretary of the Treasury, pursuant to the authority of the Second Liberty Bond Act, as amended, invites tenders on a yield basis for $750,000,000, or thereabouts, of bonds of the United States, designated Treasury Bonds of 1995–2000. The interest rate for the bonds will be determined as set forth in Section III, paragraph 3, hereof. Additional amounts of these bonds may be issued at the average price of accepted tenders to Government accounts and to Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities. Tenders will be received up to 1:30 p.m., Eastern Standard time, Thursday, January 30, 1975, under competitive and noncompetitive bidding, as set forth in Section III hereof. The 5¾ percent Treasury Notes of Series A–1975 and 5⅞ percent Treasury Notes of Series E–1975, maturing February 15, 1975, will be accepted at par in payment, in whole or in part, to the extent tenders are allotted by the Treasury.

2. Defered payment for 50 percent of the amount of bonds allotted may be made as provided in Section IV hereof. Delivery of bearer bonds will be made on February 18, 1975, except that delivery of that portion of the bonds on which payment is deferred will be made on March 3, 1975.

II. DESCRIPTION OF BONDS

1. The bonds will be dated February 18, 1975, and will bear interest from that date, payable on a semiannual basis on August 15, 1975, and thereafter on February 15 and August 15 in each year until the principal amount becomes payable. They will mature February 15, 2000, but may be redeemed at the option of the United States on and after February 15, 1995, in whole or in part, at par and accrued interest on any interest day or days, on 4 months' notice of redemption given in such manner as the Secretary of the Treasury shall prescribe. In case of partial redemption, the bonds to be redeemed will be determined by such method as may be prescribed by the Secretary of the Treasury. From the date of redemption designated in any such notice, interest on the bonds called for redemption shall cease.

2. The income derived from the bonds is subject to all taxes imposed under the Internal Revenue Code of 1954. The bonds are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority.

3. The bonds will be acceptable to secure deposits of public moneys. They will not be acceptable in payment of taxes.

4. Bearer bonds with interest coupons attached, and bonds registered as to principal and interest, will be issued in denominations of $1,000, $5,000, $10,000, $100,000 and $1,000,000. Book-entry bonds will be available to eligible bidders in multiples of those amounts. Interchanges of bonds of different denominations and of coupon and registered bonds, and the transfer of registered bonds will be permitted.

5. The bonds will be subject to the general regulations of the Department of the Treasury, now or hereafter prescribed, governing United States bonds.

III. TENDERS AND ALLOTMENTS

1. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D.C. 20226, up to the closing hour, 1:30 p.m., Eastern Standard time, Thursday, January 30, 1975. Each tender must state the face amount of bonds bid for, which must be $1,000 or a multiple thereof, and the yield desired, except that in the case of noncompetitive tenders the term "noncompetitive" should be used in lieu of a yield. In the case of competitive tenders, the yield must be expressed in terms of an annual yield with two decimals, e.g., 7.11. Fractions may not be used. Noncompetitive tenders from any one bidder may not exceed $500,000.

2. Commercial banks, which for this purpose are defined as banks accepting demand deposits, may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others than commercial banks will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from banking institutions for their own account, Federally-insured savings and loan associations, States, political subdivisions or instrumentalities thereof, public pension and retirement and other public funds, international organizations in which the United States holds membership, foreign central banks and foreign States, dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions with respect to Government securities and borrowings thereon, and Government accounts. Tenders from others must be accompanied by payment (in cash or the notes referred to in Section I which will be accepted at par) of 5 percent of the face amount of bonds applied for.

3. Immediately after the closing hour tenders will be opened, following which public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Those submitting competitive tenders will be advised of the acceptance or rejection thereof. In considering the acceptance of tenders, those with the lowest yields will be accepted to the extent required to attain the amount offered. Tenders at the highest accepted yield will be prorated if necessary. After the determination is made as to which tenders are accepted, an interest rate will be established at the nearest ⅛ of one percent necessary to make the average accepted price 100.00 or less. That will be the rate of interest that will be paid on all of the bonds. Based on such interest rate, the price on each competitive tender allotted will be determined and each successful competitive bidder will be required to pay the price corresponding to the yield bid. Price calculations will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, including the right to accept tenders for more or less than the $750,000,000 of bonds offered to the public, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for $500,000 or less without stated yield from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive tenders.

4. All bidders are required to agree not to purchase or sell, or to make any agreements with respect to the purchase or sale or other disposition of any bonds of this issue at a specific rate or price, until after 1:30 p.m., Eastern Standard time, Thursday, January 30, 1975.

5. Commercial banks in submitting tenders will be required to certify that they have no beneficial interest in any of the tenders they enter for the account of their customers, and that their customers have no beneficial interest in the banks' tenders for their own account.

IV. PAYMENT

1. Settlement for accepted tenders in accordance with the bids must be made or completed on or before February 18, 1975, at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt, except that a bidder may elect to defer payment for not more than 50 percent of the amount of bonds allotted until March 3, 1975. Payment must be in cash, notes referred to in Section I (interest coupons dated February 15, 1975, should be detached), in other funds immediately available to the Treasury by February 18, or by check drawn to the order of the Federal Reserve Bank to which the tender is submitted, or the United States Treasury if the tender is submitted to it, which must be received at such Bank or at the Treasury no later than: (1) Tuesday, February 11, 1975,

if the check is drawn on a bank in the Federal Reserve District of the Bank to which the check is submitted, or the Fifth Federal Reserve District in the case of the Treasury, or (2) Monday, February 10, 1975, if the check is drawn on a bank in another district. Checks received after the dates set forth in the preceding sentence will not be accepted unless they are payable at a Federal Reserve Bank. Accrued interest from February 18 to March 3, 1975, will be charged on the face amount of bonds on which payment is deferred, at the coupon yield established for the bonds. Where partial payment for bonds allotted is to be deferred, delivery of 5 percent of the total par amount of bonds allotted, adjusted to the next higher $1,000, will be withheld from all bidders required to submit a 5 percent payment with tenders, until payment for the total amount allotted has been completed. Payment will not be deemed to have been completed where registered bonds are requested if the appropriate identifying number as required on tax returns and other documents submitted to the Internal Revenue Service (an individual's social security number or an employer identification number) is not furnished. In every case where full payment is not completed, the payment with the tender up to 5 percent of the amount of bonds allotted shall, upon declaration made by the Secretary of the Treasury in his discretion, be forfeited to the United States. When payment is made with notes, a cash adjustment will be made to or required of the bidder for any difference between the face amount of notes submitted and the amount payable on the bonds allotted.

V. ASSIGNMENT OF REGISTERED NOTES

1. Registered notes tendered as deposits and in payment for bonds allotted hereunder are not required to be assigned if the bonds are to be registered in the same names and forms as appear in the registrations or assignments of the notes surrendered. Specific instructions for the issuance and delivery of the bonds, signed by the owner or his authorized representative, must accompany the notes presented. Otherwise, the notes should be assigned by the registered payees or assignees thereof in accordance with the general regulations governing United States securities, as hereinafter set forth. Bonds to be registered in names and forms different from those in the inscriptions or assignments of the notes presented should be assigned to "The Secretary of the Treasury for Treasury Bonds of 1995–2000 in the name of (name and taxpayer identifying number)." If bonds in coupon form are desired, the assignment should be to "The Secretary of the Treasury for coupon Treasury Bonds of 1995–2000 to be delivered to ____." Notes tendered in payment should be surrendered to the Federal Reserve Bank or Branch or to the Bureau of the Public Debt, Washington, D.C. 20226. The notes must be delivered at the expense and risk of the holder.

VI. GENERAL PROVISIONS

1. As fiscal agents of the United States, Federal Reserve Banks are authorized and requested to receive tenders, to make such allotments as may be prescribed by the Secretary of the Treasury, to issue such notices as may be necessary, to receive payment for and make delivery of bonds on full-paid tenders allotted, and they may issue interim receipts pending delivery of the definitive bonds.
2. The Secretary of the Treasury may at any time, or from time to time, prescribe supplemental or amendatory rules and regulations governing the offering, which will be communicated promptly to the Federal Reserve Banks.

WILLIAM E. SIMON,
Secretary of the Treasury.

SUPPLEMENT TO DEPARTMENT CIRCULAR NO. 4–75. PUBLIC DEBT

DEPARTMENT OF THE TREASURY,
Washington, January 31, 1975.

The Secretary of the Treasury announced on January 30, 1975, that the interest rate on the bonds described in Department Circular—Public Debt Series—No. 4–75, dated January 23, 1975, will be 7⅞ percent per annum. Accordingly, the bonds are hereby redesignated 7⅞ percent Treasury Bonds of 1995–2000. Interest on the bonds will be payable at the rate of 7⅞ percent per annum.

JOHN K. CARLOCK,
Fiscal Assistant Secretary.

Summary of information pertaining to Treasury bonds issued during fiscal year 1975

Date of preliminary announcement	Department circular No.	Department circular Date	Concurrent offering circular No.	Treasury bonds issued (all auctioned for cash)	Type of auction [1]	Accepted tenders: Average price	Accepted tenders: High price	Accepted tenders: Low price	Issue date	Maturity date	Date tenders received	Payment date [2]
1974		*1974*							*1974*		*1974*	*1974*
July 31	10-74	Aug. 1	8-74, 9-74	8½ percent of 1994-99	Price	98.70	[3] 99.76	98.00	May 15 [4]	May 15, 1999	Aug. 8	Aug. 15
Oct. 30	15-74	Oct. 31	13-74, 14-74	8½ percent of 1994-99	do	103.04	103.50	102.79	May 15 [5]	do	Nov. 8	[6] Nov. 15
1975		*1975*							*1975*		*1975*	*1975*
Jan. 22	4-75	Jan. 23	2-75, 3-75	7⅞ percent of 1995-2000	Yield	99.191	99.837	99.084	Feb. 18	Feb. 15, 2000	Jan. 30	[7] Feb. 18
Mar. 12	10-75	Mar. 13	9-75	8¼ percent of 1990	do	99.455	[3] 100.826	98.947	Apr. 7	May 15, 1990	Mar. 20	Apr. 7
May 1	15-75	May 2	13-75, 14-75	8¼ percent of 2000-05	do	99.450	[3] 100.000	99.232	May 15	May 15, 2005	May 8	[8] May 15

[1] Some issues of bonds were auctioned by the "price" method, with the interest rate being announced prior to the auction, and bidders were required to bid a price. Other auctions were held by the "yield" method in which bidders were required to bid a yield; after tenders were allotted, an interest rate for the bonds was established at the nearest ⅛ of 1 percent necessary to make the average accepted price 100.000 or less.

[2] Payment could not be made through Treasury tax and loan accounts for any of the issues.

[3] Relatively small amounts of bids were allotted at a price or prices above the high shown. However, the higher price or prices are not shown in order to prevent an appreciable discontinuity in the range of prices, which would make it misrepresentative.

[4] Interest was payable from Aug. 15, 1974.

[5] Interest was payable from Nov. 15, 1974.

[6] Payment could be deferred until Dec. 3, 1974, for not more than 50 percent of the amount of bonds allotted.

[7] Payment could be deferred until Mar. 3, 1975, for not more than 50 percent of the amount of bonds allotted.

[8] Payment could be deferred until June 2, 1975, for up to 100 percent of the amount of bonds allotted.

NOTE.—The maximum amount that could be bid for on a noncompetitive basis for each issue was $500,000. All issues had a minimum denomination of $1,000.

Exhibit 3.—Treasury bills

During the fiscal year there were 52 weekly issues of 13-week and 26-week bills (the 13-week bills represent additional amounts of bills with an original maturity of 26 weeks), 13 52-week issues, 1 299-day issue, 1 292-day issue, 1 227-day issue, 3 issues of tax anticipation series, and an issue of a strip of weekly bills. A press release inviting tenders is reproduced in this exhibit and is representative of all such releases. Also reproduced is a press release which is representative of releases announcing the results of offerings. Data for each issue during the fiscal year appears in table 39 in the Statistical Appendix.

PRESS RELEASE OF MAY 27, 1975

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $5,500,000,000, or thereabouts, to be issued June 5, 1975, as follows:

91-day bills (to maturity date) in the amount of $2,800,000,000, or thereabouts, representing an additional amount of bills dated March 6, 1975, and to mature September 4, 1975 (CUSIP No. 912793 XM3), originally issued in the amount of $2,500,980,000, the additional and original bills to be freely interchangeable.

182-day bills, for $2,700,000,000, or thereabouts, to be dated June 5, 1975, and to mature December 4, 1975 (CUSIP No. 912793 YA8).

The bills will be issued for cash and in exchange for Treasury bills maturing June 5, 1975, outstanding in the amount of $4,805,505,000, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,314,740,000. These accounts may exchange bills they hold for the bills now being offered at the average prices of accepted tenders.

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their face amount will be payable without interest. They will be issued in bearer form in denominations of $10,000, $15,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value), and in book-entry form to designated bidders.

Tenders will be received at Federal Reserve Banks and Branches up to one-thirty p.m., Eastern Daylight Savings time, Monday, June 2, 1975. Tenders will not be received at the Department of the Treasury, Washington. Each tender must be for a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. In the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions with respect to Government securities and borrowings thereon may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Those submitting competitive tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for each issue for $500,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids for the respective issues. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank or Branch on June 5, 1975, in cash or other immediately available funds or in a like face amount of Treasury bills maturing June 5, 1975. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which bills issued hereunder are sold is considered to accrue when the bills are sold, redeemed or otherwise disposed of, and the bills are excluded from consideration as capital assets. Accordingly, the owner of bills (other than life insurance companies) issued hereunder must include in his Federal income tax return, as ordinary gain or loss, the difference between the price paid for the bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made.

Department of the Treasury Circular No. 418 (current revision) and this notice prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or Branch.

PRESS RELEASE OF JUNE 2, 1975

Tenders for $2.8 billion of 13-week Treasury bills and for $2.7 billion of 26-week Treasury bills, both series to be issued on June 5, 1975, were opened at the Federal Reserve Banks today. The details are as follows:

Range of accepted competitive bids	13-week bills maturing Sept. 4, 1975			26-week bills maturing Dec. 4, 1975		
	Price	Discount rate	Investment rate [1]	Price	Discount rate	Investment rate [1]
			Percent			*Percent*
High	[2] 98.680	5.222	5.38	97.260	5.420	5.67
Low	[3] 98.664	5.285	5.45	[4] 97.198	5.542	5.80
Average	98.671	5.258	5.42	97.217	5.505	5.76

[1] Equivalent coupon-issue yield.
[2] Excepting one tender of $30,000.
[3] Tenders at the low price for the 13-week bills were allotted 24 percent.
[4] Tenders at the low price for the 26-week bills were allotted 91 percent.

Total tenders applied for and accepted by Federal Reserve districts

District	13-week bills		26-week bills	
	Received	Accepted	Received	Accepted
Boston	$45,745,000	$27,595,000	$18,950,000	$8,950,000
New York	3,946,285,000	1,724,080,000	3,268,815,000	2,278,015,000
Philadelphia	39,865,000	39,865,000	7,825,000	7,700,000
Cleveland	140,090,000	47,450,000	44,615,000	39,615,000
Richmond	34,560,000	25,360,000	9,885,000	9,885,000
Atlanta	35,190,000	29,940,000	55,770,000	45,770,000
Chicago	321,280,000	87,180,000	199,935,000	149,485,000
St. Louis	45,825,000	31,305,000	27,090,000	17,590,000
Minneapolis	27,765,000	18,965,000	22,880,000	22,380,000
Kansas City	44,295,000	39,260,000	23,565,000	21,065,000
Dallas	30,825,000	21,825,000	18,285,000	18,285,000
San Francisco	903,215,000	708,415,000	199,350,000	81,450,000
Total	5,614,940,000	[1] 2,801,240,000	3,896,965,000	[2] 2,700,190,000

[1] Includes $445,850,000 noncompetitive tenders from the public.
[2] Includes $158,420,000 noncompetitive tenders from the public.

Exhibit 4.—Department Circular, Public Debt Series No. 1–63, January 10, 1963, Amendment, regulations governing United States retirement plan bonds

DEPARTMENT OF THE TREASURY,
Washington, October 2, 1974.

LIMITATION ON HOLDING

Section 341.5 of Department of the Treasury Circular, Public Debt Series No. 1–63, dated January 10, 1963, as amended (31 CFR Part 341), is hereby further amended to prescribe a higher limitation on holdings. As so amended it reads as follows:

§ 341.5 Limitation on holdings.

The limit on the amount of any Retirement Plan Bonds issued during 1974, or in any one calendar year thereafter, that may be purchased in the name of any one person as registered owner is $10,000 (face value).

* * * * * * *

(Sections 1 and 20, Second Liberty Bond Act, as amended, 40 Stat. 288, 48 Stat. 343, both as amended (31 U.S.C. 752, 754b); (5 U.S.C. 301))

The foregoing amendment was effected for the purpose of increasing the limitation on holdings of United States Retirement Plan Bonds. Notice and public procedures thereon are unnecessary as the fiscal and tax policies of the United States are involved.

JOHN K. CARLOCK,
Fiscal Assistant Secretary.

Exhibit 5.—Department Circular No. 653, Ninth Revision, March 18, 1974, First Supplement, offering of United States savings bonds, Series E

DEPARTMENT OF THE TREASURY,
Washington, January 3, 1975.

The purpose of this first supplement to Department of the Treasury Circular No. 653, Ninth Revision, dated March 18, 1974 (31 CFR Part 316), is to show the redemption values and investment yields for the next extended maturity period for United States Savings Bonds of Series E bearing issue dates of (1) June 1 through November 1, 1945, (2) June 1 through September 1, 1955, (3) October 1 through November 1, 1955, (4) June 1 through November 1, 1968, and (5) June 1 through November 1, 1969. Accordingly, in § 316.14 the tables to the circular are hereby supplemented by the addition of Tables 12–A, 39–A, 40–A, 86–A and 88–A.

Dated: December 24, 1974.

JOHN K. CARLOCK,
Fiscal Assistant Secretary.

§ 316.14 Reservations as to terms of offer.

TABLE 12-A.—*Bonds bearing issue dates from June 1 through Nov. 1, 1945*

Issue price	$7.50	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	Approximate investment yield (annual percentage rate)		
Denomination	10.00	25.00	50.00	100.00	200.00	500.00	1,000.00			
Period (years and months after 2d extended maturity at 30 yrs. 0 mos.)	(1) Redemption values during each half-year period (values increase on 1st day of period)* THIRD EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each half-year period	(3) From beginning of each half-year period to beginning of next half-year period	(4) From beginning of each half-year period to 3d extended maturity
								Percent	*Percent*	*Percent*
0-0 to 0-6 [1] (6/1/75)	$22.46	$56.15	$112.30	$224.60	$449.20	$1,123.00	$2,246.00	....	5.98	6.00
0-6 to 1-0 (12/1/75)	23.13	57.83	115.66	231.32	462.64	1,156.60	2,313.20	5.98	6.02	6.00
1-0 to 1-6 (6/1/76)	23.83	59.57	119.14	238.28	476.56	1,191.40	2,382.80	6.00	6.01	6.00
1-6 to 2-0 (12/1/76)	24.54	61.36	122.72	245.44	490.88	1,227.20	2,454.40	6.00	6.00	6.00
2-0 to 2-6 (6/1/77)	25.28	63.20	126.40	252.80	505.60	1,264.00	2,528.00	6.00	5.98	6.00
2-6 to 3-0 (12/1/77)	26.04	65.09	130.18	260.36	520.72	1,301.80	2,603.60	6.00	6.02	6.00
3-0 to 3-6 (6/1/78)	26.82	67.05	134.10	268.20	536.40	1,341.00	2,682.00	6.00	6.00	6.00
3-6 to 4-0 (12/1/78)	27.62	69.06	138.12	276.24	552.48	1,381.20	2,762.40	6.00	5.99	6.00
4-0 to 4-6 (6/1/79)	28.45	71.13	142.26	284.52	569.04	1,422.60	2,845.20	6.00	5.99	6.00
4-6 to 5-0 (12/1/79)	29.30	73.26	146.52	293.04	586.08	1,465.20	2,930.40	6.00	6.01	6.00
5-0 to 5-6 (6/1/80)	30.18	75.46	150.92	301.84	603.68	1,509.20	3,018.40	6.00	5.99	6.00
5-6 to 6-0 (12/1/80)	31.09	77.72	155.44	310.88	621.76	1,554.40	3,108.80	6.00	6.02	6.00
6-0 to 6-6 (6/1/81)	32.02	80.06	160.12	320.24	640.48	1,601.20	3,202.40	6.00	6.00	6.00
6-6 to 7-0 (12/1/81)	32.98	82.46	164.92	329.84	659.68	1,649.20	3,298.40	6.00	5.99	6.00
7-0 to 7-6 (6/1/82)	33.97	84.93	169.86	339.72	679.44	1,698.60	3,397.20	6.00	6.00	6.00
7-6 to 8-0 (12/1/82)	34.99	87.48	174.96	349.92	699.84	1,749.60	3,499.20	6.00	5.99	6.00
8-0 to 8-6 (6/1/83)	36.04	90.10	180.20	360.40	720.80	1,802.00	3,604.00	6.00	6.02	6.00
8-6 to 9-0 (12/1/83)	37.12	92.81	185.62	371.24	742.48	1,856.20	3,712.40	6.00	5.99	6.00
9-0 to 9-6 (6/1/84)	38.24	95.59	191.18	382.36	764.72	1,911.80	3,823.60	6.00	6.00	6.00
9-6 to 10-0 (12/1/84)	39.38	98.46	196.92	393.84	787.68	1,969.20	3,938.40	6.00	5.99	5.99
10-0 [2] (6/1/85)	40.56	101.41	202.82	405.64	811.28	2,028.20	4,056.40	[3] 6.00	....	....

[1] Month, day, and year on which issues of June 1, 1945, enter each period. For subsequent issue months add the appropriate number of months.
[2] Third extended maturity value reached at 40 yrs. and 0 mos. after issue.
[3] Yield on purchase price from issue date to 3d extended maturity date is 4.26 percent.
*For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
**This table does not apply if the prevailing rate for series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 39-A.—*Bonds bearing issue dates from June 1 through Sept. 1, 1955*

Period (years and months after 1st extended maturity at 19 yrs. 8 mos.)								Approximate investment yield (annual percentage rate)		
Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7,500			
Denomination	25.00	50.00	100.00	200.00	500.00	1,000.00	10,000			
	(1) Redemption values during each half-year period (values increase on 1st day of period)* — SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each half-year period	(3) From beginning of each half-year period to beginning of next half-year period	(4) From beginning of each half-year period to 2d extended maturity
								Percent	*Percent*	*Percent*
0-0 to 0-6 [1] (2/1/75)	$40.93	$81.86	$163.72	$327.44	$818.60	$1,637.20	$16,372		6.01	6.00
0-6 to 1-0 (8/1/75)	42.16	84.32	168.64	337.28	843.20	1,686.40	16,864	6.01	5.98	6.00
1-0 to 1-6 (2/1/76)	43.42	86.84	173.68	347.36	868.40	1,736.80	17,368	5.99	6.03	6.00
1-6 to 2-0 (8/1/76)	44.73	89.46	178.92	357.84	894.60	1,789.20	17,892	6.01	5.99	6.00
2-0 to 2-6 (2/1/77)	46.07	92.14	184.28	368.56	921.40	1,842.80	18,428	6.00	5.99	6.00
2-6 to 3-0 (8/1/77)	47.45	94.90	189.80	379.60	949.00	1,898.00	18,980	6.00	5.99	6.00
3-0 to 3-6 (2/1/78)	48.87	97.74	195.48	390.96	977.40	1,954.80	19,548	6.00	6.02	6.00
3-6 to 4-0 (8/1/78)	50.34	100.68	201.36	402.72	1,006.80	2,013.60	20,136	6.00	6.00	6.00
4-0 to 4-6 (2/1/79)	51.85	103.70	207.40	414.80	1,037.00	2,074.00	20,740	6.00	5.98	6.00
4-6 to 5-0 (8/1/79)	53.40	106.80	213.60	427.20	1,068.00	2,136.00	21,360	6.00	6.03	6.00
5-0 to 5-6 (2/1/80)	55.01	110.02	220.04	440.08	1,100.20	2,200.40	22,004	6.00	6.00	6.00
5-6 to 6-0 (8/1/80)	56.66	113.32	226.64	453.28	1,133.20	2,266.40	22,664	6.00	6.00	6.00
6-0 to 6-6 (2/1/81)	58.36	116.72	233.44	466.88	1,167.20	2,334.40	23,344	6.00	6.00	6.00
6-6 to 7-0 (8/1/81)	60.11	120.22	240.44	480.88	1,202.20	2,404.40	24,044	6.00	5.99	6.00
7-0 to 7-6 (2/1/82)	61.91	123.82	247.64	495.28	1,238.20	2,476.40	24,764	6.00	6.01	6.00
7-6 to 8-0 (8/1/82)	63.77	127.54	255.08	510.16	1,275.40	2,550.80	25,508	6.00	5.99	6.00
8-0 to 8-6 (2/1/83)	65.68	131.36	262.72	525.44	1,313.60	2,627.20	26,272	6.00	6.00	6.00
8-6 to 9-0 (8/1/83)	67.65	135.30	270.60	541.20	1,353.00	2,706.00	27,060	6.00	6.00	6.00
9-0 to 9-6 (2/1/84)	69.68	139.36	278.72	557.44	1,393.60	2,787.20	27,872	6.00	6.00	6.00
9-6 to 10-0 (8/1/84)	71.77	143.54	287.08	574.16	1,435.40	2,870.80	28,708	6.00	5.99	5.99
10-0 [2] (2/1/85)	73.92	147.84	295.68	591.36	1,478.40	2,956.80	29,568	[3] 6.00		

[1] Month, day, and year on which issues of June 1, 1955, enter each period. For subsequent issue months add the appropriate number of months.

[2] Second extended maturity value reached at 29 yrs. 8 mos. after issue.

[3] Yield on purchase price from issue date to 2d extended maturity date is 4.68 percent.

*For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.

**This table does not apply if the prevailing rate for series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 40-A.—*Bonds bearing issue date Oct. 1 or Nov. 1, 1955*

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7,500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1,000.00	10,000			
Period (years and months after 1st extended maturity at 19 yrs. 8 mos.)	(1) Redemption values during each half-year period (values increase on 1st day of period)* SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each half-year period	(3) From beginning of each half-year period to beginning of next half-year period	(4) From beginning of each half-year period to 2d extended maturity
								Percent	*Percent*	*Percent*
0-0 to 0-6 [1](6/1/75)	$41.38	$82.76	$165.52	$331.04	$827.60	$1,655.20	$16,552		5.99	6.00
0-6 to 1-0 (12/1/75)	42.62	85.24	170.48	340.96	852.40	1,704.80	17,048	5.99	6.01	6.00
1-0 to 1-6 (6/1/76)	43.90	87.80	175.60	351.20	878.00	1,756.00	17,560	6.00	6.01	6.00
1-6 to 2-0 (12/1/76)	45.22	90.44	180.88	361.76	904.40	1,808.80	18,088	6.00	5.97	6.00
2-0 to 2-6 (6/1/77)	46.57	93.14	186.28	372.56	931.40	1,862.80	18,628	6.00	6.01	6.00
2-6 to 3-0 (12/1/77)	47.97	95.94	191.88	383.76	959.40	1,918.80	19,188	6.00	6.00	6.00
3-0 to 3-6 (6/1/78)	49.41	98.82	197.64	395.28	988.20	1,976.40	19,764	6.00	5.99	6.00
3-6 to 4-0 (12/1/78)	50.89	101.78	203.56	407.12	1,017.80	2,035.60	20,356	6.00	6.01	6.00
4-0 to 4-6 (6/1/79)	52.42	104.84	209.68	419.36	1,048.40	2,096.80	20,968	6.00	5.99	6.00
4-6 to 5-0 (12/1/79)	53.99	107.98	215.96	431.92	1,079.80	2,159.60	21,596	6.00	6.00	6.00
5-0 to 5-6 (6/1/80)	55.61	111.22	222.44	444.88	1,112.20	2,224.40	22,244	6.00	6.01	6.00
5-6 to 6-0 (12/1/80)	57.28	114.56	229.12	458.24	1,145.60	2,291.20	22,912	6.00	6.01	6.00
6-0 to 6-6 (6/1/81)	59.00	118.00	236.00	472.00	1,180.00	2,360.00	23,600	6.00	6.00	6.00
6-6 to 7-0 (12/1/81)	60.77	121.54	243.08	486.16	1,215.40	2,430.80	24,308	6.00	5.99	6.00
7-0 to 7-6 (6/1/82)	62.59	125.18	250.36	500.72	1,251.80	2,503.60	25,036	6.00	6.01	6.00
7-6 to 8-0 (12/1/82)	64.47	128.94	257.88	515.76	1,289.40	2,578.80	25,788	6.00	5.99	6.00
8-0 to 8-6 (6/1/83)	66.40	132.80	265.60	531.20	1,328.00	2,656.00	26,560	6.00	5.99	6.00
8-6 to 9-0 (12/1/83)	68.39	136.78	273.56	547.12	1,367.80	2,735.60	27,356	6.00	6.02	6.01
9-0 to 9-6 (6/1/84)	70.45	140.90	281.80	563.60	1,409.00	2,818.00	28,180	6.00	5.99	6.00
9-6 to 10-0 (12/1/84)	72.56	145.12	290.24	580.48	1,451.20	2,902.40	29,024	6.00	6.01	6.01
10-0 [2] (6/1/85)	74.74	149.48	298.96	597.92	1,494.80	2,989.60	29,896	[3] 6.00		

[1] Month, day, and year on which issues of Oct. 1, 1955, enter each period. For issues of Nov. 1, 1955, add 1 month.

[2] Second extended maturity value reached at 29 yrs. 8 mos. after issue.

[3] Yield on purchase price from issue date to 2d extended maturity date is 4.72 percent.

*For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.

**This table does not apply if the prevailing rate for series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 86-A.—*Bonds bearing issue dates from June 1 through Nov. 1, 1968*

Issue price	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$7,500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	75.00	100.00	200.00	500.00	1,000.00	10,000			
Period (years and months after original maturity at 7 yrs. 0 mos.)	(1) Redemption values during each half-year period (values increase on 1st day of period)* EXTENDED MATURITY PERIOD**								(2) From beginning of current maturity period to beginning of each half-year period	(3) From beginning of each half-year period to beginning of next half-year period	(4) From beginning of each half-year period to extended maturity
									Percent	*Percent*	*Percent*
0-0 to 0-6 [1](6/1/75)	$26.81	$53.62	$80.43	$107.24	$214.48	$536.20	$1,072.40	$10,724		5.97	6.00
0-6 to 1-0 (12/1/75)	27.61	55.22	82.83	110.44	220.88	552.20	1,104.40	11,044	5.97	6.01	6.00
1-0 to 1-6 (6/1/76)	28.44	56.88	85.32	113.76	227.52	568.80	1,137.60	11,376	5.99	6.05	6.00
1-6 to 2-0 (12/1/76)	29.30	58.60	87.90	117.20	234.40	586.00	1,172.00	11,720	6.01	5.94	6.00
2-0 to 2-6 (6/1/77)	30.17	60.34	90.51	120.68	241.36	603.40	1,206.80	12,068	5.99	6.03	6.00
2-6 to 3-0 (12/1/77)	31.08	62.16	93.24	124.32	248.64	621.60	1,243.20	12,432	6.00	5.98	6.00
3-0 to 3-6 (6/1/78)	32.01	64.02	96.03	128.04	256.08	640.20	1,280.40	12,804	6.00	6.00	6.00
3-6 to 4-0 (12/1/78)	32.97	65.94	98.91	131.88	263.76	659.40	1,318.80	13,188	6.00	6.01	6.00
4-0 to 4-6 (6/1/79)	33.96	67.92	101.88	135.84	271.68	679.20	1,358.40	13,584	6.00	6.01	6.00
4-6 to 5-0 (12/1/79)	34.98	69.96	104.94	139.92	279.84	699.60	1,399.20	13,992	6.00	6.00	6.00
5-0 to 5-6 (6/1/80)	36.03	72.06	108.09	144.12	288.24	720.60	1,441.20	14,412	6.00	6.00	6.00
5-6 to 6-0 (12/1/80)	37.11	74.22	111.33	148.44	296.88	742.20	1,484.40	14,844	6.00	5.98	6.00
6-0 to 6-6 (6/1/81)	38.22	76.44	114.66	152.88	305.76	764.40	1,528.80	15,288	6.00	6.02	6.00
6-6 to 7-0 (12/1/81)	39.37	78.74	118.11	157.48	314.96	787.40	1,574.80	15,748	6.00	5.99	6.00
7-0 to 7-6 (6/1/82)	40.55	81.10	121.65	162.20	324.40	811.00	1,622.00	16,220	6.00	6.02	6.00
7-6 to 8-0 (12/1/82)	41.77	83.54	125.31	167.08	334.16	835.40	1,670.80	16,708	6.00	5.99	6.00
8-0 to 8-6 (6/1/83)	43.02	86.04	129.06	172.08	344.16	860.40	1,720.80	17,208	6.00	6.00	6.00
8-6 to 9-0 (12/1/83)	44.31	88.62	132.93	177.24	354.48	886.20	1,772.40	17,724	6.00	6.00	6.00
9-0 to 9-6 (6/1/84)	45.64	91.28	136.92	182.56	365.12	912.80	1,825.60	18,256	6.00	6.00	6.00
9-6 to 10-0 (12/1/84)	47.01	94.02	141.03	188.04	376.08	940.20	1,880.40	18,804	6.00	6.00	6.00
10-0 [2] (6/1/85)	48.42	96.84	145.26	193.68	387.36	968.40	1,936.80	19,368	[3] 6.00		

[1] Month, day, and year on which issues of June 1, 1968, enter each period. For subsequent issue months add the appropriate number of months.
[2] Extended maturity value reached at 17 yrs. 0 mos. after issue.
[3] Yield on purchase price from issue date to extended maturity date is 5.66 percent.

*For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
**This table does not apply if the prevailing rate for series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 88-A.—*Bonds bearing issue dates from June 1 through Nov. 1, 1969*

Issue price	$18.75	$37.50	$56.25	$75.00	$150.00	$375.000	$750.000	$7,500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	75.00	100.00	200.00	500.00	1,000.00	10,000			
Period (years and months after original maturity at 5 yrs. 10 mos.)	(1) Redemption values during each half-year period (values increase on 1st day of period)* EXTENDED MATURITY PERIOD**								(2) From beginning of current maturity period to beginning of each half-year period	(3) From beginning of each half-year period to beginning of next half-year period	(4) From beginning of each half-year period to extended maturity
									Percent	Percent	Percent
0-0 to 0-6 [1] (4/1/75)	$25.77	$51.54	$77.31	$103.08	$206.16	$515.40	$1,030.80	$10,308	----------------	5.98	6.00
0-6 to 1-0 (10/1/75)	26.54	53.08	79.62	106.16	212.32	530.80	1,061.60	10,616	5.98	6.03	6.00
1-0 to 1-6 (4/1/76)	27.34	54.68	82.02	109.36	218.72	546.80	1,093.60	10,936	6.00	6.00	6.00
1-6 to 2-0 (10/1/76)	28.16	56.32	84.48	112.64	225.28	563.20	1,126.40	11,264	6.00	5.97	6.00
2-0 to 2-6 (4/1/77)	29.00	58.00	87.00	116.00	232.00	580.00	1,160.00	11,600	5.99	6.00	6.00
2-6 to 3-0 (10/1/77)	29.87	59.74	89.61	119.48	238.96	597.40	1,194.80	11,948	5.99	6.03	6.00
3-0 to 3-6 (4/1/78)	30.77	61.54	92.31	123.08	246.16	615.40	1,230.80	12,308	6.00	5.98	6.00
3-6 to 4-0 (10/1/78)	31.69	63.38	95.07	126.76	253.52	633.80	1,267.60	12,676	6.00	6.00	6.00
4-0 to 4-6 (4/1/79)	32.64	65.28	97.92	130.56	261.12	652.80	1,305.60	13,056	6.00	6.00	6.00
4-6 to 5-0 (10/1/79)	33.62	67.24	100.86	134.48	268.96	672.40	1,344.80	13,448	6.00	6.01	6.00
5-0 to 5-6 (4/1/80)	34.63	69.26	103.89	138.52	277.04	692.60	1,385.20	13,852	6.00	6.01	6.00
5-6 to 6-0 (10/1/80)	35.67	71.34	107.01	142.68	285.36	713.40	1,426.80	14,268	6.00	6.00	6.00
6-0 to 6-6 (4/1/81)	36.74	73.48	110.22	146.96	293.92	734.80	1,469.60	14,696	6.00	5.99	6.00
6-6 to 7-0 (10/1/81)	37.84	75.68	113.52	151.36	302.72	756.80	1,513.60	15,136	6.00	6.03	6.00
7-0 to 7-6 (4/1/82)	38.98	77.96	116.94	155.92	311.84	779.60	1,559.20	15,592	6.00	6.00	6.00
7-6 to 8-0 (10/1/82)	40.15	80.30	120.45	160.60	321.20	803.00	1,606.00	16,060	6.00	5.98	6.00
8-0 to 8-6 (4/1/83)	41.35	82.70	124.05	165.40	330.80	827.00	1,654.00	16,540	6.00	6.00	6.00
8-6 to 9-0 (10/1/83)	42.59	85.18	127.77	170.36	340.72	851.80	1,703.60	17,036	6.00	6.01	6.00
9-0 to 9-6 (4/1/84)	43.87	87.74	131.61	175.48	350.96	877.40	1,754.80	17,548	6.00	6.02	6.00
9-6 to 10-0 (10/1/84)	45.19	90.38	135.57	180.76	361.52	903.80	1,807.60	18,076	6.00	5.97	5.97
10-0 [2] (4/1/85)	46.54	93.08	139.62	186.16	372.32	930.80	1,861.60	18,616	[3] 6.00	----------------	----------------

[1] Month, day, and year on which issues of June 1, 1969, enter each period. For subsequent issue months add the appropriate number of months.
[2] Extended maturity value reached at 15 yrs. 10 mos. after issue.
[3] Yield on purchase price from issue date to extended maturity date is 5.83 percent.

*For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
**This table does not apply if the prevailing rate for series E bonds being issued at the time the extension begins is different from 6.00 percent.

Exhibit 6.—Department Circular, Public Debt Series No. 1–75, January 1, 1975, regulations governing United States individual retirement bonds

DEPARTMENT OF THE TREASURY,
Washington, January 3, 1975.

AUTHORITY: Sec. 2002, Pub. L. 93–406, 88 Stat. 958 (31 U.S.C. 738a, 752, 754b); 5 U.S.C. 301.

§ 346.0 Offering of bonds.

The Secretary of the Treasury, under the authority of the Second Liberty Bond Act, as amended, and pursuant to the Employee Retirement Income Security Act of 1974, offers for sale, beginning January 1, 1975, bonds of the United States, designated as United States Individual Retirement Bonds. The bonds will be available for investment only to individuals eligible to make deductions on their Federal income tax returns for retirement savings, as provided in Section 2002 of the latter Act. This offering of bonds will continue until terminated by the Secretary of the Treasury.

§ 346.1 Description of bonds.

(a) *Investment yield (interest).* United States Individual Retirement Bonds, hereinafter sometimes referred to as Individual Retirement Bonds, will be issued at par. The investment yield (interest) on the bonds will be 6 percent per annum, compounded semiannually, except that no interest shall accrue on any such bonds redeemed within twelve (12) months of its issue date. See the table of redemption values appended to this circular. Interest will be paid only upon redemption of the bonds. The accrual of interest will continue until the bonds have been redeemed or have reached maturity, whichever is earlier, in accordance with these regulations.

(b) *Term.* The maturity date of any bond issued under this circular shall be the first day of the month in which the registered owner thereof has attained the age of 70½ years, or five years after the date of his death, but no later than the first day of the month in which he would have attained the age of 70½ years, if he had lived. Unless sooner redeemed in accordance with these regulations, the investment yield on a bond will cease on the interest accrual date coinciding with, or, where no such coincidence occurs, the interest accrual date next preceding (1) the first day of the seventh (7th) month following the 70th anniversary of the birth of the person in whose name it is registered, or (2) the first day of the sixtieth (60th) month following the date of death of the person in whose name it is registered, except that such date shall be no later than the date on which he would have attained the age of 70½ years, had he lived.

(c) *Denominations—issue date.* Individual Retirement Bonds will be available only in registered form and in denominations of $50, $100 and $500. At the time of issue, the issuing agent will enter in the upper right-hand portion of the bond the *issue date* (which shall be the first day of the month and year in which payment of the purchase price is received by an authorized issuing agent), and will imprint the agent's validating stamp in the lower right-hand portion. The issue date, as distinguished from the date in the agent's validating stamp, will determine the date from which interest will begin to accrue on the bond. An Individual Retirement Bond shall be valid only if an authorized issuing agent receives payment therefor, duly inscribes, dates, stamps, and delivers it.

§ 346.2 Registration.

(a) *General.* The registration of Individual Retirement Bonds is limited to the names of natural persons in their own right, whether adults or minors, in either single ownership or beneficiary form. A bond registered in the beneficiary form will be inscribed substantially as follows (for example): "John A. Doe payable on death to (*or* P.O.D.) Richard B. Roe." No more than one beneficiary may be designated on a bond.

(b) *Inscription.* The inscription on the face of each bond will show the name, address, date of birth, and the social security account number of the registered owner. The name of the beneficiary, if one is to be designated, together with his social security account number, where available, will also be shown in the inscription.

§ 346.3 Purchase of bonds.

(a) *Agencies.* Individual Retirement Bonds may be purchased over-the-counter or by mail from Federal Reserve Banks and Branches and the Bureau of the Public Debt, Securities Transactions Branch, Washington, D.C. 20226. Customers of commercial banks and trust companies may be able to arrange for the purchase of the bonds through such institutions, but only the Federal Reserve Banks and Branches, and the Department of the Treasury itself, are authorized to issue the securities. The date of receipt of the application and payment by such issuing agencies will govern the dating of the bonds issued.

(b) *Applications.* Applications for the purchase of Individual Retirement Bonds should be made on Form PD 4345, accompanied by a remittance to cover the purchase price. Personal checks will be accepted, subject to collection. Checks, or other forms of exchange, should be drawn to the order of the Federal Reserve Bank or the U.S. Treasury, as the case may be. Checks payable by endorsement are not acceptable.

(c) *Delivery.* Delivery of bonds will be made in person, or by mail at the risk and expense of the United States at the address given by the purchaser, but only within the United States, its territories and possessions, the Commonwealth of Puerto Rico, and the Canal Zone. No mail deliveries elsewhere will be made. If the registered owner temporarily resides abroad, the bonds will be delivered to such address in the United States as the purchaser directs.

§ 346.4 Proof of purchase.

At the time an Individual Retirement Bond is issued, the issuing agent will furnish therewith to the purchaser a copy of Form PD 4345 for the purchaser's personal records. The form will show the name and address of the registered owner, his date of birth, social security account number, the number of bonds issued, a description thereof by issue date, serial numbers, denominations, and registration.

§ 346.5 Limitation on holdings.

The amount of Individual Retirement Bonds issued during any one calendar year that may be purchased in the name of any one person as registered owner shall not exceed an amount equal to 15 percent of compensation includible in his gross income for that year, or $1,500, whichever is less. This limitation does not apply to rollover contributions, as described in sections 402(a)(5), 403(a)(4) or 408(d)(3).

§ 346.6 Nontransferability.

United States Individual Retirement Bonds are not transferable, and may not be sold, discounted or pledged as collateral for a loan or as security for the performance of an obligation, or for any other purpose.

§ 346.7 Judicial proceedings.

No judicial determination will be recognized which would give effect to an attempted voluntary transfer inter vivos of an Individual Retirement Bond. Otherwise, a claim against a registered owner will be recognized when established by valid judicial proceedings, but in no case will payment be made to the purchaser at a sale under a levy or to the officer authorized to levy upon the property of the owner under appropriate process to satisfy a money judgment unless or until the bond has become eligible for authorized redemption pursuant to these regulations. Neither the Department of the Treasury nor any of its agencies will accept notices of adverse claims or of pending judicial proceedings or undertake to protect the interests of litigants who do not have possession of the bond.

§ 346.8 Payment or redemption during lifetime of owner.

(a) *During first 12 months of issue date.* An Individual Retirement Bond is redeemable at any time during the first twelve (12) months of its issue date. No interest will be paid on any bond so redeemed.

(b) *Prior to age 59½.* (1) *With penalty.* Unless redeemed within twelve months of its issue, or except as provided under paragraph (b)(2) and (c)(2) of this section, if an Individual Retirement Bond is cashed by its owner before he attains age 59½, he must include on his Federal income tax return for the year of redemption the value of the bond. In addition, there is an additional income tax equal to 10 percent of the value of the bond imposed by section 409(c) of the Internal Revenue Code of 1954.

(2) *In case of disability.* An Individual Retirement Bond will be paid at its then current redemption value upon a registered owner's request (or by a person recognized as entitled to act on his behalf) prior to his attainment of age 59½ years upon submission of a physician's statement or any similar evidence show-

ing that the owner has become disabled to such an extent that he is unable to engage in any substantial, gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration. The following are examples of impairments which would ordinarily be considered as preventing substantial, gainful activity:

(i) Loss of use of two limbs.

(ii) Certain progressive diseases which have resulted in the physical loss or atrophy of a limb, such as diabetes, multiple sclerosis, or Buerger's disease.

(iii) Diseases of the heart, lungs, or blood vessels which have resulted in major loss of heart or lung reserve as evidenced by X-ray, electrocardiogram, or other objective findings, so that despite medical treatment breathlessness, pain, or fatigue is produced on slight exertion, such as walking several blocks, using public transportation, or doing small chores.

(iv) Cancer which is inoperable and progressive.

(v) Damage to the brain or brain abnormality which has resulted in severe loss of judgment, intellect, orientation, or memory.

(vi) Mental diseases (*e.g.*, psychosis or severe psychoneurosis) requiring continued institutionalization or constant supervision of the individual.

(vii) Loss or diminution of vision to the extent that the effected individual has a central visual acuity of no better than 20/200 in the better eye after best correction, or has a limitation in the fields of vision such that the widest diameter of the visual fields subtends an angle no greater than 20 degrees.

(viii) Permanent and total loss of speech.

(ix) Total deafness uncorrectible by a hearing aid.

In any case coming under the provisions hereof, the evidence referred to above must be submitted to the Bureau of the Public Debt, Division of Securities Operations, Washington, D.C. 20226, for approval before any bonds may be paid. If, after review of the evidence, the Secretary of the Treasury is satisfied that the owner's disability has been established a letter will be furnished authorizing payment of his Individual Retirement Bonds. This letter must be presented each time any of the owner's bonds are submitted for payment to a Federal Reserve Bank or Branch or to the Department of the Treasury.

(c) *Prior to age 70½*. (1) *General.* An Individual Retirement Bond will be redeemable at its current redemption value upon the request of the registered owner (or a person recognized as entitled to act on his behalf), provided he is 59½ years of age or older. The owner's age will be determined from the date of birth shown on the face of the bond, provided, however, that the Secretary of the Treasury reserves the right in any case or class of cases to require proof, in the form of a duly certified copy of his birth certificate, that the owner has attained the age of 59½ years. If such evidence is unavailable, one of the following documents may be furnished in lieu thereof:

(i) Church records of birth or baptism

(ii) Hospital birth record or certificate

(iii) Physician's or midwife's birth record

(iv) Certification of Bible or other family record

(v) Military, naturalization, or immigration records

(vi) Other evidence of probative value

Similar documentary evidence will also be required to support any claim made by an owner that the date of birth shown on his bond is incorrect.

(2) *For change of investment.* Under section 409(b)(3)(c) of the Internal Revenue Code, if an Individual Retirement Bond is cashed at any time before the end of the taxable year in which the owner attains age 70½, and the entire redemption proceeds are transferred to an individual retirement account, an individual annuity, an employees' trust, or annuity plan, as described in sections 408(a), 408(b), 401(a) and 403(a), respectively, of the Internal Revenue Code, on or before the 60th day after receipt of such proceeds, they shall be excluded from gross income and the transfer shall be treated as a rollover contribution described in section 408(d)(3) of the Internal Revenue Code.

(d) *Requests for payment.* (1) *By owner.* When redemption of any Individual Retirement Bond is desired by the registered owner, it should be presented, with the request for payment on the back of the bond signed and duly certified, to a Federal Reserve Bank or Branch or to the Bureau of the Public Debt, Securities Transactions Branch, Washington, D.C. 20226. If payment is requested on account of disability, the letter described in paragraph (b)(2) of this section should accompany the bond.

(2) *By person other than owner.* When redemption of any Individual Retirement Bond is desired by the legal guardian, committee, conservator, or similar representative of the owner's estate, it should be presented, with the request signed as described below, to a Federal Reserve Bank or Branch or to the Department of the Treasury. If payment is requested on account of disability, the letter described in paragraph (b)(2) of this section should accompany the bond.[1] The request for payment, in either case, should be signed by the representative in his fiduciary capacity before an authorized certifying officer, and must be supported by a certificate or a certified copy of the letters of appointment from the court making the appointment, under seal, or other proof of qualification if the appointment was not made by a court. Except in the case of corporate fiduciaries, such evidence should state that the appointment is in full force and should be dated not more than one year prior to the presentation of the bond for payment.

(e) *Partial redemption.* An Individual Retirement Bond in a denomination greater than $50 (face value), which is otherwise eligible for redemption, may be redeemed in part, at current redemption value, upon the request of the registered owner (or a person recognized as entitled to act on his behalf), but only in amounts corresponding to authorized denominations. In any case in which partial redemption is desired, before the request for payment is signed, the phrase "to the extent of $________ (face value) and reissue of the remainder" should be appended to the request. Upon partial redemption of the bond, the remainder will be reissued as of the original issue date. No partial redemption of a bond will be made after the death of the owner in whose name it is registered.

§ 346.9 Payment or redemption after death of owner.

(a) *Order of precedence where owner not survived by beneficiary.* If the registered owner of an Individual Retirement Bond dies before it has been presented and surrendered for payment, and there is no beneficiary shown thereon, or if the designated beneficiary predeceased the owner, the bond shall be paid in the following order of precedence:

(1) To the duly appointed executor or administrator of the estate of the owner, who should sign the request for payment on the back of the bond in his representative capacity before an authorized certifying officer, such request to be supported by a court certificate or a certified copy of his letters of appointment, under seal of the court, which should show that the appointment is in full force and effect, and be dated within six months of its presentation;

(2) If no legal representative of the deceased registered owner's estate has been or will be appointed, to the widow or widower of the owner;

(3) If none of the above, to the child or children of the owner and the descendants of deceased children by representation;

(4) If none of the above, to the parents of the owner, or the survivor of them;

(5) If none of the above, to other next-of-kin of the owner, as determined by the laws of the domicile of such owner at the time of his death.

In any case coming under the provisions of this paragraph, a duly certified copy of the registered owner's death certificate will ordinarily be required. Proof of death of the beneficiary, if any, will be required where he predeceased the owner. Payment of bonds under paragraph (a)(1) of this section will be made by a Federal Reserve Bank or by the Bureau of the Public Debt, Securities Transactions Branch, Washington, D.C. 20226. Payment of bonds under paragraph (a) (2) to (5) of this section will be made upon receipt of applications on Form PD 3565–1, together with the bonds and supporting evidence, by the Bureau of the Public Debt, Division of Securities Operations, Washington, D.C. 20226.

(b) *Order of precedence where beneficiary survived owner.* If the registered owner of an Individual Retirement Bond dies before it has been presented and surrendered for payment, and the beneficiary shown thereon survived the owner, the bond shall be paid in the following order of precedence:

(1) To the designated beneficiary upon his presentation and surrender of the bond with the request for payment signed and duly certified;

[1] In any case in which a legal representative has not been appointed for the estate of a registered owner who has attained the age of 59½ years, or who has become disabled, a person seeking payment of a bond on the owner's behalf should furnish a complete statement of the circumstances to the Bureau of the Public Debt, Division of Securities Operations, Washington, D.C. 20226. Appropriate instructions will then be furnished.

(2) If the designated beneficiary survived the registered owner but failed to present the bond for payment during his own lifetime, payment will be made in the order of precedence specified in paragraph (a) (1) to (5) of this section to the legal representative, surviving spouse, children, parents, or next-of-kin of such beneficiary, and in the manner provided therein.

In any case coming under the provisions of this subsection, a duly certified copy of the registered owner's death certificate will ordinarily be required. Proof of death of the beneficiary will also be required where he survived the owner but failed to present the bond for payment during his own lifetime. Payment of a bond to a designated beneficiary will be made by a Federal Reserve Bank or by the Bureau of the Public Debt, Securities Transactions Branch, Washington, D.C. 20226.

(c) *Ownership of redemption proceeds.* The orders of precedence set forth in paragraphs (a) and (b) of this section, except in cases where redemption is made for the account of a registered owner, are for the Department's convenience in discharging its obligation on an Individual Retirement Bond. The discharge of the obligation in accordance therewith shall be final so far as the Department is concerned, but those provisions do not otherwise purport to determine ownership of the redemption proceeds of a bond.

§ 346.10 Reissue.

(a) *Addition or change of beneficiary.* An Individual Retirement Bond will be reissued to add a beneficiary in the case of a single ownership bond, or to eliminate or substitute a beneficiary in the case of a bond registered in beneficiary form upon the owner's request on Form PD 3564. No consent will be required to support any reissue transaction from a beneficiary whose name is to be removed from the registration of an Individual Retirement Bond. If the registered owner dies after the bond has been presented and surrendered for reissue, upon receipt of notice thereof by the agency to which the request for reissue was submitted, such request shall be treated as ineffective, provided the notice of death is received by the Federal Reserve Bank or the Bureau of the Public Debt, Division of Securities Operations, Washington, D.C. 20226, to which the request was sent, in sufficient time to withhold delivery, by mail or otherwise, of the reissued bond.

(b) *Error in issue—change of name.* Reissue of an Individual Retirement Bond will be made where an error in issue has occurred, as well as in cases where the owner's name has been changed by marriage, divorce, annulment, order of court, or in any other legal manner upon an appropriate request. Information as to the procedure to be followed in securing such reissue may be obtained from a Federal Reserve Bank or the Bureau of the Public Debt, Division of Securities Operations, Washington, D.C. 20226.

§ 346.11 Use of power of attorney.

No designation of an attorney, agent, or other representative to request payment or reissue on behalf of the owner, beneficiary, or other person entitled under § 346.9, other than as provided in these regulations, will be recognized.

§ 346.12 Lost, stolen, or destroyed bonds.

If an Individual Retirement Bond is lost, stolen, or destroyed, relief will be granted upon identification of the bond and proof of its loss, theft, or destruction. A description of the bond by denomination, serial number, issue date and registration should be furnished at the time the report of loss, theft, or destruction is made. Such reports should be sent to the Bureau of the Public Debt, Division of Securities Operations, Washington, D.C. 20226. Full instructions for obtaining substitute bonds, or payment, in appropriate cases, will then be given.

§ 346.13 Taxation.

The tax treatment provided under Section 409 of the Internal Revenue Code of 1954, as amended, shall apply to all Individual Retirement Bonds. The bonds are subject to estate, inheritance, or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, municipality, or any local taxing authority. Inquiry concerning the application of any Federal tax to these bonds should be directed to the District Director of Internal Revenue for the district in which the taxpayer resides.

§ 346.14 Certifying officers.

Officers authorized to certify requests for payment or for any other transaction involving Individual Retirement Bonds include:

(a) *Post offices.* Any postmaster, acting postmaster, or inspector-in-charge, or other post office official or clerk designated for that purpose. A post office official or clerk, other than a postmaster, acting postmaster, or inspector-in-charge, should certify in the name of the postmaster or acting postmaster, followed by his own signature and official title. Signatures of these officers should be authenticated by a legible imprint of the post office dating stamp.

(b) *Banks and trust companies.* Any officer of a Federal Reserve Bank or Branch, or a bank or trust company chartered under the laws of the United States of those of any State, Commonwealth, or Territory of the United States, as well as any employees of such bank or trust company expressly authorized to act for that purpose, who should sign over the title "Designated Employee." Certifications by any of these officers or designated employees should be authenticated by either a legible imprint of the corporate seal, or, where the institution is an authorized issuing agent for United States Savings Bonds, Series E, by a legible imprint of its dating stamp.

(c) *Issuing agents of Series E savings bonds.* Any officer of a corporation or any other organization which is an authorized issuing agent for United States Savings Bonds, Series E. All certifications by such officers must be authenticated by a legible imprint of the issuing agent's dating stamp.

(d) *Foreign countries.* In a foreign country requests may be signed in the presence of and be certified by any United States diplomatic or consular representative, or the manager or other officer of a foreign branch of a bank or trust company incorporated in the United States whose signature is attested by an imprint of the corporate seal or is certified to the Department of the Treasury. If such an officer is not available, requests may be signed in the presence of and be certified by a notary or other officer authorized to administer oaths, but his official character and jurisdiction should be certified by a United States diplomatic or consular officer under seal of his office.

(e) *Special provisions.* The Commissioner of the Public Debt, or his delegate, or any Federal Reserve Bank or Branch is authorized to make special provision for certification in any particular case or class of cases where none of the officers authorized above is readily accessible.

§ 346.15 General provisions.

(a) *Regulations.* All Individual Retirement Bonds shall be subject to the general regulations prescribed by the Secretary with respect to United States securities, which are set forth in Department of the Treasury Circular No. 300, current revision, to the extent applicable. Copies of the general regulations may be obtained upon request from any Federal Reserve Bank or the Department of the Treasury.

(b) *Reservation as to issue of bonds.* The Secretary of the Treasury reserves the right to reject any application for the purchase of Individual Retirement Bonds, in whole or in part, and to refuse to issue or permit to be issued any such bonds in any case or any class or classes of cases if he deems such action to be in the public interest, and his action in any such respect shall be final.

(c) *Additional requirements.* In any case or any class of cases arising under this circular, the Secretary of the Treasury may require such additional evidence as may in his judgment be necessary, and may require a bond of indemnity, with or without surety, where he may consider such bond necessary for the protection of the United States.

(d) *Waiver of requirements.* The Secretary of the Treasury reserves the right, in his discretion, to waive or modify any provision or provisions of this circular in any particular case or class of cases for the convenience of the United States, or in order to relieve any person or persons of unnecessary hardship, if such action is not inconsistent with law, does not impair any existing rights, and he is satisfied that such action would not subject the United States to any substantial expense or liability.

(e) *Fiscal agents.* Federal Reserve Banks and Branches, as fiscal agents of the United States, are authorized to perform such services as may be requested of them by the Secretary of the Treasury in connection with the issue, delivery, redemption, reissue, and payment of Individual Retirement Bonds.

(f)) *Reservation as to terms of circular.* The Secretary of the Treasury may at any time, or from time to time, supplement or amend the terms of this circular, or any amendments or supplements thereto.

JOHN K. CARLOCK,
Fiscal Assistant Secretary of the Treasury.

Table of redemption values providing an investment yield of 6 percent per annum for bonds bearing issue dates beginning January 1, 1975

Table shows how the Individual Retirement Bonds bearing issue dates beginning January 1, 1975, by denomination, increase in redemption value during successive half-year periods following issue. The redemption values have been determined to provide an investment yield of approximately 6 percent per annum, compounded semiannually, on the purchase price from issue date to the beginning of each half-year period. The period to maturity is fixed in accordance with the provisions of § 346.1(b) of this circular.

Issue price	$50.00	$100.00	$500.00
Period after issue date	Redemption values during each half-year period (values increase on first day of period shown)		
First ½ year	$50.00	$100.00	$500.00
½ to 1 year	51.50	103.00	515.00
1 to 1½ years	53.05	106.10	530.50
1½ to 2 years	54.64	109.28	546.40
2 to 2½ years	56.28	112.56	562.80
2½ to 3 years	57.96	115.92	579.60
3 to 3½ years	59.70	119.40	597.00
3½ to 4 years	61.49	122.98	614.90
4 to 4½ years	63.34	126.68	633.40
4½ to 5 years	65.24	130.48	652.40
5 to 5½ years	67.20	134.40	672.00
5½ to 6 years	69.21	138.42	692.10
6 to 6½ years	71.29	142.58	712.90
6½ to 7 years	73.43	146.86	734.30
7 to 7½ years	75.63	151.26	756.30
7½ to 8 years	77.90	155.80	779.00
8 to 8½ years	80.24	160.48	802.40
8½ to 9 years	82.64	165.28	826.40
9 to 9½ years	85.12	170.24	851.20
9½ to 10 years	87.68	175.36	876.80
10 to 10½ years	90.31	180.62	903.10
10½ to 11 years	93.01	186.02	930.10
11 to 11½ years	95.81	191.62	958.10
11½ to 12 years	98.68	197.36	986.80
12 to 12½ years	101.64	203.28	1,016.40
12½ to 13 years	104.69	209.38	1,046.90
13 to 13½ years	107.83	215.66	1,078.30
13½ to 14 years	111.06	222.12	1,110.60
14 to 14½ years	114.40	228.80	1,144.00
14½ to 15 years	117.83	235.66	1,178.30
15 to 15½ years	121.36	242.72	1,213.60
15½ to 16 years	125.00	250.00	1,250.00
16 to 16½ years	128.75	257.50	1,287.50
16½ to 17 years	132.62	265.24	1,326.20
17 to 17½ years	136.60	273.20	1,366.00
17½ to 18 years	140.69	281.38	1,406.90
18 to 18½ years	144.91	289.82	1,449.10
18½ to 19 years	149.26	298.52	1,492.60
19 to 19½ years	153.74	307.48	1,537.40
19½ to 20 years	158.35	316.70	1,583.50
20 to 20½ years	163.10	326.20	1,631.00

Exhibit 7.—Federal Financing Bank Circular No. 1–74, July 10, 1974, offering of Federal Financing Bank bills

FEDERAL FINANCING BANK,
Washington, July 10, 1974.

The Federal Financing Bank Act of 1973 created a body corporate to be known as the Federal Financing Bank. The Bank, which is subject to the general supervision and direction of the Secretary of the Treasury, is an instrumentality of the United States. It is authorized, with the approval of the Secretary of the Treasury, to issue publicly obligations having such maturities and bearing such rate or rates of interest as may be determined by the Bank.

A new Chapter VIII, entitled "Federal Financing Bank", containing a new Part 810, entitled "Federal Financing Bank Bills", is added to Title 12 of the Code of Federal Regulations. The new Part sets forth the regulations contained in Federal Financing Bank Circular No. 1–74. As these regulations relate to the fiscal policy of the United States notice and public procedures thereon are unnecessary.

In consideration of the foregoing, Title 12 of the Code of Federal Regulations is amended by the addition of a new Chapter VIII, as set forth below, effective July 10, 1974.

AUTHORITY: The provisions of this Part 810 are issued under Secs. 9–11, 87 Stat 939, 940; 12 U.S.C. 2288, 2289, 2290.

Sec. 810.0. *Authority for issue and sale.*—The Federal Financing Bank is authorized, under the Federal Financing Bank Act of 1973, to issue publicly, with the approval of the Secretary of the Treasury, obligations having such maturities and bearing such rate or rates of interest as may be determined by the Bank. Pursuant to this authority, Federal Financing Bank bills, referred to herein as "FFB bills", are offered for sale from time to time and tenders invited therefor, through the Federal Reserve Banks. The FFB bills so offered, the tenders made, and all subsequent transactions therein are subject to the terms and conditions of the public notice offering the bills for sale, this circular, and to the extent not inconsistent with such notice and circular, to Department of the Treasury Circular No. 418, current revision, the regulations governing United States Treasury bills, and all other regulations governing United States securities.

Sec. 810.1. *Description of Federal Financing Bank bills.*

(a) *General.*—Federal Financing Bank bills are bearer obligations of the Federal Financing Bank, the terms of which provide for payment of a specified amount on a specified date. They are issued only by Federal Reserve Banks and Branches, pursuant to tenders accepted by the Federal Financing Bank, and are available in both definitive and book-entry form. Where issued as a definitive security, it shall not be valid unless the issue date, the maturity date and the CUSIP number are imprinted thereon.

(b) *Denominations.*—Federal Financing Bank bills will be issued in denominations of $10,000, $15,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value).

Sec. 810.2. *Public notice of offering.*—On the occasion of an offering of FFB bills, tenders therefor will be invited through public notices issued by the Federal Financing Bank. Each notice will set forth the amount offered, the issue date, the date they will be due and payable, the place and the date of the closing hour for the receipt of tenders and the date on which payment for accepted tenders must be made or completed.

Sec. 810.3. *Payment at maturity.*—Each FFB bill will be paid in its face amount at maturity upon presentation and surrender to any Federal Reserve Bank or Branch or to the Department of the Treasury, Bureau of the Public Debt, Securities Transactions Branch, Washington, D.C. 20226. If an FFB bill is presented and surrendered for redemption after it has become overdue, the Federal Financing Bank may require satisfactory proof of ownership, as provided in § 306.25 of Department of the Treasury Circular No. 300, current revision.

Sec. 810.4. *Acceptance of FFB bills for various purposes.*—Federal Financing Bank bills are lawful investments and may be accepted as security for all fiduciary, trust, and public funds, the investment or deposit of which shall be under the authority or control of the United States, the District of Columbia, the Commonwealth of Puerto Rico or any territory or possession of the United States. They are eligible for purchase by national banks, and will be accepted at maturity value to secure public moneys.

Sec. 810.5. *Taxation.*—All FFB bills shall be subject to Federal taxation to the same extent as obligations of private corporations are taxed.

Sec. 810.6. *Exemption.*—Obligations of the Federal Financing Bank are deemed to be exempted securities within the meaning of § 3(a)(2) of the Securities Act of 1933 (15 U.S.C. 77c(a)(2)), of § 3(a)(12) of the Securities Exchange Act of 1934 (15 U.S.C. 78(a)(12)), and of § 304(a)(4) of the Trust Indenture Act of 1939 (15 U.S.C. 77d(a)(4)).

Sec. 810.7. *Federal Reserve Banks as fiscal agents.*—The Federal Reserve Banks, as fiscal agents of the United States, have been authorized by the Department of the Treasury to perform all such acts as may be necessary to carry out the provisions of this and other circulars of the Department of the Treasury as may be applicable to FFB bills, and of any public notice or notices issued in connection with any offering of these securities.

Sec. 810.8 *Reservations as to terms of circular.*—The Federal Financing Bank reserves the right to amend, supplement, revise or withdraw all or any of the provisions of this circular at any time or from time to time.

JACK F. BENNETT,
President,
Federal Financing Bank.

Exhibit 8.—An act to increase the temporary debt limitation and to extend such temporary limitation until June 30, 1975

[Public Law 94–3, 94th Congress, H.R. 2634, February 19, 1975]

Public debt limit. Temporary increase. 31 U.S.C. 757b note. Repeal; effective date. 31 U.S.C. 757b note.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That during the period beginning on the date of the enactment of this Act and ending on June 30, 1975, the public debt limit set forth in the first sentence of section 21 of the Second Liberty Bond Act (31 U.S.C. 757b) shall be temporarily increased by $131,000,000,000.

SEC. 2. Effective on the date of the enactment of this Act, the first section of the Act of June 30, 1974, providing for a temporary increase in the public debt limit for a period ending March 31, 1975 (Public Law 93–325), is hereby repealed.

Exhibit 9.—An act to provide for a temporary increase in the public debt limit

[Public Law 94–47, 94th Congress, H.R. 8030, June 30, 1975]

Public debt limit. Temporary increase. 31 U.S.C. 757b note. Repeal; effective date. 31 U.S.C. 757b note. *Ante,* p. 5.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That during the period beginning on the date of the enactment of this Act and ending on November 15, 1975, the public debt limit set forth in the first sentence of section 21 of the Second Liberty Bond Act (31 U.S.C. 757b) shall be temporarily increased by $177,000,000,000.

SEC. 2. Effective on the date of the enactment of this Act, the first section of the Act of February 19, 1975, entitled "An Act to increase the temporary debt limitation and to extend such temporary limitation until June 30, 1975" (Public Law 94–3), is hereby repealed.

Federal Debt Management

Exhibit 10.—Remarks by Under Secretary Schmults, January 27, 1975, before the National Savings and Loan League, Washington, D.C., on the Financial Institutions Act

I am happy to be here with you today to discuss the Financial Institutions Act and its prospects in 1975. Exhaustive, in-depth hearings were conducted on the act in the 93d Congress by Senator McIntyre's Subcommittee on Financial Institutions, and I am sure that most of you are familiar with the general nature of the reform program. The basic thrust of the legislation is to provide a minimum, balanced set of structural financial reforms. We believe that the administration's proposals will, among other things, strengthen thrift institutions and allow them to manage change in the future.

The basic problem that has increasingly come to plague savings institutions is their structural inability to adapt to changing financial conditions quickly enough. The crises of disintermediation during periods of monetary restraint and the distress caused by comparatively mild institutional innovations, such as the variable rate note of last summer, are symptomatic of this difficulty. The mortgage portfolios of savings and loan associations are the justification for their existence. But, as you know, at the same time they are at the root of the problem. The relatively slow turnover of their mortgage portfolios makes it difficult for thrifts to respond to change, especially where such responses may require a greater competitiveness with respect to savers. The traditional remedy in the past has been for the industry to turn to the Government for support. But the remedy has created problems of its own. Perhaps chief among these is the impact of Federal agency borrowings on the capital markets. Since the need for additional agency finance is greater during periods of tight money, Federal support has been partially self-defeating in that it has made it even more difficult for thrifts to compete for deposits.

The FIA (Financial Institutions Act) seeks to resolve the *basic* problem of thrift institutions by a restructuring so as to provide them with the ability to compete more effectively on their own. The FIA makes for greater flexibility and adaptability by increasing both asset and depository freedom. Savings institutions will be allowed to hold a more varied portfolio of earning assets, such as consumer loans and commercial paper which have a high rate of turnover. The earnings from these instruments are sensitive to changing market conditions and, thus, they provide a flexible source of funds. This will reduce the critical impact of tight money by raising yields sufficiently to enable thrifts to compete for savings deposits and/or "buy time" as the low-yielding oldest portion of the mortgage portfolio rolls over. It also provides a source of funds for new, higher yielding mortgage assets.

Expanded deposit powers, including demand deposits and N.O.W. (negotiable order of withdrawal) accounts, will promote the broadened concept of thrifts as centers for family financial services. Thrifts will prove more profitable if well managed. Only the degree of ingenuity and innovativeness of thrift institution managers will limit the profitability of these operations.

Because of these and other reform provisions of the FIA, we expect that the competitive strength of thrift institutions will increase materially. We anticipate (and we have some empirical support for this) that the net volume of savings flows to thrifts, and probably to all financial institutions, will increase. In particular, even though savings institutions will become more diversified than at present, the larger flows of savings will support larger extensions of mortgage credit, and housing is expected to benefit materially from financial reform.

Increased flexibility and responsiveness of financial institutions were our objectives when we first introduced the FIA in the fall of 1973. The introduction followed an almost 2-year review and implementation program regarding the findings of the Hunt Commission. The planning was carried out in cooperation with all of the depository regulatory agencies, and involved extensive consultation with affected groups.

By necessity, then, the program contained elements of compromise, consisting of much that was desired by and useful to individual classes of institutions but also some measures that were thought to be objectionable.

When the bill was introduced, there was a natural response by affected institutions of discounting the potential benefits of the program and magnifying the potential costs. There was opposition to the FIA by the savings and loan and housing industries, who saw in the eventual abolition of Regulation Q and other deposit rate ceilings an immediate threat to their viability. This fear was intensified by the brief but fierce competition for deposits following the introduction of "wild card" CD's during the summer of 1973.

The administration has maintained the position that the ceiling rates are a self-defeating means of protection necessitated by the structural inability of thrifts to compete effectively. It is our view that ceilings force small savers to subsidize mortgage credit borrowers and at the same time encourage disintermediation because of the low interest rate relative to the yields available on other money-market instruments.

As the policy of monetary restraint pursued by the Federal Reserve in 1974 to combat inflation intensified, and as interest rates rose, agreement on the need for financial reform became more widespread. Despite a substantial effort by Federal agencies involved in housing finance, net mortgage creation and housing starts were totally inadequate during 1974. Savings flows at insured savings and loan associations fell by $4.8 billion during the first 11 months of 1974 compared to the same period during 1973, and the flow of mortgage repayments fell by over $3.4 billion. Six and one-quarter billion dollars in home loan advances were important, but insufficient to reverse these pressures. As a result, mortgage loans made or acquired by federally insured savings and loan associations were some $9.9 billion less than for the comparable period during 1973. A greater effort by the Federal agencies might well have placed greater pressure on the already strained capital markets, raising the level of interest rates even higher and providing even greater incentive for depositors to shift their funds into higher yielding, alternative investments, such as Treasury or agency paper or the liquid asset mutual funds, which grew rapidly during the period.

By the fall of 1974 it appeared that most of the affected financial institutions viewed reform as necessary, and were in closer agreement on the need to focus such reform on the extension of asset and deposit powers. As this growing coalescence of attitudes becomes apparent, and since the FIA would have to be resubmitted during 1975, the Treasury Department decided to formally meet with the industry representatives to attempt to bridge the remaining gaps preventing agreement. A series of such meetings were held in November and December, and as a result there will be some modifications in the form of the FIA during 1975. The basic intent and the thrust of the legislation remains unchanged.

Probably the two most important changes, from your point of view, concern the eventual abolition of Regulation Q and all other deposit rate ceilings, and the substitution of the mortgage interest tax credit for the bad debt loss reserve deduction you currently enjoy. It seems that we are closer to agreement on both these issues than might be apparent simply by reading position papers and testimony. I am optimistic that our restatement of titles I and VII of the FIA will result in a bill that will enjoy your enthusiastic support.

At present Regulation Q and other deposit rate ceilings must be renewed periodically; otherwise, they automatically cease to exist. Although there is usually little difficulty in securing an extension of the regulations, there is no guarantee that this will always be the case. In addition, preparation of support for the preservation of the ceilings requires time, effort, and expense.

Our revised title I extends deposit rate ceilings continuously for a period of 5½ years and will require no periodic renewal by the Congress. We are confident that the expanded powers given you by other provisions of the act will strengthen your competitive position to such an extent that at the end of that period of time you will no longer require the protection of the ceilings.

We are proposing some changes in what is to take effect during the 5½-year period. First, the act as written now calls for the phaseout of the differential over 4 years, starting 18 months after the bill is enacted. A portion would be phased out for each of the 4 years. We are now proposing that the act be silent regarding the phaseout of the differential. Since the differential in most cases is only one-fourth of a percent, a gradual phaseout seems unnecessary.

Second, prior to the end of the 5½-year period, we are recommending that the administration conduct a thorough review of how the financial system is functioning to determine whether or not the FIA has worked to the full extent we expect it to. We will submit recommendations based upon our findings to the Congress at that time. Congress will take whatever remedial action it feels is desirable. If Congress decides no further action is necessary, the ceilings will expire.

Although we realize that the 96th Congress will not be bound by the conditions set by the 94th Congress, we anticipate that the possibility of a permanent end to the ceilings will spur savings institutions to integrate the new powers into their structure as rapidly as possible. Equally important will be the competitive incentives encouraging thrifts to profitably use their powers to take advantage of changing economic, technological, and institutional changes. We are confident that the restructuring proposed in the FIA will enable the thrift industry to gain strength and independence, savers to receive a wider variety and a higher level of services, and the housing industry to benefit from the resulting increase in savings flows.

Turning now to the mortgage tax credit and the bad debt loss reserve tax deduction: The mortgage tax credit is probably our best assurance that the housing market will not suffer as the reforms contained in the FIA are phased in. The tax credit would give almost 70 basis points to savings and loan associations and over 50 basis points to mutual savings banks, on average, for each mortgage they accept at current market rates. This would provide a considerable incentive for these institutions to maintain or increase mortgage flows.

Another strong advantage of this measure is that it is countercyclical in nature. As interest rates rise, the tax value of the credit on new loans rises proportionately. This is when the credit is most needed by thrift institutions. When interest rates fall, however, the basic conditions for successful operations of thrift institutions reassert themselves, and it is then that the tax value of the credit falls. The mortgage tax credit provides our economy with an efficient automatic stabilizer for the housing industry, one that has been badly needed for years, one that presents few administrative problems and that can be modified fairly easily if warranted by economic conditions.

Your association commissioned one of the best studies on this topic to date. In it Dr. Beiderman and his associates suggest that "the mortgage tax credit procedure might be offered as a possible substitute for the loss reserve formula; i.e., each association could then select the more beneficial of the two methods." This is precisely what we are doing in our revision of title VII.

As it will be presented to Congress, the FIA will permit each thrift institution a one-time option to shift from the bad debt loss reserve method to the mortgage tax credit. The switch would be made at the option of the individual thrift institution, but once having made the decision an institution would not then be able to switch back. Because the value of the bad debt loss reserve deduction is to decline to 40 percent by 1979 pursuant to the Tax Reform Act of 1969 and the prospects of a return to the low mortgage rates of the 1950's in the near term are unlikely, the mortgage tax credit will probably offer a greater tax advantage than the present method in the near future. Indeed, John Stafford of the U.S. League estimates that in 1972, when the bad debt deduction was most favorable relative to the credit, 44 percent of the approximately 2,100 thrifts sampled would have found the mortgage interest tax credit resulting in a lower tax bill. By 1979 we expect virtually all thrifts to have opted for this treatment. It is proposed that thereafter, in order to simplify administration of the law, the bad debt loss deduction be eliminated.

There are other, and from your point of view minor, changes in the FIA. We believe that the net impact of all of the modifications is to define a program of financial reform that deserves your warmest support. You are certainly aware that this support is necessary to assure speedy passage through the Congress, and I'd like to reemphasize our view that it is to your advantage, and that of the entire Nation, to get the bill signed into law as quickly as possible.

The FIA does not contain all of the reforms needed by the financial system. However, we do not see the FIA as the only vehicle of financial reform. We expect that other efforts at restructure and reform will be made, and we will welcome these insofar as they reinforce the objectives of this program.

Right now there is a certain amount of breathing room as the current Federal Reserve policy of monetary ease lowers short-term interest rates relative to long-term yields and enhances your ability to compete for deposits. But, I believe that you should keep in mind that all of this can change practically overnight, as has been demonstrated twice during the past 2 years. In particular, whether the President's economic program, a congressional economic program, or a blend of the two is enacted, huge new cash borrowings approaching $90 billion will be required by the Treasury during the next year and a half. This will certainly have an impact on capital markets and interest rates, to the extent that it is not offset by the Fed.

As a result, it is important to enact the FIA program while there is still time to unhurriedly integrate its reforms into the structure of thrift institutions. The alternative is to trust to luck and Government support if another crunch should come. Depositors have learned more about alternative investments during the last tight money period. As a result, it is possible that the deposit outflows you experience the next time around will be even more sudden and severe. If this happens, you will get Government support. But such will burden the capital markets even further, putting additional pressure on interest rates and increasing further the potential for disintermediation.

The alternative, as we see it, is to meet periods of high interest rates with the increased ability to withstand them and even benefit from them. The reforms contained within the FIA will provide this additional strength. I urge your enthusiastic support for the program when it is reintroduced in the Congress.

Thank you.

Exhibit 11.—Statement of Secretary Simon, February 10, 1975, before the Senate Finance Committee, on the public debt limit

In the second portion of my testimony today, I would like to discuss with you another subject of immediate concern: The need to raise the Federal debt ceiling.

As you know, the current limit on the Federal debt is $495 billion. That is a temporary limit which will expire on March 31; in the absence of legislation, the limit will revert on April 1 to $400 billion.

Our current estimates show that the Government will exceed the temporary limit of $495 billion on February 18—less than 10 days from now. Thus, there is a genuine need for immediate action on the part of the Congress.

Just over 2 weeks ago I presented to the House Ways and Means Committee the administration's proposal to raise the debt ceiling to $604 billion. Barring unforeseen developments, that new ceiling should be adequate to carry us through June 30, 1976, which would be the end of fiscal year 1976. I also pointed out that if the ceiling were extended only to the end of fiscal year 1975, it would have to be set no lower than $531 billion. Our estimates are based on the conventional assumption of a $6 billion cash balance and a $3 billion margin for contingencies.

The House last week approved a bill authorizing a temporary debt limit of $531 billion through the end of the current fiscal year, at which time the limit would revert to the permanent ceiling of $400 billion.

Our request for a higher figure carrying us through fiscal year 1976 was consistent with legislation passed by the Congress last year, the Congressional Budget and Impoundment Control Act. In that law, the Congress set up a timetable for spending and revenue decisions. When that timetable takes effect, the Congress by May 15 of each year is to have completed action on the first concurrent resolution providing new budget authority, setting revenue figures and establishing the public debt limit for the fiscal year beginning that October 1. A second concurrent resolution and reconciliation bill, if needed, must be enacted by late September. Thus, prior to the new fiscal year, the debt limit will be set for that entire fiscal year. This is essentially the idea that we are asking the Congress to approve for fiscal year 1976, and we strongly urge your support for this proposal.

For your background, I am submitting to the committee today four tables which usually accompany our discussion of the debt ceiling:

Table 1 shows actual operating balances and the debt which is subject to limit through December 31, 1974. It also shows the estimated debt subject to limit at the end of each month through the end of fiscal year 1975.

Table 2 extends these estimates through fiscal year 1976.

Table 3 shows the budget estimates for fiscal years 1975 and 1976, providing you with the basis for the figures in the earlier tables.

Table 4 presents our tentative revenue estimates for fiscal years 1975 and 1976.

As all of you know, the rapid downward slide of the economy has reduced the Federal revenues below our original expectations in January of 1974. As a result, Federal deficits are mounting rapidly and are causing the current squeeze on the debt ceiling. A slowdown in the economy had been anticipated, but the current recession is steeper and will probably last longer than first expected. We have thus been required to reduce our fiscal year 1975 estimates of individual income taxes by $6.7 billion, reflecting higher unemployment, shorter workweeks, less overtime, and fewer second jobs. We have also reduced our estimates of corporate income taxes by $3.7 billion, due in large measure to the decline in corporate profits.

TABLE 1.—*Public debt subject to limitation, fiscal year 1975, based on estimated budget receipts of $279 billion, outlays of $313 billion, and deficit of $35 billion*

[In billions of dollars]

	Operating cash balance	Public debt subject to limitation	With usual $3 billion margin for contingencies
		ACTUAL	
1974			
June 30	9.2	476.0	
July 31	6.5	475.6	
Aug. 31	5.4	482.1	
Sept. 30	8.7	481.7	
Oct. 31	2.2	480.5	
Nov. 30	3.1	485.7	
Dec. 31	5.9	493.0	
1975			
Jan. 31	5.9	494.5	
		ESTIMATED	
Feb. 28	6	502	505
Mar. 31	6	507	510
Apr. 30	6	510	513
May 31	6	522	525
June 30	6	528	531

TABLE 2.—*Public debt subject to limitation, fiscal year 1976, based on estimated budget receipts of $298 billion, outlays of $349 billion, and deficit of $52 billion*

[In billions of dollars]

	Operating cash balance	Public debt subject to limitation	With usual $3 billion margin for contingencies
		ESTIMATED	
1975			
June 30	6	528	531
July 31	6	532	535
Aug. 31	6	538	541
Sept. 30	6	544	547
Oct. 31	6	551	554
Nov. 30	6	558	561
Dec. 31	6	567	570
1976			
Jan. 31	6	571	574
Feb. 29	6	577	600
Mar. 31	6	583	586
Apr. 30	6	584	587
May 31	6	596	599
June 17 (peak)	6	601	604
June 30	6	596	599

TABLE 3.—*Budget summary*

[In billions of dollars]

	Actual 1974	Estimated 1975	Estimated 1976
Receipts:			
Federal funds	181	186	199
Trust funds	105	119	127
Interfund transactions	−21	−26	−28
Total budget receipts	265	279	298
Outlays:			
Federal funds	199	229	254
Trust funds	91	110	123
Interfund transactions	−21	−26	−28
Total budget outlays	268	313	349
Surplus, or deficit (−):			
Federal funds	−18	−43	−55
Trust funds	14	8	3
Total budget	−4	−35	−54

TABLE 4.—*Estimated unified budget receipts, fiscal years 1975–1976*

[In billions of dollars]

	Current estimate including proposed legislation 1975	Current estimate including proposed legislation 1976
Individual income taxes	118	106
Corporation income taxes	38	48
Employment taxes and contributions	75	80
Unemployment insurance	7	7
Contributions for other insurance and retirement	4	5
Excise taxes	20	32
Estate and gift taxes	5	5
Customs duties	4	4
Miscellaneous receipts	8	11
Total budget receipts	279	298

Most of you are aware that a number of corporations are switching their inventory accounting methods from "first in, first out" to "last in, first out." LIFO accounting methods exclude a large portion of the effect of inventory price increases from the calculation of business profits and thus lessen corporate tax liability. This trend toward LIFO accounting methods in fiscal year 1975 is expected to reduce our total revenues by \$3–\$4 billion. I should point out that in first estimating revenues for fiscal year 1975, we anticipated reductions in revenue of approximately this size from companies switching to LIFO, so that it has not been a factor in changing our predictions.

The changes in forecasts that we are making this year are similar in nature to those that were made in past recessions. In the recessions of 1969–1970 and 1960–61, corporate and individual income tax collections fell well below estimates. On one of those occasions, fiscal year 1962, an increase in the debt ceiling was also needed prior to the expiration of the one then in effect.

The new debt ceiling we are requesting today incorporates our tentative estimates for both Federal revenues and expenditures, based upon our projections for the economy over the next 17 months and upon the economic and energy proposals that the President has presented to the Congress. As I noted earlier, it also includes the traditional \$6 billion cash operating balance and the \$3 billion margin for contingencies. It does not take account of new spending programs which might be enacted.

Let me point out that the debt figures also include Treasury borrowing to finance the Federal Financing Bank. The bank has one marketable issue of \$1.5 billion now outstanding and maturing at the end of March. In the future, I believe that the bank should borrow from the Treasury rather than going into the market. The bank's cost of borrowing is somewhat greater than Treasury's and the additional interest costs which result are inappropriate. Moreover, we can already anticipate that large budget deficits projected for fiscal years 1975 and 1976 will put some upward pressure on interest rates. Federal Financing Bank market borrowing would be likely to put somewhat more pressure on rates than the equivalent Treasury borrowing. In order to minimize costs to the Government and the taxpayers, it would thus be prudent for the bank to borrow from the Treasury.

Some members of the committee may think that the new debt ceiling is too high and the deficits too big. I would emphasize that there is no one in Washington today who feels more strongly than either the President or I that deficits of the magnitude we are now facing are horrendous. We believe that many of the economic troubles we have today are rooted in more than a decade of excesses in fiscal and monetary policy. To continue the rapid upward momentum of Government growth over an indefinite period would erode the very foundations of our economy and could threaten us with social ruin. But we also recognize that because of the recession, receipts are inevitably going to be lower than we would like and we believe that in order to stimulate the economy, we must temporarily—and I stress the word "temporarily"—cut taxes and leave more money in the private spending stream. Big Federal deficits in fiscal years 1975 and 1976 are thus a result of both the recession and the cumulative cost of the many Federal spending programs that have been enacted in recent years.

Other members of this committee may feel that, to the contrary, Federal outlays should be increased significantly this year so that the deficits and, therefore, the debt ceiling should be much higher than we propose. The President strenuously opposes this view. If we open up the sluice gates on Federal spending during the coming year, we could seriously overheat the economy and insure that further down the road we will be riding the tiger of inflation once again—and inflation then would be even more virulent and powerful than what we have had over the past year. That is why the President has proposed a moratorium on all new spending programs outside of the energy field and why he intends to veto bills which violate that moratorium.

Impact of deficits on the credit markets

A second reason why the administration wants to hold the line on massive new spending programs is in order to preserve the private credit markets.

There is considerable dispute among economists and market specialists on this question. My own view is that the deficits anticipated by the President's program will cause some strains in the markets, but those strains could be manageable. However, in the event that the Congress is unwilling to accept the strong discipline the President is trying to impose upon the Federal spending, the higher deficits that will result will certainly threaten the private credit markets with intolerable burdens. We could quickly clog up those markets and create genuine havoc in the Nation's financial system.

The anticipated deficits already exceed the upper limit of demands that the Government should place on the financial markets. Normally, financial conditions ease substantially in a recession, and normally they remain easy for some time after the recovery gets underway. This slackening occurs because private demands for credit fall off at the same time that the Federal Reserve moves to maintain or increase the rate of growth in money and credit. We have seen some evidence of this easing in recent declines in business loans and in the Federal discount rate. Under such conditions, interest rates decline and credit becomes more readily available—all of which is part of the process by which the economy pulls out of a recession and regains the road to prosperity.

A decline in interest rates, in both the short-term and long-term markets, has in fact been underway for several months. There are reasons to question, however, whether the decline in interest rates will continue.

In the first place, current pressures on the financial markets from private business are heavier than normal for a recession. The borrowing needs of only a few sectors have moderated, and the financing of oil consumption both here and abroad as well as the external financing needs of business have remained extraordinarily large. As businessmen will readily confirm, the inflationary forces of recent years have helped to produce a marked decline in profits and have seriously eroded the liquidity base of both households and businesses. As a result, huge amounts of credit are needed in the private sector just to sustain existing levels of economic activity. Moreover, with the stock market so low that many issues are selling well below book value, new equity financing is not a feasible source of funds. Therefore, the demand from the private sector for new long-term debt issues is unusually high—unusual at least for this stage of the business cycle.

The members of this committee have probably read that borrowing demands are declining in the private sector and therefore, according to some analysts, Federal borrowing should not present a problem in the credit markets. Private short-term credit demands are indeed declining, but the point is that they are not declining as much as we would expect in a normal recession, and corporate bond issues are running at levels considerably above the totals of any other previous year. Our latest projections show that net new corporate bond issues, which rose from $12½ billion in 1973 to $25 billion in 1974, will advance even further to some $30 billion or more in 1975. In addition, while some slowing in business demand for short-term credit is underway, total short-term credit for 1975 is still expected to be one of the highest yearly totals on record.

A second reason why interest rates may not continue their decline lies in the borrowing needs of the Federal Government. Under proposed programs, we estimate that the Treasury during this calendar year will be coming into the capital markets for almost $70 billion of net new financing, of which $65 billion will be marketable securities (table 5). Federally sponsored agencies may account for another $14 billion in borrowing. Total borrowing of net new money attributable to the Federal Government will thus come to an enormous sum—more net new funds, in fact, than have ever been borrowed before by both the private and public sectors combined.

I have frequently attempted to provide some perspective on the enormity of the Government's financing requirements, and I have pointed out that borrowing for all Federal programs has ranged between half to two-thirds of the total amount of funds borrowed by all issuers of securities in the U.S. capital markets in recent years.

In table 6 we have charted the level of Government borrowing in the debt capital markets over a period of more than two decades. This table clearly illustrates the progressive domination of the private capital markets by the Federal Government. In fiscal years 1955–59, the Federal Government accounted for 20 percent of net funds in the capital markets; in fiscal years 1970–74, the Federal share grew to 45 percent. In fiscal year 1976, we anticipate that even with the moratorium on new spending and other spending control measures proposed by the President, total Federal borrowing will account for 68 percent of the capital markets, and if we add to that amount the anticipated borrowing by State and local governments, total government borrowing during the coming fiscal year will be 80 percent of the capital markets. Only 20 percent will be left to private industry in a financial market that has always been the centerpiece of our free enterprise system.

TABLE 5.—*Treasury money market borrowing (including foreign nonmarketable securities)*

[In billions of dollars]

Calendar year	Gross new issues [1]	Maturities [2]	Net new money	Peak increase in borrowing
		First half		
1970	22	24	−2	4
1971	27	24	3	3
1972	13	15	−2	7
1973	17	16	1	10
1974	17	22	−5	4
1975[e]	45	17	28	31
1976[e]	49	23	24	28
		Second half		
1970	31	15	16	16
1971	37	15	22	22
1972	21	7	14	16
1973	20	15	5	5
1974	32	18	14	14
1975[e]	48	11	37	37
		Full year		
1970	53	39	14	14
1971	64	38	25	25
1972	34	22	12	13
1973	37	31	6	6
1974	49	40	9	9
1975[e]	93	27	65	65

[e] Estimated.
[1] Includes increases in regular bills.
[2] Includes paydowns in regular bills.

TABLE 6.—*Net funds raised in the capital markets by major sector*

[Fiscal years, billions of dollars]

	U.S. Treasury and Federal Financing Bank	Federal and sponsored agencies	Total Federal sector	State and local	Corporate and foreign [1]	Total securities	Federal sector as a percent of total securities	Government sector as a percent of total securities [3]
1954	3.6	1.7	5.3	5.5	3.4	14.2	37.4	76.0
1955	1.7	−.1	1.7	5.4	2.6	9.7	17.4	73.1
1956	−4.3	.6	−3.7	4.6	3.3	4.1	----------------	21.0
1957	−3.6	.9	−2.7	4.0	5.7	7.0	----------------	18.6
1958	6.3	.8	7.1	5.1	6.9	19.2	37.1	63.9
1959	8.0	1.4	9.3	5.7	4.7	19.7	47.5	76.4
1960	.8	2.0	2.8	5.7	3.5	12.1	23.5	70.7
1961	2.0	.1	2.1	4.9	5.0	12.0	17.7	58.5
1962	8.8	2.4	11.2	6.0	5.5	22.7	49.4	75.6
1963	6.4	1.1	7.6	5.5	5.5	18.6	40.7	70.3
1964	2.7	1.5	4.2	5.2	3.8	13.2	31.8	71.4
1965	3.1	2.2	5.4	6.9	5.2	17.5	30.8	70.4
1966	−1.0	6.7	5.7	7.3	9.2	22.2	25.8	58.9
1967	.6	2.6	3.3	6.0	12.2	21.5	15.2	43.3
1968	18.2	5.5	23.8	7.2	15.1	46.1	51.6	67.3
1969	−1.9	5.7	3.8	12.0	14.7	30.5	12.4	51.8
1970	6.8	8.1	14.9	9.7	14.8	39.4	37.9	62.4
1971	20.5	2.7	23.2	15.0	23.0	61.3	37.9	62.4
1972	19.6	8.7	28.2	15.6	15.8	59.7	47.2	73.5
1973	18.5	14.3	32.8	12.6	10.5	55.9	58.6	81.2
1974	2.1	21.3	23.3	16.7	15.6	55.6	41.9	72.0
1975e [2]	43.9	17.6	61.5	12.5	26.3	100.3	61.3	73.8
1976e [2]	63.7	14.7	78.4	14.6	22.7	115.7	67.8	80.4

e Estimated.

[1] Bonds issued by nonfinancial corporations.

[2] Assumes adoption of President's budget program, with budget deficits of $35 billion in fiscal 1975 and $52 billion in fiscal 1976.

[3] Includes State and local as part of government sector.

Source: Fiscal 1954–1974 data based on Federal Reserve Board "Flow of Funds."

Some observers have suggested that those figures are misleading because they do not take into account the full range of borrowing in our financial markets. For instance, they do not encompass the mortgage market. My staff has recently been working to develop measurements of the entire financial markets. This project poses many difficult analytical and data collection problems, but we have developed preliminary data for current years, and in the near future we hope to have a more comprehensive presentation which will show these borrowing activities for earlier years. The preliminary data is included in tables 7A, 7B, and 7C. These tables measure the levels of borrowing in all of our financial markets for fiscal years 1972 through 1976 and show the impacts of Federal and federally assisted borrowings on each major sector within these markets. Included here are the markets for debt securities, mortgages, securities, business loans, and consumer credit.

These are remarkable tables, and I would urge that at your leisure each of you spend a few moments examining them. The tables show that the estimated Federal share of funds raised in all sectors of the economy increased from less than one-fourth in fiscal year 1974 to almost one-half in fiscal years 1975 and 1976. The growing domination of the Government in our credit markets represents an alarming situation, reflecting the even more alarming growth of Government in this country.

It is startling enough to realize that we reached the point in recent years where the Federal Government's stamp was on 1 out of every 4 dollars of credit flowing in this country. But we are now entering a period in which 1 out of every 2 credit dollars must be blessed by Washington.

TABLE 7A.—*Federal and federally assisted credit as percent of total flow of funds in U.S. financial markets, by type of credit**

[Fiscal years 1975 and 1976 projected; dollar amounts in billions]

Net funds raised	Fiscal 1975			Fiscal 1976		
	Total	Federal Government	Percent	Total	Federal Government	Percent
Long-term funds:						
Mortgages:						
Residential	$35.3	$10.4	29.5	$43.7	$8.5	19.5
Commercial	7.9			8.7		
Farm	4.6	6.9	150.0	5.2	3.8	73.1
Total	47.8	17.3	36.2	57.6	12.3	21.3
Corporate securities: **						
Bonds	29.1	2.0	6.9	26.9	1.6	5.9
Stocks	5.3			7.9		
Total	34.4	2.0	5.8	34.8	1.6	4.6
Total long-term funds	82.2	19.3	23.5	92.4	13.9	15.0
Government securities:						
U.S. Government	43.9	43.9	100.0	63.7	63.7	100.0
Federal agencies	17.6	17.6	100.0	14.7	14.7	100.0
State and local governments	12.5	2.2	17.6	14.6	1.9	13.0
Total	74.0	63.7	86.1	93.0	80.3	86.3
Other funds: ***						
Business credit	36.8	6.1	16.6	41.1	7.9	19.2
Consumer credit	3.2	.1	3.1	7.0	.3	4.3
Security credit	−.4			1.0		
Other loans, including foreign	1.9	4.0	210.5	9.2	5.3	57.6
Total	41.5	10.2	24.6	58.3	13.5	23.2
Total funds raised	197.7	93.2	47.1	243.7	107.7	44.2

* Based on Federal Reserve flow of funds accounts (through third quarter 1974) and Special Analyses C and E, Budget of the U.S. Government, 1976.
** Including foreign.
*** Includes bank term loans and long-term Federal credits.

TABLE 7B.—*Federal and federally assisted credit as percent of total flow of funds in U.S. financial markets, type of credit**

[Fiscal years 1973 and 1974; dollar amounts in billions]

Net funds raised	Fiscal 1973			Fiscal 1974		
	Total	Federal Government	Percent	Total	Federal Government	Percent
Long-term funds:						
Mortgages:						
Residential	$55.7	$10.9	19.6	$45.3	$12.9	28.5
Commercial	16.7			15.9		
Farm	3.3	3.2	97.0	4.5	2.1	46.7
Total	75.7	14.1	18.6	65.7	15.0	22.8
Corporate securities:**						
Bonds	15.5	.2	1.3	17.4	.6	3.4
Stocks	12.2			7.1		
Total	27.7	.2	.7	24.5	.6	2.4
Total long-term funds	103.4	14.3	13.8	90.2	15.6	17.3
Government securities:						
U.S. Government	18.5	18.5	100.0	2.1	2.1	100.0
Federal agencies	14.3	14.3	100.0	21.3	21.3	100.0
State and local governments	12.6	2.2	17.5	16.7	1.9	11.4
Total	45.4	35.0	77.1	40.1	25.3	63.1
Other funds:***						
Business credit	53.1	4.5	8.5	72.3	6.8	9.4
Consumer credit	23.3			16.3	.1	.6
Security credit	−4.8			−3.7		
Other loans, including foreign	13.2	3.2	24.2	13.8	2.4	17.4
Total	84.8	7.7	9.1	98.7	9.3	9.4
Total funds raised	233.6	57.0	24.4	229.0	50.2	21.9

*Based on Federal Reserve flow of funds accounts and Special Analyses C and E, Budget of the U.S. Government, 1975 and 1976.
**Including foreign.
***Includes bank term loans and long-term Federal credits.

TABLE 7C.—*Federal and federally assisted credit as percent of total flow of funds in U.S. financial markets, type of credit**

[Fiscal year 1972; dollar amounts in billions]

Net funds raised	Total	Federal Government	Percent
Long-term funds:			
Mortgages:			
Residential	43.7	11.2	25.6
Commercial	12.6		
Farm	2.6	2.3	88.5
Total	58.9	13.5	22.9
Corporate securities:**			
Bonds	21.6	.2	.9
Stocks	15.5		
Total	37.1	.2	.5
Total long-term funds	96.0	13.7	14.3
Government securities:			
U.S. Government	19.6	19.6	100.0
Federal agencies	8.8	8.8	100.0
State and local governments	16.2	1.9	11.7
Total	44.6	30.3	67.9
Other funds:***			
Business credit	26.7	3.3	12.4
Consumer credit	15.2		
Security credit	9.5		
Other loans, including foreign	9.4	2.9	30.9
Total	60.8	6.2	10.2
Total funds raised	201.4	50.3	25.0

* Based on Federal Reserve flow of funds accounts and Special Analyses C and E, Budget of the U.S Government, 1976.
** Including foreign.
*** Includes bank term loans and long-term Federal credits.

There are several ways in which the strains created in the private capital markets by Federal borrowing could be eased this year. For instance, the deficits could be financed without difficulty and interest rates could decline even further if the recession becomes deeper than we expect, if inflation subsides more than we anticipate, if the OPEC nations put a larger amount of their accumulated funds into investments in this country, or if the American people save more and spend less of their rebate. Some financial analysts expect such developments even with a set of economic projections similar to our own. We cannot, however, be sure that any one of these events will occur so that it would be foolish to base our policy decision upon such assumptions.

Moreover, we must be aware of what might happen if the Federal Government does begin to elbow other borrowers out of the market:

> Housing, for example, is always at the end of the line in the credit markets and thus the first sector to be crowded out. We now expect that a recovery in housing starts will get underway by midyear, but we cannot overload the continuing danger that excessive Government borrowing, coupled with a high demand coming from a private sector that is suffering from illiquidity, could drive up interest rates and seriously disrupt this recovery or even abort it at an early stage.
>
> Business firms of marginal financial strength, especially small businesses, would also be cut off from the supply of credit if the Federal Government completely dominates the capital markets. This would further weaken the creditworthiness of such firms. Lenders would then intensify their preference for high-quality debt issues, and marginal firms would be unable to obtain enough credit. Their ability to expand would therefore be limited and bankruptcies could result.

Let me stress that I am not predicting these events, I am only suggesting the scenarios that could unfold if we ignore the President's call for fiscal discipline and increase Federal deficits beyond their projected levels. It is too early to tell precisely what will happen this year in the credit markets, but we do know that Government will preempt most of this market and we must constantly be alert to the possibility that unrestrained Government borrowing could drive the economy into an even worse mess than it is today.

Some observers suggest that it would be easy to avoid these difficulties—at least for now—if the Federal Reserve were to adopt more aggressively easy monetary policies. In other words, to prevent the Federal Government's demands from crowding others out of the market, the Federal Reserve would make the market larger by increasing the total supply of money and credit. This approach, however, is a sure formula for still higher inflation rates when the recovery gets into full swing—if not sooner. It does not solve our problems, it only postpones them, and when they recur they could be much worse than they are today. By now, like the man who gives up drinking because he can't stand the hangovers, we should have learned that short-term binges with easy money and excessive spending are no substitute for the long-term virtues of savings, investment and moderation in our monetary and fiscal policies.

This dilemma, I would hope, emphasizes for all of the members of this committee the fundamental importance of a tough policy to restrain the growth of budget outlays by reducing less urgent programs and postponing new initiatives that are not included in the President's package of economic and energy policies. We already have enough problems on our hands—many of them created by irresponsible Government policies over the past decades—so that we should be sensible enough to avoid the shoals of even more serious troubles.

Let me review for a moment the staggering size of the deficits that are already contemplated. Under the budget program submitted by the President, the deficit estimated for fiscal year 1975 is close to $35 billion and in fiscal year 1976 the estimated deficit is the biggest in peacetime history—almost $52 billion. That's a total of approximately $87 billion over 2 fiscal years, an amount that hardly anyone can welcome gladly. But I would remind you that even these deficits are significantly below what will happen without the cap that the President is seeking to impose on Federal expenditures. Six billion dollars will be saved by limiting Federal pay increases to 5 percent through the end of fiscal year 1976 and by placing a similar limit on those Federal benefit programs, like social security, that increase automatically with the cost of living. In addition, we can realize savings of $14 billion through the budget reductions requested or planned by the administration for fiscal years 1975 and 1976. Thus, overall, the President's proposed actions would save $20 billion in expenditures. If the Congress ignores this call and overrides the President without making savings in other areas, the additional $20 billion in deficits would make the combined deficit figure for fiscal years 1975 and 1976 well over $100 billion—more than the total deficits of the previous 10 years combined.

Unfortunately, even these deficits do not tell the full story of Federal borrowing, for they do not include the borrowing for off-budget programs or the myriad of obligations issued by federally sponsored agencies or guaranteed by Federal agencies. For fiscal years 1965–1974, the cumulative deficit of the unified budget was $102.9 billion. During that same period, the cumulative borrowing for off-budget programs was $137 billion.

I cannot overemphasize the dangers that may be created by such mammoth deficits at the Federal level, nor can I urge upon you more strongly a plea for maximum fiscal discipline during the life of the 94th Congress. It is absolutely imperative that during the 1970's we turn this country's fiscal policies around.

The capital investment challenge

If time permitted today, I would very much like to discuss with you in greater detail the impact that the growth of Government has had upon our free market system:

The way that irresponsible fiscal and monetary policies stretching back to the mid-1960's and earlier have created strong, underlying forces of inflation in our economy, forces that we must contend with for many years to come;

The way that excessive governmental regulation has discouraged new production and growth in many of our industries, particularly in the fields of agriculture and energy;

The way that the wage and price controls of the early 1970's disrupted the economy and have left us a residue of troubles that are still working their way through the system;

The way that the Government's policies have encouraged consumption at the expense of adequate savings and investment;

The way that broad Government domination of many of the industries in the Nation has stifled individual initiative and spawned a new breed of business managers who seem more eager to rely upon the judgments of a GS-16 in Washington than upon their own judgments and competitive instincts. To me, there is nothing more distressing than to see businessmen trade their economic freedoms to the Government in exchange for what they falsely perceive to be financial security.

Rather than dwelling further on this point, however, I ask you to consider the net result of the kind of Government growth as well as other social forces which have gained favor in the United States.

The net result, I would suggest, is that we have tilted our great economic machine in the wrong direction. Instead of continually renewing and enlarging our economic foundations, we have allowed them to rust and crumble while we have enjoyed a long binge of overspending and overconsumption. The bills are coming due today, and unless we soon reverse these trends, the bills can only grow larger in the future.

Once again, let's look at the facts. From 1960 through 1971, as an accompanying table shows (table 8), annual capital investment in this country averaged approximately 18 percent of our gross national product—the smallest figure of any major industrialized nation in the free world. In Japan, for instance, annual capital investment averaged over 33 percent of the GNP, while in Germany it averaged 26 percent and in France, 25 percent. Thus, the amount of its annual income that the United States was willing to put back into new plant equipment was smaller than in most of the nations with whom we compete.

TABLE 8.—*International comparisons of investment and productivity, 1960 through 1973*

	Average private investment as percent of GNP (excluding defense expenditures)	Average annual growth in productivity (output per man-hour)
		Percent
United States	18.0	3.3
Canada	22.4	4.3
Japan	33.4	10.7
France	24.9	5.9
Germany	26.2	5.8
Italy	21.4	6.2
United Kingdom	18.9	4.2
OECD less United States*	24.2	6.3
All OECD*	20.5	4.8

*Figures in the first column for the OECD country groups represent private investment as a percent of GNP including defense expenditures and cover the 1960-1971 period only.

Sources: OECD and national sources; Bureau of Labor Statistics.

The recent figures that are available for international comparisons—figures showing investments in 1973—indicate an even bleaker investment picture for the United States. In that year, our investment in private industry sank to 14.9 percent of our GNP, lower than any other major industrialized nation except Italy.

Higher rates of capital investment do not guarantee lower rates of inflation. Japan, for instance, has the highest rate of inflation among the countries mentioned, even though it has also had the highest level of capital investment. But there is a close correlation between the rate of capital investment and the increase in a nation's productivity. The annual growth in productivity during the 1960's and early 1970's averaged more than 10 percent in Japan, almost 6 percent in

Germany and France, and only 3.3 percent here in the United States. As you can see, the United States had the lowest level of capital investment among these countries and also the rate of growth in productivity. I need not explain to this committee that it is growth in productivity which determines how much of an increase in living standards that the American people can achieve over time.

In the future, we are going to have to do better. The capital requirements of the American economy over the next decade will be enormous. We will need up to a trillion dollars for energy alone. Beyond that, we will need extremely large sums for control of pollution, urban transportation, and rebuilding some of our basic industries where new investment languished over the past decade. In addition, there are the more conventional, but still mammoth, requirements for capital to replace and add to the present stock of housing, factories, and machinery.

Yet in the face of these massive requirements, we are not providing adequate incentives for new investment. Over the past decade the inflation has led to high effective rates of business taxation and low rates of profitability, which in turn have greatly eroded the incentives for capital formation. It is not unfair to say that we are in a profits depression in this country. Nonfinancial corporations reported profits after taxes in 1974 of $65.5 billion as compared to $38.2 billion in 1965, an apparent 71-percent increase. Those profit increases are an optical illusion created by inflation and outmoded accounting methods. When depreciation is calculated on a basis that provides a more realistic accounting for the current value of the capital used in production and when the effect of inflation on inventory values is eliminated, after-tax profits actually declined from $37.0 billion in 1965 to $20.6 billion in 1974—a 50-percent decline. A major factor contributing to this decline is that income taxes were payable on these fictitious elements of profits. That resulted in a rise in the effective tax rate on true profits from about 43 percent in 1965 to 69 percent in 1974.

Corporate profits normally provide the foundation upon which corporations build for the future. They are not only a source of investment funds in themselves, but they also permit corporations to attract or borrow other funds which may be used for capital investment and which in turn create more jobs. The decline in profits therefore has grave implications for capital formation and growth. That is perhaps seen best in the figures for retained earnings of nonfinancial corporations, restated on the same basis to account realistically for inventories and depreciation. It is the retained earnings that corporations have available to finance additional *new* capacity, as distinguished from the replacement of existing capacity. In 1965, retained earnings totaled $20 billion. By 1973, after 8 years in which real GNP had increased more than 35 percent, the retained earnings of nonfinancial corporations had dropped 70 percent to $6 billion. And for 1974, our preliminary estimate for retained earnings is a *minus* of nearly $10 billion. That means that there was not nearly enough even to replace existing capacity, and nothing to finance investment in additional new capacity.

It is a simple but compelling economic fact of life that increases in productive performance are required over time to support a rising standard of living. Yet, as a Nation, we are rapidly expanding public payments to individuals but neglecting to provide adequate incentives for new investment. Since 1965, in real terms, economic output has increased by one-third while government transfer payments to persons have more than doubled. On the other hand, private investment expenditures—upon which the economic future of all of us inevitably depends—have failed to keep pace, rising by approximately one-fourth.

It is imperative that we make better provision for the future. This means that we must place much greater emphasis upon saving and investment and much less upon consumption and government expenditure. Today, recession and inflation dominate the discussion of economic events and policy. We must take determined action to deal with these interrelated problems and I believe we shall. At the same time, however, we must begin to shift the longrun balance of domestic priorities away from consumption and government spending and toward investment and increased productivity. I believe history will judge us, not on how we handle our shortrun problems such as recession, but on our ability to deal with the more fundamental problems of the allocation of resources and capital formation. If, as a Nation, we fail to address these problems, we will fail to attain the prosperity and the rising standard of living that the American people can achieve. I hope that the recession has taught all of us the folly of pursuing a "no-growth" policy, as some figures once argued. Our goal should be to enlarge the economic pie, not just redistribute it.

Conclusion

While many of the challenges of the economy must be solved primarily in the private sector, the Federal Government has a positive responsibility to help, and there are a number of ways that I believe we can help:

First, we can and must take steps to prevent the recession from deepening to intolerable levels.

Second, we must not abandon the more long-range fight against inflation, for inflation is a bitter enemy of savings and investment and exacts a heavy toll on economic growth.

Third, we must enact legislation that will create greater incentives for capital investment and will allow our financial institutions to operate more flexibly.

Fourth, we must lift the heavy hand of Federal regulation from the many areas where it restricts the efficiency and growth of the free enterprise system. Competition is still the best route to an efficient and productive economic system, and that in turn remains the best means we have of fighting inflation and creating more jobs.

Fifth, as we emerge from the recession, we must restore a reasonable balance to the Federal budget and even seek to achieve budgetary surpluses in better years so that we can free up a maximum amount of capital for savings and investment.

Finally, even as we recognize that the Government should provide strong leadership, let us also resist those who would have us turn to the Government for solutions to *all* of our problems.

Considering the severity of our economic troubles today, it is easy to understand why there are so many who look to Government for instant answers. Many want to take the easy road, which means letting Government intrude more and more into our daily lives. We should understand by now that whenever we allow the Government to do something for us that we can do for ourselves, we must surrender some of our own freedom. In these difficult times, there is a continuing danger that temporary security may become so attractive to many Americans that they may become not only willing but eager to give up more of their liberty in return for security.

If we have neither the strength nor the wisdom to say "no" to those who call for further Government domination over our affairs, we will set this Nation on the road to a planned economy and the destruction of the free enterprise system that has preserved our liberties and given us the highest standard of living man has ever known. I do not want that for my children, and I am sure you don't want it for yours. Let us recognize, then, that each of us must accept the risks of freedom so that we may preserve its rewards.

Thank you.

TABLE 9.—*Summary reconciliation of debt limit need in fiscal years 1975 and 1976 with budget and off-budget activity*

[In billions of dollars]

	1975	*1976*
Debt subject to limit end of prior year	476	531
Adjusted to $6.0 cash balance	473	531
Plus:		
Unified budget deficit	35	52
Trust fund surplus	8	3
Off-budget agency spending financed by Treasury	14	11
Allowance for contingencies	3	
Less:		
Change in checks outstanding (assumed flow of tax rebate checks)	2	−2
Equals debt subject to limit end of year	531	599

Exhibit 12.—Statement of Deputy Secretary Gardner, May 14, 1975, before the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing, and Urban Affairs, on S. 1267, the proposed Financial Institutions Act of 1975

I appreciate the opportunity to testify on behalf of S. 1267, the so-called Financial Institutions Act (FIA) of 1975. This committee has played a leading role in the Congress in the consideration of these structural reforms which will broaden the powers of financial intermediaries that serve consumers. Nothing has happened since the original drafting of similar legislation in 1973 that invalidates the concept and purpose of the legislation. On the contrary, the need for granting expanded powers has been demonstrated by our problems with inflation and disintermediation. In fact, in the last year your committee's hearings and the substantial dialogue between industry and consumer representatives and the Treasury Department have developed better understanding and support for the principal thrust of S. 1267.

The proposed Financial Institutions Act of 1975 also contains a number of significant changes from the legislative proposals you considered last year. I believe these changes are responsive to the comments made at your hearings and our discussions with the public.

The bill before you now is designed to increase the strength and viability of a number of classes of financial institutions by permitting them to respond more readily to economic, financial, and institutional change. But I want to say at the outset that a clear beneficiary of this change will be the consumer. The bill encourages greater competition and provides new opportunities for savers to earn a competitive rate on their investment while providing homebuyers with greater assurance that the flow of funds for home mortgages will not be disrupted during periods of high interest rates.

If the Congress enacts this bill into law, our financial institutions will benefit from the ability to offer new services and enter new markets; and their customers, both depositors and borrowers, will share these benefits.

Savings and loan associations and mutual savings banks will be permitted to offer checking and negotiable order of withdrawal (N.O.W.) accounts to individuals and businesses, while diversifying a portion of their investments into consumer loans, unsecured construction loans, commercial paper, and certain high-grade private debt securities.

Commercial banks will be permitted to offer corporate savings accounts and N.O.W. accounts. Credit unions will be permitted to offer mortgage loans to members, make a wider range of loans at more varied interest rates, and set up an emergency loan fund.

To improve the availability of mortgage credit, commercial banks, savings and loan associations, mutual savings banks, and other taxable financial institutions will be granted a new tax incentive to enlarge their volume of mortgage loans. Finally, the act provides for the elimination of interest rate ceilings on all types of savings over a 5½-year period.

The significant changes from the original proposal involve two sections of the legislation.

First, the abolition of interest rate ceilings on deposits will still occur 5½ years after the passage of the act. However, prior to the removal of ceilings, the administration will conduct an intensive investigation to examine economic and financial conditions at that time. The study will include a review of the general state of the economy as it relates to financial institutions, how savings institutions have responded and used their new powers, and the needs and interests of the consumer/saver. The President and the Congress will then have the opportunity, if appropriate, to make any final improvements in the direction of the legislation.

It is our conviction that within 5½ years the thrift institutions, with broader powers to compete for deposits, will not need the artificial ceilings imposed by Regulation Q. During this period the coordinating committee will continue to have, however, the authority to set ceilings and differentials.

Second, the mortgage interest tax credit is included in the act as before, but savings and loan associations and mutual savings banks will be given a one-time option until 1979 to decide when to substitute this tax measure for their current bad debt loss deduction. By 1979, all savings institutions will be required to shift to the mortgage interest tax credit.

In addition, the bill has also been changed to clarify the language which authorizes S&L's to make residential mortgage loans. The purpose here is to provide parity with commercial banks. In addition, the permissible investment of S&L's in corporate assets has been expanded to include bankers' acceptances, and Federal Home Loan Mortgage Corporation securities.

Under the new version of the bill, credit unions will have the authority to make mortgage loans for up to 30 years to members, and the limits on unsecured loans are raised from $2,500 to $5,000 for credit unions that otherwise qualify.

Housing and the Financial Institutions Act

Mr. Chairman, I feel that the impact of the Financial Institutions Act on housing is a matter of great consequence. We have prepared a Treasury paper on the interaction between the FIA and housing which I have appended to my testimony and would like to submit for the record.[1]

Our views and findings in this area can be summarized briefly.

During the past 10 years, the residential construction industry has undergone three major housing cycles. The last decline has been particularly devastating: The drop in housing starts has been more severe and protracted than any other since World War II.

Much of the decrease in residential construction is the result of rising inflation, tight money, and unemployment. However, the situation has been aggravated by the statutory imperfections in the housing financing system.

In an effort to provide long-term reform of our financial institutions and reduce the severity of housing credit cycles, the administration has indeed proposed the FIA. But I should make it clear that the FIA was not intended solely as a housing measure. The basic purpose of the act is to achieve needed reform and flexibility for our financial institutions. The FIA is concerned with housing, but it is also concerned with assuring the consumer/saver of an adequate return on his savings and a wider variety of financial services, ending the disruptive and unstable pattern of savings flows to mortgage-oriented thrift institutions, increasing the strength and flexibility of these institutions, and raising the efficiency of the financial system through a greater reliance on market forces.

In the process of achieving all of these objectives, we believe that the FIA will also increase the longrun supply of housing credit and reduce the cyclical instability of mortgage financing.

Under the provisions of the FIA, mortgage-oriented thrift institutions will retain their specialized functions. They will tend to do so because of the competitive advantages of specialization, and because of the positive incentive offered by the mortgage interest tax credit provisions in title VII of the bill.

The growth of transactions balance held in these institutions as a result of their new checking account and N.O.W. account powers will add a stable source of funds for mortgage lending. The higher interest rates that institutions will be able to offer depositors as a result of increased consumer lending will attract new savings. Recent studies have shown that savings flows are highly responsive to small changes in deposit rates. If the increased yield from consumer loans enables mortgage-oriented thrift institutions to offer more competitive rates, the new savings flow is likely to exceed the volume of funds invested in consumer loan assets. As a result, there will be a larger volume of funds available for mortgage lending.

Nor will S&L's switch to consumer loans to the detriment of mortgage lending. S&L's are mortgage specialists and have expressed a strong commitment to maintain their traditional role. A comparable study of Texas savings and loan associations found that in every year between 1960 and 1972, the State chartered associations—which possess consumer lending powers—had a higher percent of savings in mortgage loans than the Federal associations. We expect consumer loans to complement mortgage loans; they will certainly not replace them.

In addition, the mortgage interest tax credit provision of the FIA will serve as an automatic stabilizer with respect to mortgage credit flows. During times of tight credit, the M.I.T.C. offers a greater incentive for thrift institutions to continue to invest in housing. If a thrift has 70 percent or more of its portfolio in mortgages, the credit raises the before-tax rate of interest on a 7-percent mortgage to 7.47 percent, a gain of 47 basis points. If, on the other hand, the mortgage interest rate is 10 percent, the equivalent before-tax yield is 10.67 percent, a gain of 67 basis points. In other words, the absolute rate advantage of mortgages will rise during times of tight money, making mortgages relatively more attractive to investors when credit is scarce.

In addition, the mortgage interest tax credit will increase the absolute importance of mortgage investments by institutions such as commercial banks. These are less subject to disintermediation and therefore total mortgage flows will be less variable.

In conclusion, I want to stress that virtually all of the available studies on financial reform along the lines of the FIA support the conclusion that housing will benefit as a result of such a program. This was the result of a study by Professors Barry Bosworth of the University of California at Berkeley and James Duesenberry of Harvard University, and it was confirmed in the recent study by the Federal Home Loan Bank Board which was prepared for your

[1] Not included in this exhibit.

committee. Further, similar results were presented in testimony to this subcommittee by Prof. Dwight Jaffee of Princeton University during the 93d Congress. We have submitted copies of what we believed to be the most significant of these studies to members of your staff, and I would be happy to submit this list for the record. I believe that you will find substantial agreement among professional economists on the need for the FIA.

Credit unions and the Financial Institutions Act

I understand that in this set of hearings the subcommittee is also considering S. 1475, Credit Union Financial Institutions Act amendments of 1975. The credit union amendments cover three major areas: (1) Restructuring the National Credit Union Administration (NCUA), (2) expanded powers, and (3) a broad central liquidity facility.

Regarding the restructuring of the National Credit Union Administration, we have not felt that detailed reform of the regulatory agencies should be included as a part of the Financial Institutions Act. Regulatory agency reform is a complex question and requires careful, independent review. While we have no objection in principle to separate consideration by the committee of the proposed restructuring of the NCUA, we do not feel it should be part of the FIA.

In the matter of expansion of credit union powers, the Treasury Department has held a number of meetings with credit union associations. We feel that as other financial institutions are allowed to expand their powers, credit unions indeed should receive similar opportunities. However, it is important to remember that credit unions have a unique role in the family of financial institutions. They serve a limited membership drawn together by some type of "common bond," and they enjoy a special tax-exempt status.

Under the revised version of the FIA, the powers of credit unions would be expanded significantly. As a part of the act, credit unions will be able to offer mortgages to their members. The maximum term of unsecured loans will be raised from 5 to 7 years, and the maximum term for secured loans from 10 to 12 years. The FIA provides for extending lines of credit to credit union members and permits such credit to vary according to the creditworthiness of their borrowers. The act permits the issuance of share certificates with varying dividend rates and maturities subject to the rules of the NCUA. And the FIA further authorizes the administrator of the National Credit Union Administration to approve loan rates above the statutory ceilings if it is appropriate.

In addition, there are a number of items that are not included in the Financial Institutions Act which we believe can be handled by regulation, subject to the judgment of the administrator of the National Credit Union Administration. For example, credit unions are concerned about third-party payments. The Financial Institutions Act does not provide for this specifically, but there is currently a share draft experiment underway which provides third-party payments for an experimental group of credit unions. We support this innovative experiment, and we are optimistic about the results.

The expanded credit union powers proposed in S. 1475 would go far beyond the balanced expansion of powers proposed in the FIA. The more significant provisions of S. 1475 would eliminate the common bond requirement, generally diminish NCUA's regulatory control, and provide authority to accept demand deposits, to participate with other lenders, to make any loan which is guaranteed by the Federal Government or State government, to provide personal trust and custodial services, to deal in "any money transfer instrument," and to hire professional managers. If this bill is enacted, credit unions would be indistinguishable from taxpaying thrift institutions.

The principal differences between the discount fund proposed in the FIA and the central liquidity facility (C.L.F.) proposed in S. 1475 are in its scope and financing.

The discount fund would be authorized to lend to its member credit unions to provide funds to meet emergency and temporary liquidity problems. The purposes of the C.L.F. would be to provide funds to meet the general liquidity needs of credit unions.

The discount fund would be authorized to borrow only from the Treasury in amounts up to five times its paid-in capital but not in excess of $150 million outstanding as authorized in appropriations acts and only in the event that the Secretary determines that an emergency exists and that there are insufficient funds in the discount fund to meet its obligations for advances to members.

The C.L.F. would be authorized to issue bonds and other obligations in the market up to 20 times its paid-in capital. Obligations of the C.L.F. would be fully and unconditionally guaranteed both as to interest and principal by the United States, and such guarantee would be required to be expressed on the face of the obligations. This provision would appear to bring the obligations of the C.L.F. within public debt subject to statutory limitation.

The C.L.F. would also be authorized to require the Treasury to lend it up to $1 billion in the event that there are insufficient funds in the C.L.F. to meet obligations for advances to members.

The broad scope of the expanded powers and C.L.F. proposals in S. 1475 raises important questions about the role of credit unions vis-a-vis competing depository-type lending institutions that bear on the tax-exempt status of credit unions. Such powers would also raise questions about the philosophy of the concept of "common bond" memberships joining together to make loans to members from the savings of other members. Authority for the C.L.F. to issue its own obligations in the market raises serious concern about the proliferation of Federal agency borrowing activities in the marketplace.

Mr. Chairman, I would again like to take the opportunity to commend you, your committee, and your staff for the consideration you have given to financial reform. Through your efforts a central forum has been provided for the discussion of policies which attempt to deal with the inadequacies of our present system of financial intermediation.

When the Financial Institutions Act was first introduced in October 1973, its method of balanced reform included measures that would strengthen the entire system. At that time each institutional group favored that portion of the bill which seemed to add to its competitive well-being and opposed measures that it felt would add to the strength of its competitors. Where the threat was perceived to be serious, institutions flatly rejected the idea of any reform at all.

Two years of recurrent high interest rates have accomplished a great deal by convincing a number of institutions and regulatory authorities of the need for immediate action and reform to enable the financial system to better cope with high interest rates and dramatic change.

It is gratifying to see that interest in reform through expanded services to depositors and borrowers has been generally accepted. The Federal Home Loan Bank Board has published or adopted regulations permitting an expanded bill-payment-type automatic third-party payment and a limited consumer-lending authority for S&L service corporations. Credit unions, with the approval of the National Credit Union Administration, are experimenting with share drafts. The National Commission on Electronic Fund Transfers, the Fair Credit Bill, Truth-in-Lending Act amendments, and the Equal Credit Opportunity Act are all in the spirit of the FIA.

We applaud such independent movement toward financial reform. At the same time, we must caution against a piecemeal approach.

The FIA–75 is a minimum reform, emphasizing balance and comprehension. It seeks to achieve financial reform while maintaining the competitive balance between institutional classes. As a result it is important that the measure be passed as a whole, rather than be broken into piecemeal legislation which might substantially alter the relative strength of competing financing institutions. It is also important that it be passed intact because certain beneficiaries, such as savers, are generally not formally organized to present their views, and may not receive sufficient consideration in a series of partial measures.

The FIA is important, responsible legislation. Over the last few years it has received substantial support from the nonpartisan academic community. It is time for the Congress to move forward. The penalties of waiting will indeed be high.

Exhibit 13.—Statement of Secretary Simon, June 25, 1975, before the Senate Finance Committee, on extension of the debt limit

It is again time to consider the borrowing authority of the Treasury Department.

The present temporary debt ceiling of $531 billion, which was enacted by the Congress on February 19, will expire at the end of this month. On July 1, in the absence of new legislation, the Treasury will be unable to issue any new debt obligations of any kind, either to refund maturing issues or to raise needed new money.

In the past, Secretaries of the Treasury have come to the Congress—as I have today—to request an increase in the debt limit only when the Treasury was close to running out of borrowing authority. I doubt, however, whether this procedure has really insured the most productive consultation between the Congress and the administration. For that reason, I would like to discuss with you today, as I did earlier with the Ways and Means Committee, some possible new departures.

Under the new procedures prescribed in the Congressional Budget and Impoundment Control Act of 1974, the Congress has now established its own timetable for determining the Government's aggregate receipts, outlays, deficit, and debt. As the new congressional budget and debt limit process is placed into effect, it would seem to me appropriate for this committee to consider shifting its focus from the amount of the debt to the way in which the debt is managed; that is, to the timing of debt issues, the size of denominations, the maturity structure, and the marketing techniques.

While a detailed account of the stewardship of the Secretary of the Treasury with regard to these debt management matters is already presented to the Congress each year in the Annual Report of the Secretary of the Treasury on the State of the Finances, we would be happy to work with this committee in any way that it sees fit in scheduling oversight hearings for the review of these important governmental activities in greater depth.

In this regard, I should note the considerable discussion in recent months of the potential impact of large Federal deficits on the prospects for economic recovery. Dr. McCracken put the matter succinctly when he noted before the Joint Economic Committee earlier this year that:

> If the financial community has been slow to appreciate the role of fiscal policy in the management of the economy, economists have been slow to face fully the implications of the fact that Treasury financing and private borrowing do compete for funds in the same money and capital markets. And Treasury requirements are now large enough so that their impact on financing in the private sector must be faced quite explicitly.

For the fiscal year 1976, the whole Congress has already spoken with regard to the debt limit. The congressional budget resolution for fiscal 1976, which was adopted by the Congress on May 14, provided for an $86.6 billion increase in the debt limit to a figure of $617.6 billion for the fiscal year ending June 30, 1976.

I understand that this congressional action does not have the force of law in the sense of providing the Treasury with borrowing authority after the end of this month. Yet, as I said to the Ways and Means Committee, I wonder whether it would not be more productive if we just accepted that number and got down to a more substantive discussion of the real issues of debt management.

We all know that there is no widespread inclination to use the debt ceiling as a real determinant of Federal spending and taxing. Decisions on those subjects are made by the Congress in other legislation, and once the taxes are set and the spending is mandated, the Government has no choice but to borrow to cover the differences between its revenues and outlays.

I could, therefore, accept the $617.6 billion figure as a reasonable estimate of the peak borrowing of the Treasury in the next fiscal year despite the fact, which you all know, that the fiscal 1976 budget deficit figure adopted by the Congress in its May 14 action is significantly larger than the deficit proposed by the President.

In suggesting that Ways and Means also adopt the $617.6 billion figure, I was influenced by several considerations.

First, I had understood that the Congress in setting its debt ceiling figure was concentrating on a forecast of the June 30, 1976, debt level. Normally, however, the debt is as much as $5 billion higher a few weeks earlier in mid-June just before the heavy June tax receipts are received.

Second, I understood that the Congress was operating with an estimate which was about $5 billion lower than our current estimate of Federal borrowing which is subject to the debt ceiling even though the purpose is to finance Federal agency programs which have been placed outside the budget.

Table 1 shows our estimates, based on the President's proposed budget program in 1976, of debt subject to statutory limitation at the end of each month through fiscal year 1976, as well as the peak debt in mid-June 1976. Our estimates include all Treasury borrowing to finance both budget and off-budget programs and make the usual assumptions of a $6 billion cash balance and $3 billion margin for contingencies. The table shows our peak debt limit need on June 15 at $613 billion, compared to the congressional figure of $617.6 billion. Given the uncertainty in estimates and the fact that the debt limit does not control spending, I questioned whether this relatively small difference was worth an extensive legislative exercise.

Indeed, in view of the new congressional procedures, the committee should consider doing away with separate legislation on the debt ceiling and concentrating on our debt management operations.

As members of this committee know, the House yesterday approved an increase in the debt limit to $577 billion through November 15, effective on the date of enactment. I am glad to be able to endorse this action as evidencing a reaffirmation of the policy adopted in the Congressional Budget and Impoundment Control Act.

Obviously, I believe that the President's views on the size of the budget deficit in fiscal 1976 should and will prevail. But it seems to me that the House action is a highly responsible act in that it provides the borrowing authority required by the budgetary targets adopted by the Congress on May 14.

It also seems to me to be significant that the expiration of the temporary limit under the House bill essentially coincides with the date for the final congressional resolution on the budget totals. Since the Congress will speak to the debt limit in that resolution, that action on the debt limit itself will be a pro forma action, and an opportunity will be afforded for the review of our debt management operations and economic and financial developments in some more detail than heretofore has been feasible.

TABLE 1.—*Public debt subject to limitation, fiscal year 1976, based on estimated budget receipts of $299.0 billion, outlays of $358.9 billion, unified budget deficit of $59.9 billion, and off-budget outlays of $14.2 billion*

[In billions of dollars]

	Operating cash balance	Public debt subject to limitation	With usual $3 billion margin for contingencies
1975		ESTIMATED	
June 30	6	533	536
July 31	6	540	543
Aug. 31	6	548	551
Sept. 30	6	547	550
Oct. 31	6	553	556
Nov. 30	6	560	563
Dec. 31	6	567	570
1976			
Jan. 31	6	569	572
Feb. 29	6	579	582
Mar. 31	6	591	594
Apr. 15	6	600	603
Apr. 30	6	593	596
May 31	6	605	608
June 15 (peak)	6	610	613
June 30	6	607	610

In light of the very large deficits that we have been financing and will need to finance in the coming year, whether we look at the congressional numbers or the President's, I think it is important for the Congress and the American people to understand what the Treasury has been doing in the area of debt management.

In making our financial decisions, we have sought and obtained the best advice of practical and experienced market participants and financial leaders.

The Government Borrowing Committee of the American Bankers Association numbers among its membership senior bank officers from banks in all geographical areas of the country and of a wide range of sizes from the very largest to relatively small banks. Commercial banks are the largest private purchasers of Government securities. Advice on bank demands for new Government securities is vital.

The Government Securities and Federal Agencies Committee of the Securities Industry Association similarly includes senior officials of institutions active in the Government securities market, a number of whom have served also in responsible positions in government—several in the Treasury as Assistants to the Secretary for Debt Management. This committee also has a broad view of the market.

The members of both advisory committees have been in full agreement that the Treasury must tap all maturity sectors of the market and that its offerings should be designed to create and build an upward sloping yield curve to appeal to nonbank investors and to improve the maturity structure of the debt. They have pointed out also that such policies would provide some protection against excessive monetary growth.

We have not followed the specific recommendations of the advisory committees in all respects, for the ultimate judgments have been ours, as they should be. But their advice has been valuable, and the results of our financing operations have indeed been satisfactory.

I agree completely with the wisdom of their consistent advice that to raise the tremendous sums we require, without extreme disturbance to our financial structure, we must issue securities in all the different maturity ranges; and we must do our best to halt the long-continued concentration of our debt in short-dated securities. In that regard, it is a matter of concern to me that the average maturity of the privately held marketable debt has been allowed to deteriorate to the point that the average maturity at the end of June will be 2 years and 9 months compared to 5 years and 9 months just a decade ago and 10 years and 5 months in June 1947.

The importance of an upward sloping yield curve should not be underestimated. In the words of one committee:

> Because the majority of institutional investors borrow short-term funds and invest them longer—this is true of commercial banks, of savings institutions and others—anything that raises short-term rates destroys the incentive to invest longer term, be it in mortgages, corporate bonds, or stocks. This is because any action that makes short rates higher than otherwise simply increases the risks of investing long, and destroys the incentive or need to extend investment maturities.

I particularly call your attention to the attached charts showing the recent course of interest rates. As these charts indicate, intermediate and longer term interest rates rose steadily from mid-February until the announcement on May 1 of our May refunding and cash financing program.

The Treasury was accused of having "talked up" these interest rates and has also been blamed by some for the market difficulties encountered by corporate and other borrowers in this period.

There is, in fact, very little, if any, lasting market effect from a statement by the Secretary of the Treasury or any other person regarding the course of future market rates unless the facts support his conclusions.

Those who make decisions in markets do not survive for long by acting on statements that are not based on fact. Market reactions to statements which are not based on facts are temporary and self-correcting. The key to fundamental market moves is what market participants perceive as the realities of current and prospective financial conditions. These, in turn, are determined by existing and anticipated conditions affecting the supply and demand for savings, including the present and prospective Federal deficits.

I would like to point out that as Secretary of the Treasury it is my responsibility to maintain the financial integrity of the U.S. Government and, in so doing, to speak out whenever that integrity is threatened. Unfortunately, the cause of a problem is too frequently attributed to the messenger rather than to the message itself. As the Wall Street Journal said in an editorial, it's like blaming the obstetricians for the high birth rate. As you all well know, in the period between February and May, it appeared that the Federal deficits for fiscal 1975 and fiscal 1976 would be increased by congressional tax and spending actions almost without limit. That was the factor in this period that was clearly responsible for the rise in interest rates.

The market rally following our May financing announcement was based on the downward revision in the anticipated Federal deficit resulting from larger than anticipated corporate and individual tax receipts and the immediate relief to the market that was provided by the reduction in our estimated borrowing requirements for the 2 months of May and June.

The further factor which has since helped to lower rates is the growing sign of greater congressional recognition of the financial and economic dangers of excessive budget deficits. Our experience has clearly indicated that further reductions in interest rates from now on depend on maintaining a firm grasp on the budget situation, on continued progress against inflation, and on continued progress in improving the financial structure of our business firms. All of these things are essential to achieving a solidly based and long-lasting recovery of the economy.

Based on the administration's projection of a $60 billion deficit in fiscal 1976, our new cash requirements, including off-budget financing, will total nearly $73 billion—$38.2 billion in the July–December 1975 half year and $34.5 billion in the January–June 1976 half year. This has not been generally recognized, except by active market participants. The simple facts are these: On December 31, 1974, private investors held $181 billion of marketable Treasury obligations. By June 30, 1976—18 months later—they will have acquired another $80–$90 billion more of marketable Treasurys.

In fiscal 1976 all government borrowing, including State and local, is expected to amount to about 80 percent of the net borrowings in the securities market; and the Federal sector alone will account for 50 percent or more of the total funds raised in all credit markets.

Tables and charts are included in my statement showing changes in the ownership of total outstanding Treasury debt over the past year; offerings of new marketable securities by maturity since January 1; the schedule of obligations maturing in the next 12 months; and historical information on new issues, maturities, and new money financing for recent years.

I believe that analysis of this data will support a conclusion by this committee and the Congress that the Treasury has been fiancing the deficit in a responsible and constructive manner. In this regard, however, I must say that I am personally deeply concerned by the notion and I sometimes hear expressed that there is some simple answer to financing the deficits which will avert painlessly all risks which are inherent in operations of this magnitude.

In addition to raising an unprecedented amount of new money, we will also have substantial refunding requirements in fiscal 1976, as table 4 shows. Apart from the $93 billion of privately held regular weekly and monthly bills, $26 billion of privately held coupon issues will mature in fiscal year 1976.

Thus, our gross financing job will total over $190 billion.

The sheer size of this financing job requires the greatest flexibility with regard to the choice of maturities for every new securities offering. And yet, under present law, however, there is a statutory limitation of $10 billion on the amount of bonds held by the general public with interest rates in excess of 4¼ percent. Moreover, Treasury notes, which are not subject to an interest rate limitation, are restricted to a maximum maturity of 7 years. Bear in mind that, since 1965, interest yields required by the market on longer term Treasury securities have been in excess of 4¼ percent, and the Congress on three occasions in this decade has recognized Treasury needs for greater flexibility in its debt management operations.

> In 1967, the maximum maturity on Treasury notes was increased from 5 years to the present maximum of 7 years, thus exempting issues up to 7 years from the 4¼-percent limitation.
>
> In 1971, the Treasury was authorized to issue up to $10 billion of bonds without regard to the 4¼-percent ceiling.
>
> Then, in 1973, the $10 billion exemption from the 4¼-percent ceiling was amended so that it would apply only to bonds outstanding in the hands of the public. The effect was to exclude any bonds held by Government accounts, including the Federal Reserve banks, in calculating the amount outstanding against the $10 billion limitation.

The Treasury has used $8.5 billion of the $10 billion bond authority. This leaves a balance of only $1.5 billion.

In light of the magnitude of our projected refunding and new money needs in fiscal year 1976 and beyond—and also in light of the basic need to restructure the debt to redress the neglect of past years—the flexibility which I now have for conducting our borrowing operations is grossly inadequate.

The weight of practical and experienced market advice, as I have already indicated, is that we should offer securities in all maturity areas to minimize the risk of an adverse impact on any particular sector. Indeed, unless we can offer securities in all the maturity ranges to a wide range of investor interests, debt management is made more difficult and the ultimate cost of financing our deficits is likely to be increased. Obviously, this means a market judgment is called for at the time of any financing, and if our choices are restricted by inadequate authority to issue a range of securities, such choices are made more difficult and the results are likely to be less satisfactory.

In this connection, I should mention the sometimes erroneous conclusions about the impact of Treasury financing operations on particular sectors of the economy. There is a tendency, for example, to think of housing finance in terms of permanent, 30-year mortgage financing, but as every homebuilder knows, the availability of short-term construction financing is as important to getting a job started as the permanent financing is to getting the job completed. We also know that the deposit flow to financial institutions, such as savings and loan associations, is far more sensitive to the competition of shorter term Treasury obligations than to the competition of longer term obligations. Indeed, every sector of the economy, every aspect of our financial markets, is so interrelated that undue concentration of Treasury financing in any particular maturity area can have adverse effects throughout the whole market—which could largely have been avoided by a better choice of new securities.

As we move forward into the recovery phase, there is an additional reason for concern with our debt structure.

It is obvious that a substantial portion of our financing in the future, as in the past, will have to be handled in the short and intermediate area. In fact, in the first 6 months of this year we have issued $47.6 billion of new marketable securities excluding exchange offerings to the Federal Reserve and Government accounts and counting only the net additions to bills. Of this total, $32.5 billion—68 percent—has been in maturities of less than 2 years; $12.4 billion—26 percent—has been in maturities of 2–7 years; and only $2.7 billion—less than 6 percent—has been in maturities over 7 years; that is, in the bond area. Only $1.5 billion, 3 percent of the total, has been in long-term maturities over 20 years.

But if we concentrate our new offerings entirely in the short- and intermediate-term areas, then, when the economy has achieved a substantial measure of recovery, the problems of the Federal Reserve will be greatly complicated, as would the problems of future Secretaries of the Treasury. The already substantial buildup in the amount of securities coming due in each year is likely to continue. Two years ago, the privately held marketable debt maturing within a year amounted to just $84 billion. Today, the figure is $119 billion. Two years ago our major refundings were quarterly, but it is now likely that we will soon have significant coupon maturities in every month of the year.

We cannot escape all of the future adverse consequences of necessary short-term financing. In my judgment, however—and I know this is a judgment shared by other market professionals—excessive amounts of short-term Treasury debt could contribute to another situation in which we could get an excessive rise in short-term interest rates, with the whole panoply of adverse economic and financial consequences such as developed in 1966, 1969–70, and again in 1973.

This is obviously not an immediate problem, but as the recovery develops and private credit demands expand, commercial banks and other lenders will attempt to liquidate Treasury securities to obtain funds for lending to the private sector.

Short-term Treasury debt is very near to money and, unless there is a substantial rise in interest rates, it can be readily liquidated at small cost to provide funds for other purposes. If Treasury financing needs are still large at that time and excess demand threatens to reignite inflationary pressures, the Federal Reserve System will have to resist this liquidation by the private sector by allowing short-term interest rates to rise.

The alternative of Federal Reserve purchases from the private sector—monetization of the debt—could temporarily restrain such a rise in rates, but only at the expense of adding to the inflationary potential.

I know the argument that we should refrain from long-term borrowing at this time when rates are historically high and wait until a time when rates are lower. Despite the superficial appeal of this argument, to preclude the Treasury from the sound debt management practices available to virtually all other financial market participants will inevitably lead to undesirable and damaging results.

It may seem strange that any Secretary of the Treasury would wish to borrow at a rate of near 8 percent in the long-term market when he could borrow at a rate of 5 percent or less with 91-day bills, an apparent cost difference of 3 percent, which could translate into many millions of dollars of interest in a year's time.

Such mechanical-type calculations beg the question.

In the first place, long-term financing avoids the need for frequent future refundings of debt at unpredictable rates of interest. Short-term rates are volatile and their volatility would be increased by concentrating Federal financing unduly in the short-term area. Such volatility would harm not only Treasury finance but the financing of private borrowers. This is one reason that the Treasury chose to do a substantial part of World War II financing with 2½ percent bonds, when the alternative was financing with ⅜ of 1 percent bills. The immediate budget cost was less of a concern than the consideration for future economic stability; but undoubtedly, with the subsequent rises in interest rates, the long-run cost of bond financing was less than the cost of continually rolling over the bills.

Second, and more important, short-term Treasury debt is a near-money, so that to achieve the same economic effects, Federal Reserve policy must be relatively more restrictive if the amount of short-term Treasury debt outstanding is larger. If we finance all of our debt in the short-term area, therefore, we will create a prospect that future interest rates will be higher throughout all financial markets than if we finance a meaningful portion of our debt in the longer term area.

Thus, the apparent interest saving from short-term financing can be an illusion, whether we are concerned about the budget alone or whether we take the point of view of the economy as a whole, and I might add that nearly every corporate or municipal Treasurer who has relied on short-term financing in the last few years will share this view.

Beyond this, an inability of the Treasury Department to utilize all maturity sectors, including the long-term sector, would be interpreted by the market, and the public generally, as indicative of a lack of will to deal with the inflation which is still our basic, longrun economic problem. Whether that were or were not a valid concern, it would be an important psychological barrier to the future reductions in longer term rates, which I perceive as essential if we are to restore health to the housing industry and are to encourage the business investment which is needed if this country's economic progress is not to falter. Long-term interest rates have continued to reflect ingrained inflationary expectations. Our financing should be conducted in a way that will help to overcome those expectations—not in a way which will tend to confirm them.

For these reasons, I believe the time is now appropriate to increase the amount of bonds that may be issued without regard to the 4¼-percent ceiling on rates and to extend the maximum maturity of Treasury notes.

I specifically recommend, with regard to the 4¼-percent ceiling, that the exception be increased from $10 billion to $20 billion. I wish to emphasize as strongly as I can that market conditions are unpredictable, so that the amount of longer term issues which might be issued in any specific period could vary greatly, depending upon market demands. The record indicates, however, that we have been responsible and sensitive to financial and economic conditions in our use of the exception to the 4¼-percent limit. We will continue to be responsible and sensitive.

I also strongly recommend that the maximum maturity of Treasury notes be extended from the present 7 years to 10 years. This extension of the maximum note maturity, assuming that market conditions permit, could be a powerful tool in helping to arrest the decline in the average maturity of the debt and reduce the concentration in short-term issues which has taken place in recent years.

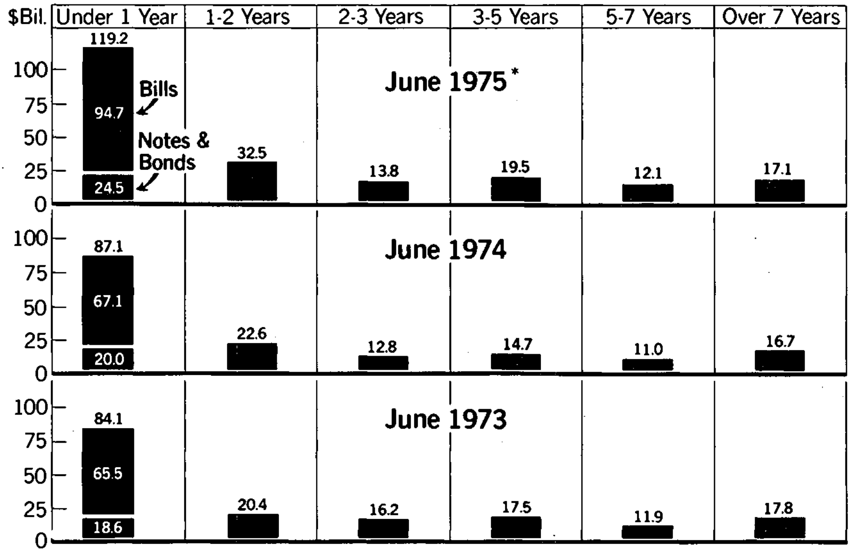
In addition, I want to urge that early consideration be given to removing the 6-percent rate ceiling on savings bonds. Such action would allow the rate on savings bonds to be varied from time to time in accordance with changing financial circumstances in the interest of both savers and taxpayers. Thus, we could provide greater assurance to the savings bond investor that his Government will continue to give him a fair rate of return on his investment. Greater flexibility to adjust savings bonds rates could also make a significant contribution to the Government's overall debt management objectives. Savings bonds account for about one-fourth of the total privately held Treasury debt, and the average savings bonds investor holds his security for a longer period than investors in marketable Treasurys and is thus an important source of stability to debt management.

Such flexibility would obviously need to be exercised with due regard to the impact of savings bonds rate changes on depositary institutions. As experience has demonstrated, however, there is no way permanently to insulate these institutions from the effects of changing economic circumstances. We have, therefore, proposed a Financial Institutions Act, which will allow the removal of Regulation Q-type ceilings by providing the thrift institutions with expanded powers which will improve their ability to compete without a Federal crutch.

The urgency of the need for greater debt management flexibility is, I believe, underscored by the facts that I have already mentioned. During this calendar year, out of the $47.6 billion of marketable securities issued to the public, $32.5 billion has been in maturities of less than 2 years. This is 68 percent of the total in money market instruments. $12.4 billion has been in maturities of 2 to 7 years. This is 26 percent of the total. And only $2.7 billion, less than 6 percent of the total, has been in the bond area over 7 years. In fact of all our market financing, only $1.5 billion, just 3 percent, has been in maturities of over 20 years.

There is a large debt management job before us. The Treasury will handle its part of the debt management job responsibility. I urge you to act promptly to give us the tools to do the job.

MATURITY DISTRIBUTION OF PRIVATELY HELD TREASURY MARKETABLE DEBT



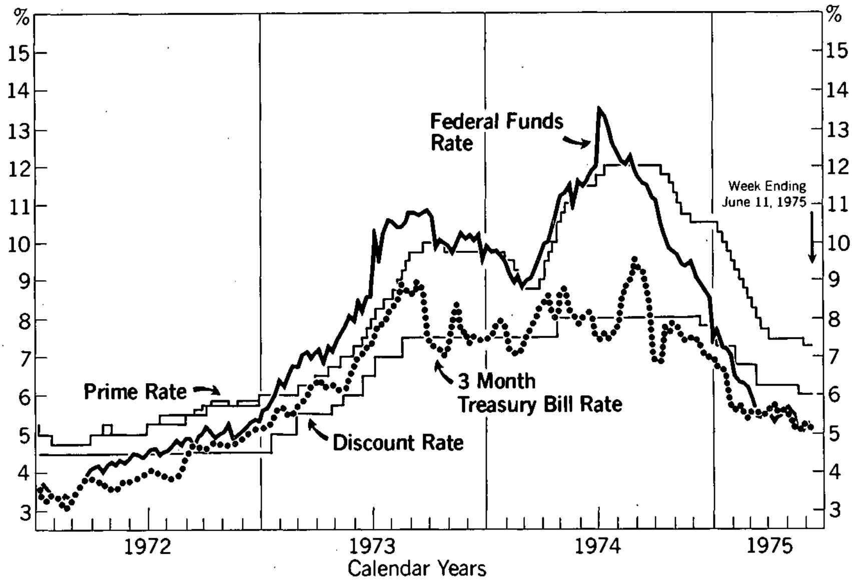
Office of the Secretary of the Treasury
Office of Debt Analysis

* Estimated

June 20, 1975-1

SHORT TERM INTEREST RATES

Weekly Averages

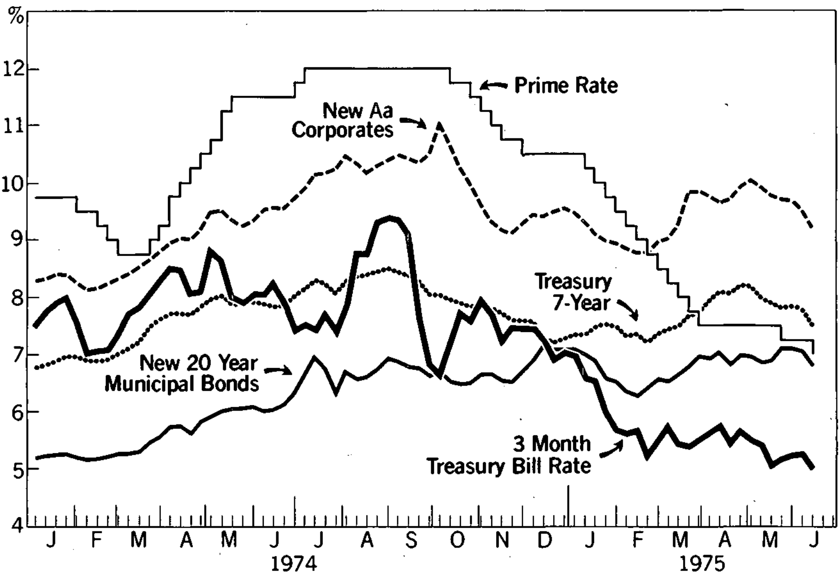


Office of the Secretary of the Treasury
Office of Debt Analysis

June 16, 1975-2

INTEREST RATES

Weekly Averages

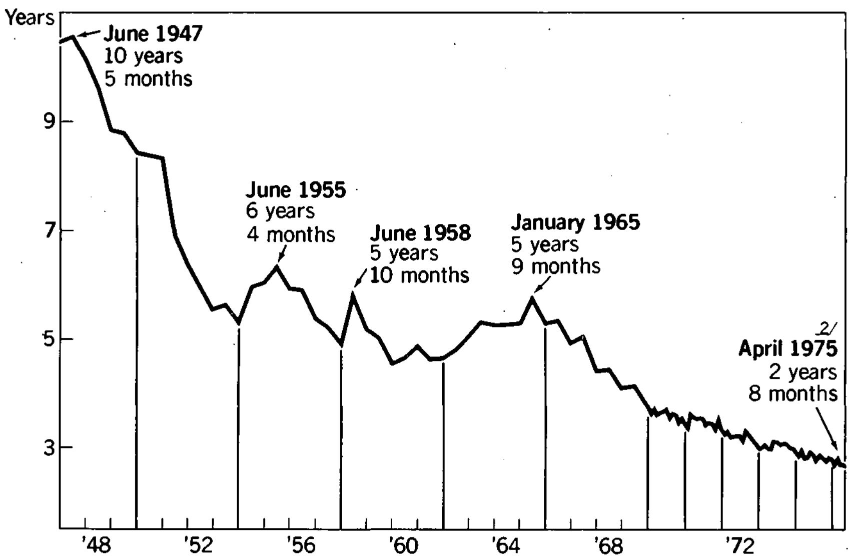


Office of the Secretary of the Treasury
Office of Debt Analysis

June 16, 1975-3

AVERAGE LENGTH OF THE MARKETABLE DEBT 1/

Privately Held



1/ Semi-annual plots, calendar years 1946-1969, monthly thereafter.
2/ Partly estimated.

Office of the Secretary of the Treasury
Office of Debt Analysis

May 12, 1975-4

TABLE 2.—*Changes in ownership of Treasury public debt securities*

[Par values [1]; in billions of dollars]

End of month	Outstanding		Fed. & G.A.		Total privately held		Commercial banks [2]		Individuals [3]		Insurance companies		Mutual savings banks		Corporations [4]		State and local governments		Foreign and international [5]		Other investors [6]	
	Lv.	Chg.	Lv.	Chg.	Lv.	Chg.	Lv.	Chg.	Lv.	Chg.	Lv.	Chg.	Lv.	Chg.	Lv.	Chg.	Lv.	Chg.	Lv.	Chg.	Lv.	Chg.
1974																						
May	474.7	2.8	215.3	4.1	259.4	−1.3	54.4	−2.4	80.0	0.8	6.0	0.1	2.6	−0.1	11.2	0.7	29.2	−0.9	57.3	1.4	18.6	−1.1
June	475.1	.4	218.7	3.4	256.4	−3.0	53.2	−1.2	80.7	.7	5.9	−.1	2.6	-------	10.8	.4	28.3	.9	57.7	.4	17.3	−1.3
July	475.3	.2	215.6	−3.1	259.7	3.3	53.9	.7	81.6	.9	5.7	−.2	2.6	-------	11.3	.5	28.8	.5	56.9	−.8	18.8	1.5
August	481.8	6.5	222.8	7.2	259.0	−.7	53.0	−.9	82.6	1.0	5.7	-------	2.6	-------	11.0	−.3	29.2	.3	56.0	.9	19.0	.2
September	481.5	−.3	221.6	−1.2	259.8	.8	52.9	−.1	83.3	.7	5.8	.1	2.5	−.1	10.5	−.5	29.3	.1	56.0	-------	19.5	.5
October	480.2	−1.3	217.8	−3.8	262.5	2.7	53.5	.6	83.8	.5	5.9	.1	2.5	-------	11.2	.7	28.8	.5	56.6	.6	20.3	.8
November	485.4	5.2	220.0	3.2	265.3	2.8	54.5	1.0	84.3	.5	5.9	-------	2.5	-------	11.0	−.2	28.7	−.1	58.3	1.7	20.1	−.2
December	492.7	7.3	221.7	1.7	271.0	5.7	56.5	2.0	84.8	.5	6.1	.2	2.5	-------	11.0	-------	29.2	.3	58.4	.1	22.4	2.3
1975																						
January	494.1	1.4	220.4	−1.3	273.8	2.8	54.5	−2.0	85.3	.5	6.2	.1	2.6	.1	11.3	.3	30.0	.8	61.5	3.1	22.3	−.1
February	499.7	5.6	220.8	.4	278.9	5.1	56.9	2.4	85.3	.0	6.2	-------	2.7	.1	11.4	.1	30.5	.5	64.6	3.1	21.3	−1.0
March	509.7	10.0	219.9	−.9	289.8	10.9	62.0	5.1	85.7	.4	6.6	.4	2.9	.2	12.0	.6	29.7	−.8	65.0	.4	25.9	4.6
April	516.7	7.0	225.9	6.0	290.9	1.1	63.0	1.0	86.1	.4	6.7	.1	3.2	.3	12.5	.5	29.8	.1	64.9	−.1	24.7	−1.2
May	528.2	11.5	226.5	.6	301.7	10.8	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

n.a. Not available.

[1] U.S. savings bonds are included at current redemption value.

[2] Consists of commercial banks, trust companies, and stock savings banks in the United States and in Territories and island possessions. Figures exclude securities held in trust departments.

[3] Includes partnerships and personal trust accounts.

[4] Exclusive of banks and insurance companies.

[5] Consists of the investments of foreign balances and international accounts in the United States. Beginning with July 1974 the figures exclude non-interest-bearing notes issued to the International Monetary Fund.

[6] Consists of savings and loan associations, nonprofit institutions, corporate pension trust funds, and dealers and brokers. Also included are certain Government deposit accounts and Government-sponsored agencies.

TABLE 3.—*Offerings of marketable securities,*[1] *January–June 1975*

[Amounts in billions of dollars]

Maturity	Amount	Percent of total
Total offerings	$47.6	100.0
Under 2 years	32.5	68.3
Bills	16.7	33.0
13-, 26-week bills	11.7	
52-week bills	2.4	
Other bills	1.6	
Coupons	16.8	35.2
1 year-3 month, issued 1/9	.8	
1 year-6 month, issued 3/3	1.7	
2 year-0 month, issued 3/3	1.7	
1 year-2 month, issued 3/25	1.6	
2 year- 0 month, issued 3/31	2.3	
1 year-8 month, issued 4/8	1.5	
2 year-0 month, issued 4/30	1.6	
2 year-0 month, issued 5/27	2.1	
1 year-5 month, issued 6/6	1.6	
2 year-0 month, to be issued 6/30	2.0	
2–7 years	12.4	26.0
4 year-4 month, issued 1/7	1.3	
3 year-3 month, issued 2/18	3.3	
6 year-0 month, issued 2/18	1.8	
6 year- 8 month, issued 3/19	1.8	
3 year-3 month, issued 5/15	2.8	
7 year-0 month, issued 5/15	1.5	
7–20 years	1.2	2.6
15 year-1 month, issued 4/7	1.2	
Over 20 years	1.5	3.2
20/25 year-0 month, issued 2/18	.8	
25/30 year-0 month, issued 5/15	.7	

[1] Includes net additions only to bills and excludes exchange offerings to Federal Reserve and Government accounts.

TABLE 4.—*Marketable maturities through June 30, 1976 (issued or announced through June 30, 1975)*

[In billions of dollars]

	Outstanding	Privately held
Treasury bills	126.9	93.2
Regular weekly	100.5	n.a.
52-week	26.4	n.a.
Coupons and other	37.0	26.0
1975		
5⅞ percent note 8/15/75	7.7	4.6
8⅜ percent note 9/30/75	2.0	1.9
1½ percent note 10/1/75	(*)	(*)
7 percent note 11/15/75	3.1	2.4
7 percent note 12/31/75	1.7	1.5
1976		
January 31 bill [1]	1.6	1.5
6¼ percent note 2/15/76	3.7	.9
5⅞ percent note 2/15/76	4.9	3.5
8 percent note 3/31/76	2.3	2.1
1½ percent note 4/1/76	(*)	(*)
6½ percent note 5/15/76	2.7	1.9
5¾ percent note 5/15/76	2.8	2.2
6 percent note 5/31/76	1.6	1.5
8¾ percent note 6/30/76	2.7	2.0
Total	163.9	119.2

*Less than $50 million.
n.a. Not available.
[1] Treasury bills in 2-year note cycle slot.

588-395 O - 75 - 22

Treasury issues, maturities, and new money, fiscal years 1973–75

[In millions of dollars]

	July–December 1972	January–June 1973	Total	July–December 1973	January–June 1974	Total	July–December 1974	January–June 1975 p	Total
Gross issues	144,374	134,745	279,119	142,145	141,228	283,373	167,379	187,419	354,798
Bills	125,297	120,660	245,957	132,111	128,981	261,092	144,307	149,565	293,872
Coupons	19,077	14,085	33,162	10,034	12,247	22,281	23,072	37,854	60,926
Gross maturities	131,565	140,915	272,480	134,562	144,349	278,911	147,651	154,632	302,283
Bills	115,975	124,463	240,438	124,490	131,740	256,230	130,854	140,859	271,713
Coupons	15,590	16,452	32,042	10,072	12,609	22,681	16,797	13,773	30,570
Net (+ or − issues)	12,809	−6,170	6,639	7,583	−3,121	4,462	19,728	32,787	52,515
Issued to private:									
Bills (net)	9,322	−3,803	5,519	7,621	−2,759	4,862	13,453	[1] 8,706	22,159
Coupons to foreign [2]	15,327	6,683	22,010	8,102	9,810	17,912	14,561	31,955	46,516
Total	24,649	2,880	27,529	15,723	7,051	22,774	28,014	40,664	68,678
Maturities privately held:									
Coupons	11,798	9,114	20,912	8,095	10,061	18,156	8,568	7,215	15,783
New money from private	12,851	−6,234	6,617	7,628	−3,010	4,618	19,446	33,446	52,892

p Preliminary.

[1] Assumes rollover of $4,506 million regular bills maturing June 26, 1975.

[2] Included in coupons issued to private.

Exhibit 14.—Other Treasury testimony in hearings before congressional committees

Secretary Simon

Statement, January 23, 1975, before the House Ways and Means Committee, on raising the Federal debt ceiling.

Statement, June 2, 1975, before the House Ways and Means Committee, on raising the Federal debt ceiling.

Under Secretary for Monetary Affairs Schmults

Statement, July 24, 1974, before the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing, and Urban Affairs, on the current disintermediation situation.

Domestic Economic Policy

Exhibit 15.—Statement by Secretary Simon, August 2, 1974, before the Joint Economic Committee, giving a midyear review of the economy

Your midyear reviews provide a valuable opportunity to examine current economic developments and to make plans for the future. It is a pleasure to be here today and to participate in these deliberations.

In this statement, I plan to comment briefly on both domestic and international aspects of our current situation. There is, however, no need for me to cover in detail our recent and prospective economic performance or our basic economic policies. These have been carefully and thoroughly described within the past week by the President and other administration spokesmen.

Nevertheless, I do want to say a few more words about the intolerably rapid rate of inflation we are now experiencing. Domestically this has become the dominant, overriding—almost overwhelming—fact of economic life. Americans are experiencing their first sustained siege of rapid peacetime inflation. It is a new and most unwelcome experience. They do not understand where double-digit inflation came from and they lack confidence that their Government will be able to get the situation under control.

How did we get here? I will not try to retrace all the causes of the current inflation, or try to fix the blame one place or another. Without too much risk of oversimplification, I think it is fair to say that the price explosion of 1973–74 is primarily attributable to (a) a series of severe temporary shocks that originated mostly outside the U.S. economic system and (b) almost a decade of excessively stimulative fiscal and monetary policies.

The outside shocks are, by now, familiar to all of us: the worldwide agricultural crop failures of 1972, enormous pressures on the prices of internationally traded raw materials, two devaluations of the dollar, and the Arab oil embargo. In addition, the end of the controls program is now operating as an additional temporary force to raise some prices and wages faster than otherwise would have been the case.

But all these special factors, as important as they have been, are of a temporary one-shot nature. Had our general economic policies not been too stimulative, the outside shocks would have had only a one-time effect. Once they had worked their way through the system, the inflation would have settled down again to a tolerable rate.

But our general economic policies have, in fact, been far too stimulative for a long period of time. Let me give you two examples of how policy changed in the mid-1960's. First, on the fiscal side: From 1955 to 1965 Federal expenditures rose at roughly a 6-percent annual rate. From 1965 to 1974, however, Federal expenditures surged to a 10-percent annual rate of growth. Second, monetary policy also broke out of a previously established pattern. From 1955 to 1965 the money supply grew at a 2½-percent rate. Since then, the growth rate has more than doubled to a 6-percent annual pace. It is no accident that during the earlier period we had a rather stable price performance, but since 1965 we have had the worst peacetime inflation in our history.

What has and is happening, then, is that the excessive budget deficits and the excessive growth of money and credit in recent years prevented the "temporary" price pressures from running their course and fading away. Instead, much of the inflation from the outside shocks is or soon will be deeply embedded in our entire system. It is or soon will be embedded into the pattern of wage settlements and into the structure of interest rates. It is or soon will be embedded into the economic expectations of consumers, of workers, of investors, of businessmen—everybody.

And because this inflation is becoming so deeply embedded, squeezing it out of the system will be a long, tough process. It is a most difficult challenge for economic policy.

In my opinion the correct course of action is to apply the necessary fiscal and monetary discipline persistently and consistently to keep the economy operating within the limits of its capacity to produce. The economy can be prosperous and it must continue to grow, but we must not let it continue to run away with itself. Demand will have to be held slightly below total potential output. Sales can show a healthy growth, but that growth will have to be constrained so that if businessmen try to raise prices too fast, competitive pressures will prevent them from doing so. Employment can grow, too, but our labor markets must not be too tight so that the joint worker-management process of wage determination can result in a gradual deceleration of the upward trend of pay scales.

Let me emphasize that this fight against inflation will take time, years of it. There are no shortcuts, no acceptable quick solutions. Frequent and abrupt changes in policy are the worst policy of all. To cure the price disease, we must be prepared to stay the long course and take an even strain on economic policy year after year. This is the only way to get the job done.

The President has put forward a coordinated program for dealing with inflation. The first requirement is to relieve those pressures of excessive demand in the economy that have caused the acceleration of advances in the price level. The second part of the program has to do with measures to relieve the casualties and inequities of inflation.

There are many who question the effectiveness of restrictive fiscal policy to counter these fundamental inflationary pressures. In my view, however, the evidence of experience is clear that fiscal restraint applied consistently and in tandem with monetary restraint can bring inflation under control.

I have attached to my statement a chart—a very instructive chart, I believe—that shows the broad relationship between the budget and inflation. As seen on the chart, the actual budget position does not correlate closely with the rate of inflation. This is where the full-employment budget proves itself to be a useful guide to economic policy; the full-employment calculation adjusts the budget data to remove the impact of the economy on the budget, and thereby brings out the impact of the budget on the economy. And when the full-employment budget position is compared to the rate of inflation, a fairly high degree of correlation shows up. The relationship is less than perfect, but in the broad sweep of things it is clear that sustained budget surpluses are associated with below-average inflation, and sustained budget deficits are associated with above-average inflation.

There are 2 years during the 26-year span covered by the chart in which the inflation is far higher than can be accounted for by fiscal policy. These years are 1950–51 and 1973–74, which were the two occasions when commodity inflation (food and industrial raw materials) had an extraordinarily large, one-time impact on the general price level. Aside from those two occasions, the relationship strongly supports the general notion that budget deficits are inflationary and budget surpluses are not inflationary.

NOTES TO CHART

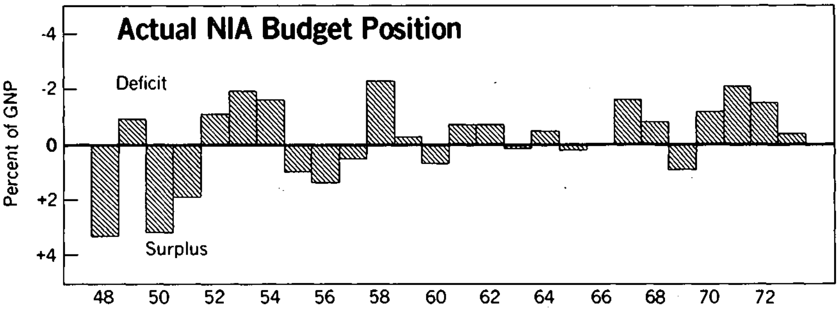
Panel 1: The budget data shown here are the actual surpluses and deficits, on a national income accounts basis, for calendar years expressed as a percent of gross national product. Note that these data are plotted on an inverted basis in order to provide an easier visual comparison with the inflation rate.

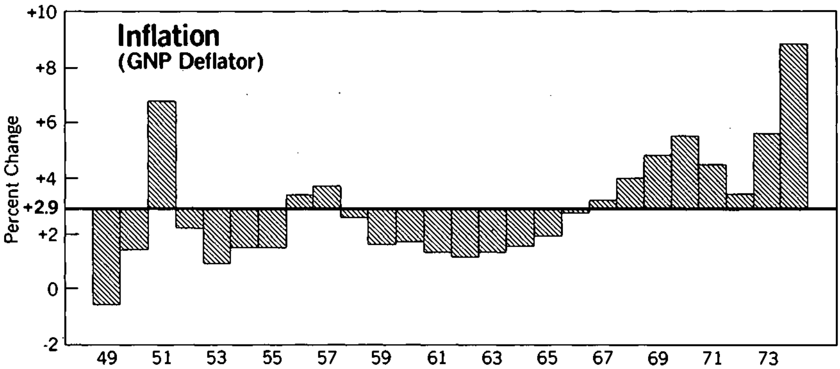
Panel 2: These budget data are the same as in panel 1 except that the surpluses and deficits have been adjusted by the Federal Reserve Bank of St. Louis to a full-employment basis by standardizing the figures to a constant 4-percent unemployment rate. The bars are plotted—for the purpose of better displaying the relationship between the budget and inflation—as deviations from the average surplus for 1948–73 of 0.8 percent of GNP. (Panel 1 was not plotted this way because the average was virtually equal to zero.)

Panel 3: Inflation is represented here by percent changes in the GNP deflator from the previous year. In effect, therefore, the inflation measure is charted with a 6-month lag compared to the budget data in panels 1 and 2. The bars are plotted as deviations from the 1949–74 average price increase of 2.9 percent.

Source of data: U.S. Department of Commerce.

THE BUDGET AND INFLATION





Note: Bars are plotted as deviations from average rather than from zero.

I do not want to suggest that countering inflation is so simple that all we have to worry about is our budget position. Quite the contrary. We all know that "money matters" and that we have to be concerned with monetary policy. Arthur Burns has already testified that a 6-percent growth in money is too high for price stability over the longer term. He has also stated that monetary policy will be conducted so as to avoid a credit "crunch."

In this regard, we should remember that a strong, steady fiscal policy is especially important when, as at present, demands for financing capital formation and housing are heavy relative to the flow of national savings. I believe the normal target for the budget should be a surplus equal to 1–2 percent of Federal outlays. With such a surplus, which would add roughly 2 percent to the national savings stream, credit requirements would be in approximate balance with this flow of savings, and the needed steadier course for monetary policy would then be less endangered by the risks of floundering credit and capital markets.

Any well-conceived anti-inflation program must also have regard for the casualties of inflation and for those whose earnings may be interrupted for a time by a program of disinflation. Without getting into detail, let me say that I believe we can gradually reduce inflation without suffering massive unemployment. For a time, we will have to live with slightly more unemployment than we would like, but it will not have to be a large amount. To deal with this contingency, the President has proposed improvements in our system of unemployment compensation, and I again urge congressional passage.

Strains in the financial markets have had particularly adverse effects on housing, and in May the President put forward a $10 billion program to augment the supply of mortgage funds. These financial strains together with higher prices of primary energy have—because of the slow pace of the regulatory process—produced dangerously low earnings for many companies in regulated industries. While these are largely State and local regulatory bodies which must act, the administration is examining what might be done to speed up the needed changes. These illustrate the kinds of economic adjustments that must be accommodated in order to facilitate the disinflationary process.

Summing up

To bring our price disease under control, we will have to keep our general economic policies under firm control. There is no acceptable alternative. We can and will pursue complementary policies—maximizing agricultural production, reorganizing inefficient Government regulatory practices, and others. But the key is to keep demands in the economy within the limits of its productive capacity through balanced fiscal and monetary restraint.

If we do not do so, we will continue to have the cruel, indiscriminate, insidious tax of inflation. Inflation hurts everybody—people on every rung of the income ladder, corporations, financial institutions, State and local governments—everybody. Most of all, it hurts the poor. And if we do not have the self-discipline to keep Federal spending in line with tax revenues, what happens is that the deficit is closed by the harsh and uneven tax of inflation, rather than by more equitable routes of achieving balance between outlays and revenues.

Profits

Before closing this discussion of our domestic economic situation, I want to say a few words about profits. To curb inflation, our policy in the short run must be to restrain demand. In the long run, however, we must make every effort to expand our productive capacity. To this end, adequate profit incentives are crucially important.

In the last year or two, there has been much talk about an excessive increase in corporate profits. I am afraid, however, that these increases in profits have not been put into proper perspective. In particular, there has been inadequate recognition of the impact of inflation on this measurement of profits.

For example, nonfinancial corporations reported profits after taxes in 1973 of $55 billion as compared to $38.2 billion in 1965, an apparent 44-percent increase. But when depreciation is calculated on a basis that provides a more realistic accounting for the current value of the capital used in production and when the effect of inflation on inventory values is eliminated, after-tax profits actually declined by 21 percent, from $36.1 billion in 1965 to $28.5 billion in 1973. One major factor behind this decline is the fact that taxes were paid on these fictitious elements of profits, which resulted in a rise in the effective tax rate on true profits from about 43 percent in 1965 to 59 percent in 1973. On this basis, furthermore, after dividend payments, the retained earnings available for reinvestment, which were $19 billion in 1965, were only $5 billion in 1973.

Thus, a more realistic calculation shows that the sharp rise in profits was an optical illusion caused by inflation. And this helps to explain why the ability of business to increase its productive capacity is in jeopardy and why our financial markets are so congested.

In this context, it is not surprising that basic industries such as steel, coal, natural gas, and aluminum are experiencing shortages in productive capacity. Increased productivity and decreased Government spending are the two essential lines of attack against inflation. Both the administration and the Congress must reassess past legislation that stimulates consumption and inhibits saving and investment. No nation can neglect investment in favor of consumption for very long and still prosper. I am quite concerned that since 1960, plant and equipment spending in the United States was only 15 percent of total output, whereas France invested 18 percent, Germany 20 percent, and Japan 27 percent. And furthermore, for gross domestic investment, which includes inventories, housing, and public investment, the proportions for 1973 are: United States, 17 percent; France, 26 percent; Germany, 25 percent; and Japan, 37 percent.

The International Economy

We have now had more than a half-year's experience with the increased oil prices announced late last year. The international economy has been profoundly changed. Fortunately the most exaggerated fears of some have not proved justified. But we are confronted by difficult problems, related both to petroleum developments and to worldwide inflation, which together have led to a widespread slowdown in economic growth this year.

As in the United States, people everywhere are suffering the wrenching pains of inflation. Few countries have escaped double-digit rates of price increase, and almost all are experiencing inflation rates considered intolerable by past standards.

Inflation is a common problem around the world, in part because of the strong forces that carry price pressures across national boundaries. Fundamentally, this reflects our growing interdependence—the fact that the links among nations have become stronger as international trade has grown more rapidly than domestic trade. To illustrate the importance of the international transmission of inflation, I would cite recent forecasts of the Organization for Economic Cooperation and Development that increases in the price of imported oil will directly add some 1½ percentage points to the rate of inflation in OECD member countries this year, and increases in the prices of imports of other primary products another percentage point. These figures do not allow for secondary effects of the import price rises on domestic prices, and thus understate the total price effect. Another striking measure of the price increases affecting international trade is that in the first half of 1974 the average value of OECD imports, swollen by the oil price increases, rose by 65 percent and the average value of exports by 32 percent.

I found in my recent travels abroad that others view the inflationary problems we are experiencing in this country somewhat differently than we do. In fact, others look at our record with a certain envy. While this does not make our inflation easier to bear or to deal with, the fact is that we are doing better than many other countries. Consumer prices have been rising at rates of about 12 percent in the United States, but this compares with figures of some 30 percent for Japan and 15 to 20 percent for Italy, the United Kingdom, and France. In Germany, on the other hand, where strong policies of demand restraint have been pursued for an extended time, prices are rising at a rate of less than 8 percent.

Recognition of the common danger of inflation has in recent months brought about a more realistic view of the prospects for growth. At the turn of the year, against the background of an oil embargo, some thought the oil-consuming nations might be thrown into chaos, and the specter of a 1930's depression was raised. Today, the embargo is lifted and energy shortages are no longer a severe restraint on growth. While the industrial world is still experiencing a slowdown, there is wide agreement that the slowdown is essential if we are to control the forces of inflation. There is a healthy recognition that the inflationary costs of excessive expansion would be unacceptable. While we cannot turn our backs on the possible future need for stimulative policies, it is understood that nothing could more severely threaten the fabric of our societies than to hit the throttle at a time when we should have our foot firmly on the brake.

The increase in oil prices brought with it the danger of an escalation of trade restrictions. There was concern that importing nations, seeing their own trade balances deteriorate because of increased oil imports, might impose restrictive trade measures which would simply shift more of the deficit elsewhere, and the cumulative effect could be excessive domestic deflation. This must, of course, be watched. However, OECD member countries agreed in May to a declaration of intent to avoid recourse to restrictive measures. In June the IMF Committee of Twenty agreed to a similar pledge for adherence by the broader membership of the International Monetary Fund. The United States strongly supported both these moves, and we are confident they will reinforce the commitment of the world trading community to a liberal trading order. It is critical that the Congress help us maintain the momentum toward expanding world trade by prompt and affirmative action on the Trade Reform Act, so that the "Tokyo Round" of multilateral trade negotiations can move forward toward reducing trade barriers and building better arrangements for managing international trade relations.

When this Committee met in February, concern had already been expressed about the problems of financing oil surpluses and deficits and the ability of private financial markets to handle the anticipated vast flows of funds. More recently, difficulties of a few banks heavily involved in international transactions have magnified expressions of concern.

We recognize that the private markets face a serious challenge. But we should not exaggerate the difficulty. Let us not make allegations unsupported by facts. An individual bank, through imprudence or other management problems particular to the firm, can certainly get into trouble. But that does not imply any impending failure of financial markets generally or of the monetary system.

Certainly there will be strains in the face of the major challenges posed for the markets. In my talks with the Finance Ministers of other countries, we have frankly recognized this prospect. And we are confident that we can develop mechanisms to deal with these strains.

I do not, however, classify as real the problem of potentially massive shifts of funds—the worry that oil monies will be capriciously shifted from one market to another, thereby disrupting the foreign exchange and financial markets. In part, this is because investments by the oil-producing countries will be in instruments of varying degrees of liquidity, some of which—probably a growing proportion—could not be liquidated without losses that would make such shifts unattractive. Beyond this, massive shifts of funds would cause pressures on exchange rates, also quickly making such transfers unprofitable. I can assure you my experience has been that the financial authorities of the Arab countries who will be managing oil revenues are indeed conservative and responsible and will not be found taking illogical actions.

The private financial markets are in fact making substantial progress in adapting to the problems of oil financing. In the first instance, bankers have initiated discussion of the problems, such as rapidly growing liabilities relative to their capital base, excessive divergence in the maturity preference of lenders and borrowers, and too much concentration on particular lenders and borrowers.

And they are adapting their own practices. In a market saturated by offers of short-term funds, banks are insisting on paying lower rates for monies in maturities they don't need. We are seeing banks acting as brokers, arranging direct placements. These are necessary, encouraging responses.

The lenders, too, are adapting. They are looking for other places to put money: government securities; advance payments for imports; phased loans to governments; credits to nationalized industries and corporate borrowers; real estate; and equity of large corporations. These shifts of funds into nonbanking channels will ease the pressures on the banks.

In these circumstances bankers must continue to look for new techniques, new channels of moving funds to those who need them. Some traditional practices may have to be reexamined. Management must, above all, be prudent and careful. But there is no reason why the banking system cannot continue to handle a very large share of these funds while the remainder move through other channels.

I am asked what the role of governments and central banks is in this situation. Certainly they must maintain a proper economic environment, by containing inflation and following suitable policies. But that is not their only duty. I do not believe that the private sector alone should carry the responsibility. Governments and central banks as bank supervisors and suppliers of liquidity—their traditional role in developed financial systems—have a clear responsibility to assure the soundness of the system as a whole. I am referring to problems of liquidity, however, not solvency. It is not the role of the public authorities to underwrite management of an individual institution or to assume the risks of its stockholders.

There will also be occasions when direct government-to-government handling of funds will be the most efficient method. Over the years, the Treasury Department has issued special securities to various countries, including particularly large amounts to Germany. Inevitably, special responsibility must be assumed by governments of the oil-exporting countries, and they are already beginning to provide direct loans and other types of financing for, and investments in, the economies of the oil customers. Iran alone has in recent weeks agreed to make substantial loans to France and the United Kingdom and made a substantial investment in the Krupp concern in Germany.

Governments' most urgent task—one for which the private markets are largely inappropriate—is to organize assistance for the poorest countries most seriously affected by the oil price increases so that severe hardships are not wrought on their populations. The new Development Council recommended by the Committee of Twenty will urgently address this problem. Public responsibility has also been recognized in the establishment of a special oil facility in the International Monetary Fund to supplement private markets—a kind of "safety net" for countries able to afford its near-market terms but unable to obtain adequate financing through the private markets. We have also expanded our extensive network of intergovernment swap agreements.

However, the objective of public policy should not be to take over the basic role the private markets have traditionally played in moving funds about the world. Rather, governments should seek to strengthen that role, as the United States did early this year when we removed our capital controls.

We are fortunate to be able to approach the problems we face today within the framework of the monetary agreement reached at the Committee of Twenty Ministerial meeting in June. That agreement represented a landmark in our efforts to reform the international monetary system. Certainly much remains to be done, and further negotiations lie ahead. But the international community has responded in a constructive manner to the challenges it faces. One of the most important results of the C–20 work was that it demonstrated both our determination and ability to work cooperatively in dealing with our problems. This spirit is essential to the success of our future efforts. I have had useful discussions with my counterparts in other countries and am confident that a solid foundation exists for our continuing to work together.

I believe, too, that the flexible exchange rate arrangements presently in place have served us well in a particularly difficult period. Despite the great uncertainties we have been through, speculative pressures have not been excessive and exchange rates fluctuations have not been extreme. The dollar, following a rather large swing from the middle of last year to the first quarter of this year, has subsequently moved against the trade-weighted average of other currencies within a range of plus or minus 2 percent around the levels prevailing following the realignments of February 1973.

I had an opportunity on my trip last month to discuss the oil financing problems with Middle Eastern and European leaders. The authorities of the oil-producing countries with whom I spoke displayed a keen awareness of their interest in and responsibility for assuring that their vastly increased oil revenues will be invested in a way that minimizes disruption to world economic and financial relationships. I am glad to report that the atmosphere I encountered in Europe on the question of recycling oil revenues was one of concern but basically consistent with our own views. It was generally agreed that we should broaden our exchange of information and ideas on developments in the financial markets. We must have contingency plans, so that we are prepared to act, and to act quickly, in the event an emergency situation requires it.

Mr. Chairman, a great deal of what I have spoken to you about today is related directly or indirectly to the question of oil prices. As you know, it is my conviction that we will see lower oil prices. I am convinced this is in the longrun interest of producers as well as consumers. I know of no single move more important to the elimination of worldwide inflation and the maintenance of international financial stability.

It would be a disservice to underestimate the tenacity with which we shall have to attack our present problems. I am confident, though, that we are on the right track, that the policies being followed nationally and internationally are the policies which will in time bring solutions to our problems. Inflation will abate. We will avoid the extremes of depression and financial collapse. We will find a new equilibrium in the commodity markets.

To achieve these goals here in the United States, the most important single action we can take is to regain control of Federal spending. To this end, close, cooperative, and bipartisan action will be required. This committee could make a significant contribution by encouraging a prompt activation of the new and stronger procedures for budget control provided in the Congressional Budget Act of 1974. Without determined action by both the administration and the Congress, the rise in Federal outlays this year and next could be so large as to impose sustained rapid inflation on the American people. To prevent that result is our most important duty as public officials.

Exhibit 16.—Summary of The Financial Conference on Inflation, September 20, 1974, Statler Hilton Hotel, Washington, D.C.

The Financial Conference on Inflation conducted by the Department of the Treasury brought together a distinguished group of private and public participants to examine the problems of inflation. Congressional cooperation and active participation was an integral element in the success of the Conference. The financial community was represented by senior officials from commercial banks, savings institutions, insurance companies, and the investment community. Participation by professional economists, consumer experts, and labor representatives insured a desirable breadth of view. Those invited put aside parochial concerns and participated actively in a serious and objective review of inflation and its financial consequences.

The Conference opened with brief statements by Secretary of the Treasury Simon, Chairman Greenspan of the Council of Economic Advisers, Associate Director Scott of the Office of Management and Budget, and Chairman Burns of the Federal Reserve. The remainder of the morning session was devoted to brief statements on the inflation problem by each of the private and congressional participants. In the afternoon a series of seven topics was discussed by the group: fiscal policy, monetary policy, capital markets and capital formation, international economic policy, financial institutions and inflation, wage-price policy, and other suggestions to deal with inflation.

The major theme that ran through the entire Conference was that the inflation problem is difficult and will not be solved quickly or easily. It was recognized that inflation had already created serious financial strains and inflicted large financial losses. At a time when the Nation faces enormous future demands for new capital, our financial markets are seriously constrained in their ability to provide the required funds. One participant pointed out that 30 million stockholders have, in the aggregate, seen their equity values decline by an estimated $500 billion since January 1973, and another observed that ". . . high interest rates kill investment bankers and brokers and bankers would not vote for them either." Yet, it may be significant that there was virtually no mention of trying to live with high rates of inflation by some full-scale adaptation of financial techniques or instruments and little suggestion that monetary policy should depart from its current course of moderate restraint. Instead, there seemed to be general consensus that inflation could, and would, be dealt with.

Fiscal policy

There was virtually unanimous opinion, however, that much greater reliance needs to be placed upon fiscal restraint, and that this should take the form of cuts in Federal expenditures. Most participants seemed to regard an expenditure figure below $300 billion in fiscal year 1975 as either essential or highly desirable. Even those who tended to minimize the direct shortrun effect on inflation of, say, $10 billion less in Federal expenditures, accepted the desirability of expenditure restraint for the beneficial financial and psychological effects that would result. There was little discussion of the details of any expenditure reduction program, but several delegates expressed their belief that definite steps should be taken before the fall elections. In addition, a suggestion that the Executive might initially be given power to withhold sufficient funds from current appropriations to meet 150 percent of any desired cut in Federal expenditures was supported by several participants. Also, several delegates contended that any large budget—corporate or Federal—could usually be cut by a few percent.

In general, expenditure reductions were regarded as the way in which fiscal restraint should be exercised. But a number of participants indicated that they would favor general tax increases if these were essential to control inflation. Also, there was some discussion of the possible desirability of imposing a sizable excise tax on gasoline and remitting part of the proceeds to low-income groups. Other tax suggestions related more directly to financial markets and financial institutions.

There was some expression of dissatisfaction with the budget concepts that are currently employed. A number of participants felt that the full-employment budget concept should be relegated to obscurity and attention directed to actual budget deficits. One felt that the actual budget concept should be narrowed by excluding the trust funds and returning to the older administrative budget concept. There was much more support, however, for widening the budget concept to include the activities of off-budget agencies and the effects of Federal credit programs. The latter were widely regarded as an important factor explaining the extent of current financial strains.

Monetary policy

In contrast to fiscal policy, monetary policy received very little criticism from the Conference participants. There was some expression of belief that high interest rates may cause inflation, rather than the reverse; but most participants seemed to accept high interest rates as a necessary evil, or as an inevitable consequence of high rates of inflation. There was some expression of hope that the Federal Reserve would find a further reduction of short-term rates compatible with the containment of inflation, but little suggestion that monetary policy should be eased appreciably. Indeed, despite the adverse effects of tight money on financial markets and institutions, the continuation of a moderate degree of monetary restraint was clearly regarded as desirable by most of the participants.

There was some departure from this apparent consensus. A few participants questioned the effectiveness of monetary restraint so long as commercial banks were not subjected to Regulation Q ceilings, and one likened unregulated financial markets to a "financial jet engine." It was suggested that a partial remedy might lie in the application of a ceiling on the bank prime rate. But this suggestion, and the analytical view upon which it was based, did not seem to elicit much support within the Conference. There was also some mention of "financial brinkmanship" and a few references to the possibility of having pressed monetary policy up to, if not beyond, the limits of prudence. But some felt that this was necessary to deal with inflationary expectations and there was general agreement that failure to employ sufficient fiscal restraint had caused undue reliance on monetary policy.

Wage-price policy

While fiscal and monetary policy were clearly regarded as the major tools for dealing with inflation, there was an articulate minority view which favored a supplementary effort in the wage-price field. This minority view ranged from advocacy of an explicit incomes policy to reliance on a less explicit "social contract" approach. There was general recognition within the Conference that we face a difficult wage-price situation, in view of the decline in labor's real earnings over the past year or so. It was suggested that tax reduction might even have merit as a quid pro quo for wage restraint, but the difficulties of such an approach were also recognized. No interest whatsoever was evidenced within the Conference for a return to wage-price controls.

Other broad issues

A number of other broad issues emerged in the course of the Conference. The view was widely expressed that there is currently a need for a clear signal to the public of the Government's intention to deal firmly with inflation—to most participants this meant sizable reductions in Federal spending. The general desirability of strong Presidential leadership and an early initiative in the economic field was also mentioned. Several speakers stressed the need for a deeper public understanding of the inflation problem and one called for more responsible reporting of economic news by the TV networks.

There was a fair amount of discussion of the desirability of achieving a greater feeling of involvement in the inflation fight on the part of the public. The issue was raised a number of times in different contexts. Several suggestions were advanced as to how closer public involvement might be achieved. For example, millions of publicly owned acres could be made suitable for community gardens to cope with rising food costs.

There was frequent expression of the importance of taking steps to insure that the cost of reducing inflation be fairly shared. The attention of the Conference was directed to the possibility that the burden of unemployment falls so heavily on minority groups that some members may be driven to prefer the comparative security of welfare programs.

International economic policy

In the international area, attention was directed to the fact that since the end of World War II there has been a progressive dismantling of barriers to the movement of goods, services, and people across national boundaries. This has had enormously beneficial effects. Now, however, there is some danger that inflation may drive countries into economic nationalism. It was urged that we push ahead on the Trade Reform Act to enable this country to take a leadership role in pursuing lower barriers to trade and investment. Some concerns were expressed over the potential instabilities inherent in the Eurodollar market and it was questioned whether the "recycling" problem had been solved satisfactorily.

There was some expression of belief that international matters might have been insufficiently emphasized within the Conference. But more importantly there was a fairly widespread view that the United States had failed to deal effectively with broad problems cutting across economic and political areas, e.g., the quadrupling of oil prices. It was suggested that the responsibility for U.S. foreign economic policy is too fragmented and that better coordination would result if policy decisions were reached in an "International Quadriad" headed by Treasury and including State, NSC, and the Federal Reserve.

Capital markets

A certain degree of pessimism was expressed on longer term domestic financial developments. The basic difficulty is the inability of financial markets to function efficiently in an inflationary environment. Many participants pointed to the current sad state of the equity markets, and the difficulties faced by long-term debt markets. There was general agreement that future capital requirements would be very large in comparison with past experience. The need to offer greater incentives to both saving and investment was stressed. Adequate levels of profits were regarded as essential and there was considerable discussion of the accounting problems involved during inflationary periods in both the inventory and capital investment areas.

Regulatory requirements and costs

Attention was directed by a number of participants to the harmful effect upon productivity of Government regulations. Particular reference was made to the difficult situation of the utility industry. It was suggested that there is a need for a thoroughgoing review at all levels of Government of regulations on industry which result in increased costs without increased benefits to the consumer. Several participants cited the desirability of a more gradual approach to environmental cleanup.

Financial institutions

The special problems of savings institutions during periods of tight money received a good deal of attention. Considerable support was expressed for the reforms embodied in the administration's Financial Institutions Act. A few participants pointed, however, to the long road ahead before savings institutions can compete on anything like an equal basis with commercial banks. Possible future resort to variable rate mortgages was mentioned. An issue to which a number of participants referred was the possibility of an exemption or tax credit for interest on savings deposits.

Special topics

A number of special topics were raised by industry spokesmen and a profit-sharing proposal was described by one participant. Details on these and other matters are provided in the full transcript of the Conference proceedings.

SUMMARY

In general, the Conference felt that major reliance must continue to be placed upon the two main tools of aggregate economic policy: fiscal policy and monetary policy. There was widespread recognition of the need to insure that the burdens of any anti-inflationary program are equitably shared. The need for greater fiscal restraint was emphasized by nearly every participant. No further intensification of monetary restraint was recommended but a continued policy of moderate restraint was generally viewed as desirable. There was a minority within the Conference which favored a more active wage-price policy.

There was also wide consensus on the need to develop specific policies to deal with specific problems that have arisen in the domestic financial area as a consequence of inflation. Also, the need for a more active and better coordinated foreign economic policy was stressed.

Exhibit 17.—Remarks of Assistant Secretary Fiedler, October 26, 1974, before the Inaugural Meetings of the Eastern Economic Association, Albany, N.Y., on causes of and cures for inflation

Day before yesterday, the New York Stock Exchange celebrated—if that's the word—the 45th anniversary of "Black Thursday," the beginning of the debacle on Wall Street in 1929. Although the debacle of 1974 on Wall Street has induced some comparisons with the events of 4½ decades earlier, our economic difficulties today are of a very different nature and origin than those following 1929. Then the primary problem was depression with its shockingly high rate of unemployment. Today our primary problem is the shockingly high rate of inflation.

This is not to say that our economic difficulties today are of only one dimension. We not only have inflation, but sluggish economic activity along with it. In a word, stagflation. But I put the inflation dimension of our problems at the head of the list, not only because it is so severe and not only because the decline in activity will be (by 1930's standards at least) quite limited, but also because the basic source of the weakness in activity comes from the inflation itself.

This is a point worth some emphasis. The same forces causing prices to rise so virulently are also producing the economic downturn. It has been inflation that has dried up the supply of mortgage credit and sent housing into a tailspin. And it has been inflation that has crushed consumer confidence and put the brakes on consumer spending harder than at any time since World War II. These are the two weakest sectors of the economy, and thus it is the inflation itself that is the basic cause of our economic sluggishness and rising unemployment. In shaping policy to deal with our economic difficulties, therefore, we must continue to put top priority on the fight against inflation—even though it is so much easier and, from a short-term point of view, so much more enjoyable to fight recession.

Causes of inflation

What policies we use to counter inflation depend in part on its causes. In the long run, e.g., two decades, the monetarists are right: It is the supply of money that is the strategic variable in determining what happens to the general price level. But to know that is not much help in solving the problems we face in the short- and intermediate-range future. We must know what it is that causes changes in the quantity of money. Equally important, we must recognize that there can be extremely important nonmonetary influences on the general price index in the short run.

On this latter point we have had over the past couple of years two of the most prominent examples imaginable: food and energy. In the long run, what happens to prices of individual commodities, or commodity classes, is of little or no consequence to the rate of inflation. But in the short run, even for several years, commodity groups as important as food and fuel can have a very powerful effect.

Workers' loss of income

While on this topic, there is a related point that deserves much more attention than it has received. When real incomes are discussed, we often hear statements like, "inflation has cut the real spendable purchasing power of the average nonfarm worker's paycheck by 4 percent over the past 12 months." In a pure arithmetic sense, that statement can't be denied. Yet it seems to me to misrepresent what has actually taken place, namely, a transfer of real income out of the pockets of nonfarm workers.

Farm prices went up because food supplies went down, through natural causes. Energy prices went up because oil supplies went down, through unnatural causes. In both cases, to get the food and fuel he wants at higher relative prices the nonfarm worker must give up more of his real income to farmers and to owners of oil both here and abroad. Thus it is the reduction of supplies of both food and fuel that is the real cause of the worker's loss of real income, not the inflation. The inflation is a measure of what has taken place, but not the cause of it.

This point is not just a matter of semantics or a nice essay question for Economics 201, but also has serious ramifications for our future rate of inflation. Quite understandably, workers do not want to accept this loss of real income—they don't want to be taken advantage of by either a quixotic Mother Nature or by the countries that produce petroleum. Workers want that real income back. Accordingly, wage demands and wage settlements have escalated sharply since the end of controls. But since the worker's loss was not his employer's gain—i.e., corporate profits in almost all sectors of the economy are still in the normal range—there is no way for these accelerated wage pressures to be met except through another round of price hikes. The attempt by workers to catch up, to make up for their lost real income, is thus doomed to failure. As a group workers will be no better off—and we are all likely to be worse off. The price increases associated with reduced supplies of food and fuel will have been built into the system; they will have become embedded into our inflation rate on both the wage and price sides.

More fundamental causes

But the horrendous rate at which the price level has been rising is not due solely to bad luck, as in the case of food and fuel. It is also traceable to the dogged pursuit of bad policies for a decade or more, including—

Fiscal policy; not only the rapid growth of spending from the mid-1960's on with its accompanying deficits in prosperous years as well as slack years, but also the massive proliferation of off-budget lending programs.

Monetary policy; the accelerated growth in money and credit throughout the past decade, over and above what was in some sense "mandated" by Federal spending and lending programs, and which has succeeded only in bringing us higher prices and higher interest rates.

The maintenance for many years of an internationally overvalued dollar, which dampened inflation in the United States but contributed to the inadequate expansion of capacity by most of our basic materials industries—steel, paper, et cetera—where almost all of our inflationary bottlenecks were experienced in 1973 when we reached the limits of economic expansion. Then, when the devaluations of 1971 and 1973 occurred the United States suddenly became the most favorable place to buy those scarce raw materials, which added another special burst of price pressures to our recent inflation.

Wage and price controls, which did little to control inflation overall but which did, in those areas where prices were suppressed, create economic distortions. Perhaps the best examples are those same basic materials industries, where controls kept prices and profits at low levels, causing expansion plans to be further delayed. Then in the spring of 1974, when the controls ended, those price pressures came out of the bottle with a rush.

Thus bad economic policies joined hands with bad luck to create the rampaging inflation we are stuck with today. How much of the inflation we should allocate to each cause is impossible to determine, because of the strong interactions that are surely involved. We can safely say, however, that the country would have been in much better shape to weather the food and fuel crises, without so much inflationary damage, had we not had bad economic policies for so long.

In this catalog of the causes of inflation, I have not thus far said anything about oligopoly, administered prices and wages, and the greed of labor leaders and business managers. The omission is deliberate. Not that such conditions and characteristics do not exist. Quite the contrary. Greed, for example, is as prevalent in business and labor as it is in academe, in politics, and everywhere else. But I personally do not see greed or oligopoly or administered prices and wages as bearing any major responsibility for our inflation.

Cures for inflation

About the only sure thing that can be said about curbing inflation is that the process is unpopular. Catching the inflationary disease and then curing it are like a wild night on the town: The first few drinks appear to have decidedly pleasant effects, but oh that hangover!

Since bad luck was a significant part of the acceleration of inflationary momentum over the past few years, it would be nice if we could have a run of good luck to help us with the deceleration. We had better not count on it, however.

The critical requirement is to pursue the necessary monetary and fiscal discipline consistently and persistently to keep the economy operating within the limits of its capacity to produce. It is essential, in my opinion, that we establish and maintain a moderate degree of slack in the economy for a number of years.

This does not mean a depression. Decidedly not. After a period of weakness, of the sort we are now in, it is vital that economic growth resume at a normal pace. Business sales can show a healthy growth, but that growth will have to be constrained so that if one businessman tries to raise prices too fast there will be a competitor someplace with extra capacity who will take the orders away from the first company. Employment can grow, too, but our labor markets must have a little slack in them, so that the joint worker-management process of wage determination can result in a gradual deceleration of the upward trend of pay scales. A small gap will have to be maintained between our total economic capacity and the level of demand, if we are to achieve a meaningful slowdown in the rate of inflation.

That is not a happy prescription. No one likes to see total income and output restrained below maximum. No one likes to put off increases in worthwhile Federal spending programs, or to forego the pleasures of a tax cut. No one likes to have credit less easily available, or to see the growth of business profits held back for a while. Most important, no one is happy with the prospect of unemployment averaging slightly higher than it otherwise would. But if we are to regain control over inflation, there is no other way. These costs, which are not negligible, must be met. There is no acceptable alternative, because the costs of continued rapid inflation are much higher.

Some people think there is an easier way in the form of controls of one sort or another. I cannot accept that. We and other countries have tried comprehensive, mandatory controls, and they just don't work—short-term gains are sometimes realized, but only at the expense of long-term pains. And more benign versions of direct government intervention—guidelines or social compacts—suffer the same shortcomings. Generally, they don't provide any effective restraint on inflation, and where they do impact on individual price and wage decisions they do more harm than good. Thus, I conclude that the only choice is to operate our growing economy with a moderate margin of slack for an extended period of time.

The present situation

An effective policy to curb inflation is already underway. Our policies have already produced enough restraint to develop the necessary margin of slack in the economy, as is becoming clearer every week. The first crucial step in the anti-inflation fight is therefore behind us.

The restraint created thus far, however, has come almost entirely from the monetary side. The Federal Reserve has been bearing the burden of restrictive policies substantially by itself. Thus the second vital step is to redress this imbalance between monetary and fiscal policies by achieving greater control of the budget. I would argue that total restraint from both major policy tools need not be any tougher than has been the case over the past year—perhaps slightly less, in fact—but there is a compelling argument for changing the mix. It is vital that we ease pressures in the credit markets, so that interest rates can ease off and so that funds again flow to the beleagured housing industry.

The third and final step for policy will be to keep a moderate degree of economic slack in existence for some time to come. We must not be pressured into a new round of overheating. To achieve this goal, we must be sure to have effective programs in place to cushion the impact of inflation where it strikes with disproportionate force—programs such as direct aid to housing, low-income tax relief, extended unemployment benefits and an expanded public employment program. These programs are important for two reasons: First, they are important as a simple matter of compassion for the unlucky and the disadvantaged. Second, if we are to keep the slack in existence, we must be sure that its burden is shared equitably throughout society, so that this policy attains a broad and durable political acceptance. Otherwise the American people will opt for a new round of excessive economic policy stimulus—i.e., more of what got us into this mess in the first place.

In conclusion, I can only express my hope that the American people will choose to take the unpleasant-tasting medicine of fiscal and monetary discipline. It is not an ideal solution and it is not an easy solution. None exists. But it is a better choice than another try at controls or than trying to live with double-digit inflation. Our economy will survive in any event, but I believe we will experience less economic difficulty if we follow the path of self-discipline.

Exhibit 18.—Address by Secretary Simon, February 28, 1975, before the Commonwealth Club, San Francisco, Calif., concerning the growth of government, the weakening of the free enterprise system, and inflation

It is good to be in San Francisco again, especially among so many old friends. I am also deeply honored to be at this podium, for every speaker who comes here knows he is addressing one of the finest audiences in the country.

For several months, one depressing economic statistic after another has been pouring out of Washington, subjecting all of us to an exquisite form of Chinese water torture. Back East, people are reminded of the fellow who was told by his doctor that he had to stop drinking or he would become deaf. The fellow refused to follow the doctor's advice. Asked why, he explained: "I like what I've been drinking so much better than what I've been hearing."

Times haven't been easy for any of us. The day after I took this job, a close friend of mine put it nicely. "Bill," he said, "you've just become the purser on the *Titanic*."

I don't seriously believe that, of course. Those who take such perverse delight in proclaiming the end of the American Dream are dead wrong, just as the touters of gloom and doom have always been wrong in the past. We should never underestimate either our economic system or ourselves. Certainly, our economy has its weaknesses and certainly the present rates of unemployment and inflation are unacceptably high, but our economy remains the strongest and most powerful in the world and as a people, we still have the wisdom and the will to regain control of our own destiny.

The major question before us is whether we can wake up to the malignant forces that are subtly, quietly, but very busily eating away at the foundations of our society. Once we know them for what they are, I am absolutely certain that the people of this country will rise up in rebellion and sweep these alien forces from our midst.

Today, with your indulgence, I would like to step back from our immediate concerns for a few moments and address three of the long-term trends which I find most disturbing and potentially the most destructive within our economy. What I have to say is not popular or welcome in many quarters, but I feel that these are serious and fundamental problems that must be addressed.

Massive growth of government

The first of these trends has been the massive growth of government in this country, a growth that has sharply accelerated since the mid-1960's.

It took 186 years for the Federal budget to reach $100 billion, a line it crossed in 1962. Only 9 more years were required to break the $200 billion figure, and only 4 more years to crack the $300 billion barrier—a record we are setting this year.

Government at all levels now employs one out of every six members of our work force. It has become the biggest single employer in the country, with more personnel than the auto industry, the steel industry, and all other durable goods combined.

Before the Great Depression, government took about 12 percent of our total national production. Today it soaks up about one-third of the GNP, and if recent trends prevail, it will consume some 60 percent of our total national output by the year 2000. When any government taxes away more than half of what a people produce, robbing them of their economic freedoms, can there be any doubt that the loss of their social and personal freedoms will follow close behind?

One of the Treasury Department's responsibilities is to "manage" the Federal debt and to borrow to meet the deficits that the Federal Government continues to accumulate at a rapid clip. We have watched with horror as the deficits anticipated for fiscal years 1975 and 1976 climb toward the $100 billion mark. During the next several months, we will have to borrow a billion dollars a week to pay those bills.

Those who tend to dismiss this problem by making a simplistic comparison between the growing size of the debt and the growing size of the economy are ignoring the financial implications. Combining Federal with State and local borrowing, we now expect that during fiscal year 1976, government will borrow some 80 percent of the net new funds raised in our private capital markets. The capital markets have always been the centerpiece of our free enterprise system, but in coming months only 20 percent of their new funds will be available for private industry.

We should be fully aware of the dangers that could arise in our financial markets from these budget deficits—and especially if congressional action increases these deficits beyond the levels projected. Reasonable financing of such deficits would be possible only if the recession is much deeper than we expect. Otherwise, we could either have vicious competition between the Government and private borrowers for capital funds, or the Federal Reserve would have to supply funds without regard to the inflationary consequences. In any event, despite the best intentions of the Government, a larger-than-expected budget would threaten economic recovery by crowding out medium to lower rated business borrowers, many of whom already have severe financial problems, and by elbowing aside mortgage borrowers as well, thus aborting recovery in the housing industry.

We have not only been spending too much money in Washington, but we have also been creating too much of it. From 1955 through 1965, the money supply grew at an average rate of 2½ percent a year, and we enjoyed a period of reasonable price stability. Since 1965, however, the rate of growth has more than doubled to 6 percent a year, far more than the economy could reasonably absorb. It is no accident that inflation has become a chronic problem.

In the past several weeks, there has been considerable debate whether the antirecessionary policies of the Federal Reserve should be more stimulative. While I have no intention of infringing on the independence of the Federal Reserve, I must say that I respect the view of Dr. Burns that monetary policy must and will contribute to economic recovery but excessive monetary stimulation today would only guarantee far more inflation tomorrow, as it has so often in the past.

The fiscal and monetary problems of the Government are familiar ground for most of us. What may be less familiar has been the enormous proliferation of Federal regulations in recent years. In a subtle but insidious way, these regulations have spread throughout our society so that today they encumber almost every phase of business and industrial life and cost consumers untold billions of dollars.

The independent regulatory agencies of the Government exercise control over all forms of interstate transportation, power generation, the securities market, and electronic communications—industries that account for more than 10 percent of everything made and sold in the United States. Through various environmental and safety laws, subsidy programs, contracting authorities, and other devices, Federal regulators have also heavily supplanted the decisions of private citizens in the maritime, auto, defense, drug, trade, and agricultural industries.

Economist Murray Weidenbaum, in an enlightening study published early this week, points out that the design and manufacture of the 1973 automobile was subject to 44 different Government standards and regulations involving about 780 different tests that had to be met. As the chairman of General Motors once observed, "Government today has something to say about how we design our products, how we build them, how we test them, how we advertise them, how we sell them, how we warrant them, how we repair them, the compensation we pay our employees, and even the prices we may charge our customers."

Many governmental regulations serve worthy purposes and must be continued, but there are an increasing number that are in urgent need of review. For example:

As you probably know, it is almost twice as far from San Francisco to Los Angeles than from New York to Washington, and yet the air fare on the California trip is almost a third cheaper. Why? Because airlines operating intrastate in California are not controlled by Federal regulators.

Reliable studies show that the Government now requires the railroads to maintain as many as 50,000 miles of track that may no longer be needed, creating additional financial burdens on an industry already in peril.

In the field of energy, the Federal Power Commission, despite repeated warnings from experts, has been required for more than two decades to keep the wellhead price of natural gas at an abnormally low level in order to hold down prices for consumers. But this has reduced the incentives for the development of new domestic supplies, so that today there is much less natural gas than we need. Government regulation has, in effect, created a national shortage.

Or take another example: nuclear power. This country was a pioneer in the development of nuclear power. Yet today it takes 11 years to build a nuclear powerplant in the United States, and only 4–4½ years in Europe and Japan. Why? Because of Government regulation.

Private citizens are not the only people, of course, who have reason to complain about the encroachment of Federal regulations. Public officials at the State and local level find themselves equally enmeshed in a thick web of rules and regulations issued from Washington. After only 2 months in office, Gov. Richard Lamm commented last week that he felt less like the chief executive of a semisovereign State than "a Federal regional administrator for the territory of Colorado."

In short, we are well on the way to creating:

A Government tax system that strips us of our wages and profits;

A Government spending system that controls our future; and

A Government regulatory system that strangles our free enterprise.

Columnist George Will summed it up well. We are "meandering mindlessly toward a serfdom that is no less real for being bland," he said. The growing power of the central Government "affects society the way hemlock affected Socrates: numbing begins in the extremities and moves inexorably until it extinguishes the spark of life." Unless warned, "A society, unlike Socrates, does not know it is dying until it is too weak to care."

Weakening of our economic foundations

A second trend that I want to address today has been the gradual weakening of our free enterprise system. It is a simple but compelling fact of life that increases in productive performance are required over time to create new jobs and support a higher standard of living. Yet, as a Nation we are rapidly expanding public payments to individuals but neglecting to provide adequate incentives for new investment. In the last 10 years, in real terms, Government transfer payments to people have more than doubled, while economic output has increased by only a third, and private investment expenditures—upon which the economic future of all of us inevitably depends—have risen by only a bit more than a quarter.

The record of capital investment in the United States in recent years has been the lowest of any major industrialized country in the free world. Our figures show that from 1960 through the early 1970's, private investment in the United States averaged about 18 percent a year of our GNP. By comparison, investments averaged 33 percent a year of the GNP in Japan, and 26 percent in Germany and France.

High rates of capital investment do not guarantee low rates of inflation, as can be seen from the Japanese experience. But they do have a close correlation with the growth rate of productivity and therefore with the basic strength of the economy. During the period I have just mentioned, the average growth in productivity was almost 11 percent a year in Japan, 6 percent a year in France and Germany, and in the United States—the leader of the free world—only 3 percent a year.

Why are we performing so poorly? Some of our major trading partners, of course, have been in the process of rebuilding from the war and are working from a smaller economic base. A more fundamental problem, I would suggest, is that we have had policies which promote consumption and Federal spending at the expense of savings and investment. Another illustration has been the serious deterioration in corporate profits since the mid-1960's. The American people believe that most corporations are raking in money by the barrelful and, indeed, reported profits are much higher than 10 years ago. But those high profits are an optical illusion created by the interplay of outmoded accounting practices and inflation. When those effects are removed, figures show that after-tax profits have dropped by 50 percent since 1965.

It is not unfair to say that we have been in a profits depression in the United States. Consider the level of undistributed profits. Between 1965 and 1973, undistributed profits fell nearly 85 percent to $3 billion, even though the economy grew by over 33 percent. And for 1974, our latest estimate is that the figure for undistributed profits was a *minus* $16 billion. Since profits are an important source of investment funds and also enable companies to attract even more money, it is clear that American business too often lacks the funds to invest in new plants and equipment and thus to create new jobs. The stock market, of course, recognizes the depressed state of corporate profits and will not support the companies most adversely affected. As a result, those companies are effectively barred from obtaining new investment funds in the equity markets. All of these are patterns that we simply must reverse.

Progressively higher inflation

Still a third trend that is highly damaging has been the progressive acceleration in the rate of inflation over the past decade. From 1960 through 1964, the rate of inflation was low and steady, averaging 1.2 percent a year. Then for the next 3 years, as we stepped up our efforts in Vietnam and also sharply accelerated the drive toward a "Great Society," the rate of inflation doubled to 2.5 percent a year. Then it doubled again to over 5 percent a year from 1968 through 1970. Wage and price controls helped to keep it below 5 percent in the next 2 years, but as history amply demonstrates, controls never end inflation—they only postpone it. In 1973, prices shot up over 6 percent and last year they skyrocketed by over 12 percent—the highest figure in our peacetime history.

Nor should we deceive ourselves about the future. Inflation may be receding today, but unless we take proper precautions, it could easily level off on a plateau of 7–8 percent—an easy launching pad for truly staggering inflation later on.

A half century ago, John Maynard Keynes warned us about the dangers of such inflation. "There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose." Unfortunately, that is the one part of Keynes' teachings that we should have remembered but have most conveniently forgotten.

How these trends converge

Each of these three trends—the growth of government, the weakening of the free enterprise system, and progressively higher rates of inflation—are disturbing enough by themselves. What is particularly critical, though, is how they feed upon each other. I would suggest to you that in the last decade they have joined together in an extremely powerful combination and now they lie at the root of most of our economic distress.

The huge Federal deficits of the 1960's and 1970's, for instance, have added enormously to aggregate demand for goods and services, and have thus been directly responsible for upward pressures on the price level. Heavy borrowing by the Federal sector has also been an important contributing factor to the persistent rise in interest rates and to the strains that have developed in money and capital markets. Worse still, continuation of budget deficits has tended to undermine the confidence of the public in the capacity of our Government to deal with inflation. In short, when the Federal budget runs a deficit year after year, especially during periods of high economic activity such as those we have enjoyed over the past decade, it becomes a major source of economic and financial instability.

Monetary policy has also been overly stimulative in the past decade and must be considered as another culprit of today's inflation. In part, that policy has represented an effort by the Federal Reserve to accommodate the growing financial demands of the Federal Government. But, in turn, the overly rapid growth of the money supply has also contributed significantly to the rate of inflation.

Moreover, the regulatory practices of the Federal Government have also been highly inflationary. The most obvious example is in the auto industry, where Government studies show that costs mandated by Federal rules added $320 to the price of a 1974 car. Less obvious examples are in other areas such as transportation, where Government regulators require many services that cannot be justified economically. Prof. Tom Moore at the Hoover Institute estimates that just in trucking and surface transportation alone, Government regulations cost consumers an extra $10 billion a year.

Government controls have also led to shortages in various sectors of the economy, which have in turn led to higher prices. The acreage programs in agriculture are a good example; fortunately, we have enacted legislation in recent years which is helping us to restore free enterprise on the farm. I wish we had made the same progress in deregulating the price of new natural gas. It is clear to me that consumers who are now forced to buy higher priced foreign oil because they cannot obtain natural gas would realize considerable savings if the price of new natural gas were deregulated.

No one has even been able to calculate accurately how much the total package of Federal rules and regulations is costing consumers, but it is certain that the figure is in the tens of billions of dollars. To me it is also apparent that the Federal Government in all of its fiscal, monetary, and regulatory practices has been the underlying cause of the chronic inflation that we have experienced for the past decade. That inflation was keenly aggravated by the quadrupling of oil prices last year, the explosion in food prices, and by other special factors, but as those special factors subside, we face a serious threat that continued governmental growth will perpetuate a strong inflationary momentum within the economy.

The discouraging trends in corporate profits and investments are closely tied to these same phenomena. Our Government, for example, now places a heavier tax burden on corporations than do most other major industrialized nations, many of whom have integrated their corporate tax systems with their taxes on individuals. This burden, of course, effectively reduces new investments. Moreover, an increasing percentage of capital investments are now being devoted to items required by the Federal Government. It has been estimated that in 1973 more than 10 percent of our capital investments were spent on pollution and safety outlays. These are desirable goals, but let us not ignore that such expenditures cause no measurable increase in a company's output; and this contributes to the miserable productivity trends I described earlier. The fact that many capital investments are being channeled into nonproductive uses mandated by the Government and the fact that the overall rates of investment are low also help to explain why the economy in 1973 lacked needed productive capacity. As we return to full production in future years, this lack of capacity will become a very serious problem.

Through the interplay of various forces, then, especially those emanating from misguided Government policies, we have encouraged excessive demands on the economy and discouraged production.

And the resulting inflation, I would submit, has not only cut deeply into the welfare of many families but it has also had a consequence that many people have not yet recognized: It tipped us into our current recession.

As prices soared upward in 1973 and 1974, they drove up interest rates and dried up funds in the mortgage market. We all know what happened then: The housing industry collapsed.

As prices shot upwards, they also dealt a massive blow to consumer confidence. With real incomes declining, consumers could no longer afford many items. The result was the biggest drop in consumer purchasing since World War II.

Housing and consumer spending are still the two weakest sectors of our economy, driven down by inflation. Until we recognize how inflation has thus been a fundamental cause of the recession, we are very likely to seek the wrong solutions for the future.

Policies for the future

What, then, is to be done?

Clearly, one part of the answer must be directed toward solving the energy problem, a topic that I have not tried to address here today. There can be no doubt that the United States must end its excessive reliance on foreign energy supplies that are both overpriced and insecure, and the sooner we act, the better.

Another part of the answer must be addressed to problems of recession and the serious human suffering which it causes. We remain confident that the recession will bottom out this year, and that by the end of the year we should be definitely on the road to recovery.

To attain lasting prosperity, however, we must summon all of the wisdom and strength at our command to attack the more enduring and fundamental forces that are gripping our economy:

First, we must curb the momentous growth of government in this country. The Government can and must play a positive role in our society. No one can be so emptyheaded as to denounce all the powers of government. But the growth of government that has occurred in the past decade exceeds all bounds of sensibility and is alien to our whole tradition of freedom and reward for personal endeavor.

Second, we must maintain and strengthen the foundations of our free enterprise system by shifting the emphasis of our domestic policies away from consumption and Government spending and toward greater savings, investment, and capital formation. The capital needs of our society over the next 10 years will be enormous, easily surpassing anything we have known before. We will ultimately be judged, I believe, not on how we handle our shortrun problems such as recession, but on our ability to deal with the more long-range problems of resource allocation and capital formation. History is littered with the wreckage of nations that have failed to meet this challenge.

Finally, we must always keep our sights on the single most destructive force within our economy—inflation. In warming up the economy now, we must not succumb to the temptation to overheat it again. And when we restore our prosperity, as we will, we must not sacrifice it again on the altar of Big Government. We can no longer afford the practice of living off our inheritance while mortgaging our future.

Ladies and gentlemen, if I could leave with you one thought, it would be this: America is still incredibly strong, powered by the largest and most dynamic marketplace in the world. We have the resources, and we know the way to rebuild our economy. The central question is whether we will wake up to the dangers we have created and rescue ourselves from self-destruction.

I submit that each of us in this room can help to lead this country out of the quagmire. And let me direct my remarks particularly to those of you who are leaders of the business community. You and I share common backgrounds, and today we also share a common sorrow. One of my saddest experiences in public life is to see businessmen trooping into Washington day after day, hat-in-hand, seeking shelter from the storm under a Government umbrella. Tariffs, subsidies, quotas, handouts, bailouts—I've seen them all and none of them are worth their ultimate cost. They all lead to sacrificing our freedoms for a falsely perceived security.

When will we learn our lesson? The promise of security that the Government holds out to each of us is an empty, hollow promise—a false god. History shows us time and again that when we surrender to the government the power to run our businesses or run our lives, it runs them in only one direction—right into the ground.

It cannot be said often enough that a centralized economy in America is the surest means we have of killing the goose that lays the golden egg. In the United States today we already have more government than we need, more government than most people want, and certainly more government than we are willing to pay for.

An epitaph written for ancient Athens and attributed to the pen of Edward Gibbon is relevant for us today. "In the end," he wrote, "more than they wanted freedom, they wanted security. They wanted a comfortable life and they lost it all—security, comfort, and freedom. When the Athenians finally wanted not to give to society but for society to give to them, when the freedom they wished for most was freedom from responsibility, then Athens ceased to be free."

Whether the same will one day be said of America is the basic decision now before us.

Thank you.

Exhibit 19.—Address by Secretary Simon, April 7, 1975, before the American Newspaper Publishers Association, New Orleans, La., on reporting economics in the Nation's press

I certainly welcome this opportunity to speak before such a distinguished gathering of American newspaper publishers.

Over the past 2 years, I have had the pleasure of working closely with many of your reporters and editors—first on the energy crisis and now on our economic problems—and I have gained a much keener appreciation of the influence that your publications have upon our national life. I might add that through my associations with you and members of your staffs, I have also had the good fortune of establishing many new friendships—one of the greatest rewards of my career in public office.

I came to Washington with the general notion that newspapers tell their readers what policy decisions have been made and then report on the impact of those decisions. As I have learned, however, news reports also play a major role in forming the policies themselves. Every public official soon finds that what he says is often less important than what the newspapers say that he says. Policies are often shaped so that they can be clearly communicated and will receive maximum attention in the press. And the heavy pressures of press deadlines often determine the timing and manner of policy announcements.

In view of this influence and the valuable educational role that the press can play, I thought it might be helpful today to turn the magnifying glass around for a few moments. For the last several months, your newspapers have had it trained on the Nation's economy, probing to see how much life it has left. This afternoon, I would like to devote part of my talk to the press itself, addressing in broad terms the state of reporting on the economy and suggesting ways that all of us might help to strengthen public understanding of the crucial issues now at stake.

This is an incendiary subject, and I want to avoid lighting any fuses. I have no intention of infringing upon your freedoms nor in casting stones. We have had enough of that already. For over a decade, we have witnessed a perilous decline in public confidence in all of our major institutions, including the press. America cannot be a happy, prosperous nation nor can we be an effective force for world peace if we are torn by bitter, internal divisions. In trying to improve public understanding of the economy, then, let us not try to tear each other down but to build up this great country again. Let us respect each other's independence, but let us also find ways of working together to achieve our goals.

I am often frustrated, and I think you are often frustrated in the effort to enlighten the public about the true nature of our economic difficulties and the choices we face for the future. You want to do your job right, just as I do, in a way that avoids public confusion and mistaken policies. Yet your reporters and editorial writers must necessarily jump from crisis to crisis, from one complex subject to the next with little time or space for deep analysis and, often, with little prior knowledge of the subject. The inevitable result is that a subject like the economy, which is inherently complex and can be dull, is frequently sensationalized. And too often, as Senator Fulbright remarked, reporters show more interest in the singer than in the song.

How, then, can we do better justice to the problems of economic reporting?

An initial point upon which all of us would agree, I think, is that the major economics writers have become much better acquainted with their subject. There was a time not long ago when Gardner Ackley, Chairman of the Council of Economic Advisers under President Johnson, wished that every economics reporter could measure up to two standards: First, that he had taken an introductory course in economics, and, second, that he had passed it.

Reviewing the work of the major writers who cover the economic scene in Washington. I can tell you that there has been a marked improvement in the past year. The good journalists are really very good, possessing a solid grasp of economic issues and an ability to communicate with a striking degree of clarity and subtlety.

Television networks are also making notable progress in their economic coverage, especially public television. Economic developments often lend themselves more easily to print than to electronic journalism, but the improvements that the networks have made by bolstering their economic staffs make it clear that television coverage can become more effective.

Indeed, while the path of economic journalism in newspapers, radio, and television has been steadily upwards, I think all of us would also agree that we are still far from the peak. Time magazine. in a recent assessment, said that: "since events pushed inflation and recession to Page One and the top of TV news programs, it has become painfully apparent that American journalism, by and large, provides dismal coverage of the Dismal Science." That judgment is rather harsh. but it has a ring of truth that should jar us all.

The steps that might be taken to improve the quality of your writing staffs are obviously a matter for you to decide. You might want to consider additional schooling for some of your writers. In my home State, for instance, Princeton University with the help of the Alfred Sloan Foundation has just set up a fellowship program for economics journalists. You also might want to consider setting up special training sessions for journalists, similar to those now held by the Washington Journalism Center in Washington. You might want to open up the "op-ed" pages of your newspaper to more economics writers or to guest columnists, in the way that Newsweek and the Wall Street Journal have done so successfully. Or you might want to consider ways that the wire services—the AP, the UPI, Dow Jones, and Reuters—can supplement their present news stories on the economy with more in-depth analysis of the economy.

Whatever you decide, I want to make it clear that we at the Treasury Department and elsewhere in Government are anxious to be as helpful to you as possible. We would welcome your suggestions on how we might assist you so that you can do a better job. We have a firm policy at the Treasury Department that everyone—from the top down—should be fully responsive to requests from the press, and I pledge to you that we will continue to follow that policy to the hilt.

Evaluating economic news

Another question you face is how to improve your evaluation of the news itself. One concern shared by many men and women in public life is that economic reporters are highly accurate in reporting the latest economic statistics—wholesale prices, unemployment, and the like—but they have considerable difficulty in exploring beneath the surface and explaining their real meaning.

Let me give you one example: corporate profits. Almost every time a major corporation reports high profit levels the story hits the front page. If profits drop, that's a story for the financial section. And because of inflation, many corporations do show higher profits even though their real earnings are declining. The result is that over time the American public has gained a very distorted view of the corporate profit picture. A few years ago, a poll showed that most people thought corporations reaped a profit of 28 cents on every dollar of sales; in actuality, profits are only about 5 cents on the dollar.

Looking at the past decade, in fact, there has been a dramatic decline in corporate profits, and the implications of this for the future capital investment is one of the most underreported stories of our time. The high profits we often read about are an optical illusion created by the interplay of outmoded accounting practices and inflation. When those effects are removed, the facts show that after-tax profits have dropped by 50 percent since 1965. Last year, undistributed corporate profits—the money left for investment in expanded plant and equipment and the creation of new jobs—was a *minus* $16 billion. Earnings fell that far short of covering normal depreciation of plant and equipment.

It is not unfair to say that this country has been and is today in a serious profits depression. Yet the American people do not understand this, and until they do understand it, we face the prospect of still more antibusiness legislation, and we will find it increasingly difficult to rebuild the foundations of our private enterprise system.

There are many other examples of statistics which are not well understood. For instance, the declining value of the dollar relative to the German mark and the Swiss franc has shaken some observers, when in reality, measured on a trade-weighted average basis against all OECD currencies, the dollar stands approximately where it did 2 years ago. Or consider our balance of payments. Three weeks ago, considerable attention was given to a Government press release indicating that the deficit in our balance on current and long-term capital transactions had risen to $10.6 billion in 1974 from a $1 billion deficit in 1973. But this is a highly misleading interpretation of the true balance, because this particular statistic excludes most of the identified investments in the United States by the oil-exporting nations—investments which totaled about $11 billion in 1974. By including those investments, you can see that our balance of payments picture would not appear to be so bleak and would not have attracted such dire headlines.

What this suggests is that all of us—reporters and public officials alike—have a responsibility not just to report the statistics but to explain them carefully and honestly. Within the Government, we are trying to improve our statistical reporting services so that the numbers are more meaningful. We have also taken steps to insulate the professional statisticians, freeing them from political pressures and giving the public greater confidence in the integrity of our measurements. We are mindful of the fact that in the past the Government has been frequently accused of applying a liberal dose of optimism to every set of new statistics. George Meany once said that if the Government were reporting the sinking of the *Titanic*, the announcement would read something like this: "The *Titanic* has stopped in midocean to take on a new supply of ice." Today all major economic statistics are reported straightforwardly, and they are so well protected from leaks to favored newspapers that not even a Cabinet member is allowed to see them before they are given to all members of the press.

While I agree with the need for honesty and candor, there is also such a thing as carrying statistics too far in the other direction. Earlier this year the administration published some bleak economic projections for the next 5 years which were simple arithmetic extrapolations but were taken more seriously than they were intended and, as a result, caused a certain amount of alarm across the country as well as in Congress. Since that time, I have consistently argued that those numbers should be regarded with a high degree of skepticism—no one can accurately predict where our economy will be 3 to 4 years from now—and they do not provide a sound basis for legislative policymaking.

Reporting long-term economic trends

Still a more serious problem than interpreting statistics arises, I think, in evaluating the long-range trends within our economy. I must tell you that I do not think that the press has done a particularly good job in helping the public understand how our economy has fallen into our current mess. I am not sure why. Perhaps the economy has been regarded as hopelessly complex or dull for newspaper readers, so that economic analysis has been ignored by many newspapers. Perhaps the antibusiness bias that undeniably exists among some journalists has steered them away from a hard look at what's been happening within our private enterprise system. Whatever the reason, it is clear that many Americans do not understand how they were suddenly caught in an economic storm. To them, as Churchill once said of Russia, the economy has become a "riddle wrapped inside a mystery inside an enigma."

Tell me, there is no real mystery about how we got here nor is there any secret about the cure. I appreciate the fact that other people have different opinions, but I would suggest that there are four long-range trends in our society which deserve much closer scrutiny:

One has been the enormous growth of Government spending and the accompanying growth in Federal deficits. It took this country 186 years for the Federal budget to break $100 billion, only 9 more years to break $200 billion, and only 4 more years to reach $300 billion—a line we are crossing this year. The government's share of our gross national product has nearly tripled in the past four decades—and unless we arrest the recent spurt in transfer payments, it will near the 60-percent mark by the end of this century. In 14 of the past 15 years, the Federal budget has been in the red, and our national debt is growing so fast that interest payments on it have reached $36 billion a year. We are in effect living off our inheritance and mortgaging our future at one and the same time. Neither man nor government can continue to live beyond its means for very long, and if we continue this way, we will lose not only our prosperity but our freedom as well.

Secondly, we should recognize that monetary policy has been equally at fault over the past decade. From 1955 to 1965, the money supply grew at the rate of 2½ percent a year, and we enjoyed reasonable price stability. In the decade that has followed, the money supply has been growing at an annual rate of 6 percent a year—more than double the earlier rate. It is no accident that during a long period of excessive fiscal and monetary policies, as we have had, inflation has become a chronic problem. In fact, if you will look beneath the surface, you will find that the inflation stemming from our fiscal and monetary excesses has been the single most destructive force within our economy—hurting us far more than the recent quadrupling of oil prices, the explosion of food prices, and so on.

Thirdly, in a subtle but insidious way, there has been an enormous proliferation in Government regulations in recent years so that they now encumber almost every phase of our business life and cost consumers untold billions of dollars. To rid ourselves of countless rules that cause inefficiencies and drive up prices in transportation, energy, and other fields, we must undertake a massive overhaul of our regulatory practices.

Finally, we should recognize that by discouraging profits and by encouraging consumption and Government spending at the sacrifice of saving and capital investment, we are seriously weakening the foundations of our private enterprise system. The record of capital investment in the United States since the early 1960's has been the worst of any major industrialized nation in the free world. As a consequence, our productivity is also growing more slowly than elsewhere and our economy has failed to match the growth rate of many other countries.

We simply must reverse these trends if we want to regain our prosperity and retain the premier economy of the world.

In all of the hand-wringing that is popular today, it may sound strange to hear someone talk of our "premier economy." But it's true, and in tackling our problems, we should never forget it. America is still incredibly strong, powered by the largest and most dynamic free market in the world. In the past 15 years, per capita income in this country has risen by 50 percent. We are still the wealthiest nation the world has ever known, and our citizens are the most affluent. Moreover, even though the problems of unemployment and inflation are especially painful, evidence is gathering on every side that the economy is shifting gears from recession to recovery. We are confident that the recession will bottom out during the middle months of the year, and by the end of 1975, we will definitely be on the road to recovery.

As you can see, I deeply believe that we face both a short-term and a long-term economic challenge. I am confident about our prospects in the short term: We have the resources, we have the economic strength, and we are moving swiftly in the right direction to correct our problems. But to meet the long-term challenge, we must wake up to the fact that dangerous forces are quietly but busily eating away at the foundations of our economy and could eventually destroy it unless we take effective action. That is why it is so vitally important to avoid steps now—an even greater budget deficit, for instance, or excessive monetary policies—that might propel us out of the recession but would only catapult us into a new round of spiraling inflation and still higher unemployment.

My greatest concern about the press today is that it fails to convey a greater sense of perspective to the American people about the choices we face. As George Ferguson, former editor-in-chief of the Montreal Star, has observed about modern reporting: "The sense of continuity, of the steady, implacable flow of history from the past into the immediate present, is largely forgotten. . . . The result is a kind of breathlessness, a panting sense of excitement which we build up almost subconsciously, because that is the way, and the only way . . . we have been taught to play our roles."

When the press focuses almost entirely on immediate economic news, when in effect it exploits anxiety, it contributes to a process that is potentially lethal for a free society. Time and again over the past few months, those who were so quick to foresee economic disaster—the preachers of gloom and doom—were able to grab a headline in our daily newspapers. Think back over predictions for the collapse of the international monetary system as well as predictions of a dollar a gallon for gas, a dollar a loaf for bread, and a dollar a pound for sugar. All of those forecasts were given far more currency than they deserved. And all of them were wrong. More thoughtful analysis, I believe, would have given the American people an understanding of how very unlikely it was that those things would happen; but unfortunately, very little of that analysis was presented.

With prices rising, jobs threatened, and the voices of despair crying out in the press, it is hardly surprising that public confidence crumbled. Inevitably, when the public demands explanations, they are told to blame people, not conditions. The economic process is personalized, not analyzed. And when the public demands solutions, everyone points in one direction: Washington, D.C. Pressures build for "action" by the Federal Government. Few people think very carefully about what kind of action would be beneficial, but almost everyone wants action and they want it immediately. As a result, we tend to make the same policy mistakes that helped to get us into this mess in the first place—more Government spending, higher deficits, more regulation, and the like. This is the same threat that we face today except this time the mistakes could be much larger and they could sacrifice an even larger share of our freedom.

The crux of our problem, it seems to me, is that too many public officials have too long felt that good economics is not good politics. Some of them have adopted a philosophy of spend-and-spend, elect-and-elect, as they scramble to outdo each other in cutting taxes and passing big new spending programs. They also have the mistaken notion that they can raise revenues painlessly by taxing corporations instead of people—as though businesses are not owned, managed, and staffed by people and as though their taxes are not paid for in prices charged to people. They fail to recognize that a healthy, growing private economy—which still supplies 85 percent of all jobs in this country—does more to help people than anything that government can ever hope to do. I think that the public—with your help—is gradually learning the truth behind the hollow promises of Big Government and getting "something for nothing." And if reporting continues to be fair and accurate, the day may come when voting for sound economic policies will be considered politically attractive.

Ladies and gentlemen: Let me stress once again that my comments today about the press are intended to be constructive. I believe that the coverage of economic events in this country is steadily improving. News stories that preceded the sale of gold to American citizens were truly masterful, giving the public a much better understanding of both the advantages and disadvantages of owning gold. Indeed, I am convinced that the quality of journalism in this country is higher than anywhere else in the world. But let us recognize that in reporting on the economy, reforms and improvements are still very much needed. We are still far short of the goal once set forth for newsmen by Walter Lippmann: ". . . to bring to light the hidden facts, to set them into relation with each other, and make a picture of reality on which men can act."

And let us recognize one more thing: We are all in the same boat together. The freedom that you cherish for your newspaper—the freedom of the press that must always be protected in America—is indivisible from the freedom of our enterprise system and the freedom of each of us as individuals. Those precious freedoms are in jeopardy today. In our desire for instant solutions, instant prosperity, and instant relief from the cares of the world, we are tending more and more to choose the false security offered by Big Government in exchange for small pieces of our freedoms. It is up to all of us here today—publishers, reporters, and public servants alike—to stand up and fight for those freedoms for ourselves and for our children.

Thank you.

Exhibit 20.—Statement by Secretary Simon, May 7, 1975, before the Senate Finance Committee, on capital investment needs for the future

I welcome this opportunity to appear before you this morning on a subject of timely and urgent concern: our capital investment needs for the future.

For several months, many economic policymakers in Washington have been preoccupied with the problems of ending the recession, slowing the rate of inflation, and steering the Nation back to a course of stable, durable economic growth. Today there are many signs that the economic slide is gradually decelerating, and we can be increasingly confident that we will be on the road to recovery before the end of this year.

As we emerge from the recession, it is especially important that we now begin to focus greater public attention on the longer range problems of our country. While the process of recovery will require careful and vigilant management, we must be equally concerned whether the period of the recovery and beyond will bring sustained economic progress or a sorrowful repetition of the boom and bust cycles of the past.

Certainly there is no subject more central to our hopes for the future than our ability and our willingness to meet the capital investment needs of coming years. Those needs are impressively large, and they will demand a full-scale effort. In my testimony this morning, I want to draw upon an abundance of documentary evidence showing that the United States has not been keeping pace in its capital investments and that we must devote more of our resources to this purpose if we are to achieve our most basic economic dreams for the future. To summarize, the record shows that—

During the 1960's, the United States had the worst record of capital investment among the major industrialized nations of the free world.

Correspondingly, our records of productivity growth and overall economic growth during this period were also among the lowest of the major industrialized nations.

As other nations have channeled relatively more of their resources into capital investment and have acquired more modern plants and equipment, they have eroded our competitive edge in world markets.

Our record on capital investments reflects the heavy emphasis we are placing on personal consumption and Government spending as opposed to savings and capital formation.

Our record also reflects a precipitous decline in corporate profits since the mid-1960's.

While the U.S. economy remains sufficiently large and dynamic to overcome our investment record of recent years, our future economic growth will be tied much more directly to the adequacy of our capital investments.

Estimates of future needs vary, but it is relatively clear that in coming years we will have to devote approximately three times as much money to capital investments as we have in the recent past.

It is an economic fact of life that increased productivity is the only way to increase our standard of living. For the sake of future economic growth—jobs, real income, and reasonable price stability—the inescapable conclusion is that Government policies must become more supportive of capital investment and that we must make a fundamental shift in our domestic policies away from continued growth in personal consumption and Government spending and toward greater savings, capital formation, and investment.

Some analysts have concluded that it will not be possible to meet our future capital investment needs. I disagree. I firmly believe that we are capable of achieving our basic investment goals, but I also believe that they represent one of the most formidable economic challenges of the decade ahead.

I. Capital Investment Experience

The beginning point for our consideration of capital investment—and one that should be of keen concern to everyone—is the pattern of economic growth during the decade of the 1960's. The average annual rate of real economic growth during that period for the 20 nations belonging to the Organization of Economic Cooperation and Development (OECD) ranged from a high of 11.1 percent for Japan, to a median of about 5 percent for Australia, the Netherlands, and Norway, to a low of 2.8 percent for the United Kingdom. The United States during this time experienced an average growth rate of 4 percent a year—17th among the 20 nations.

Of the many economic, political, and social factors that influence economic growth rates, none is more important than the level of capital investment. Economists generally agree that the factors affecting growth include: (1) the accumulated base of capital goods; (2) the current pace of new capital investments; (3) the effective application of new technology; (4) the quality of the national labor force—its education, training, discipline, and commitment; (5) the infrastructure of transportation, communication, financial and service facilities; (6) access to industrial raw materials; (7) managerial skills; and (8) the organization of the economic system. The mix of these basic economic variables, along with other specific factors not listed, varies from country to country and changes over time. It is also possible to substitute one, or a combination, of these productivity variables for specific inadequacies. Most analysts agree, however, that a strong rate of new capital investment is required to generate sustained growth. In fact, the effectiveness of all of the other factors that determine productivity are heavily dependent upon the quantity and quality of capital goods made available by new investment.

The United States retains a position of economic leadership because it has been blessed over a long period of time with a favorable mix of all of the important economic variables, along with political stability and improving social mobility. For many years our advantageous ratio of capital to labor has been acknowledged as the basis of the remarkable rise of the U.S. economy. Even now spending for plant and equipment continues to increase and these outlays still exceed the amounts invested elsewhere because of the large size of the U.S. economy. In 1974, gross private domestic fixed investment totaled $195.6 billion, up from $194.0 billion in 1973 and $131.7 billion in 1970. Investments in business structures and producers' durable equipment totaled $149.6 billion in 1974, up from $136.8 billion in 1973 and $100.6 billion in 1970.

Nonetheless, even though plant and equipment expenditures will continue in the future as the economy grows, it is unrealistic to assume that the historical patterns of investment and productivity will be adequate to meet the priorities of the future. And I certainly am not suggesting that we can fulfill every claim presented by society. The disappointing record of Federal deficits in 14 of the last 15 years ending with fiscal year 1975—or 40 out of the last 48 years—and the unfortunate boom and bust pattern of economic performance over the past decade indicate that we have not been able to effectively identify and manage our national economic priorities. Some analysts have claimed that future economic growth will release unused resources to fulfill new claims against the national output. To the contrary, the intensity of claims for available resources will likely increase in the future. The assertion that additional Government spending programs can be added without disrupting the allocation of resources in the private sector has been refuted by the events of the past decade, particularly the increasing inflation pressures and shortages of materials and production capacity.

Comparative rates of investment

Recognizing the relatively low rate of U.S. economic growth in the 1960's, it is worthwhile to look now at the relative rate of capital investment in this country. Although the amounts of capital investment continue to increase in the United States and our capital-to-labor ratio is still relatively high, other nations during recent years have allocated a substantially larger share of their resources to new capital formation. Furthermore, the gap between the U.S. level of investment, measured as a share of national output, and the commitments of other leading industrial nations has increased. A study prepared by the Department of the Treasury indicates that total U.S. fixed investment as a share of national output during the time period 1960 through 1973 was 17.5 percent. The U.S. figure ranks last among a group of eleven major industrial nations; our investment rate was 7.2 percentage points below the average commitment of the entire group. When only nonresidential investment is considered the level of commitment is naturally lower for every nation but the relative position of the United States is not changed.

*Investment as percent of real national output, 1960–73**

Country	Total fixed**	Nonresidential fixed
Japan	35.0	29.0
West Germany	25.8	20.0
France	24.5	18.2
Canada	21.8	17.4
Italy	20.5	14.4
United Kingdom	18.5	15.2
United States	17.5	13.6
11 OECD countries	24.7	19.4

*OECD concepts of investment and national product. The OECD concept includes nondefense government outlays for machinery and equipment in the private investment total which required special adjustment in the U.S. national accounts for comparability. National output is defined in this study as "gross domestic product," rather than the more familiar measure of gross national product, to conform with OECD definitions.
**Including residential.

The reduced pace of capital investment in the U.S. economy has also been emphasized by Professor Paul W. McCracken, former Chairman of the Council of Economic Advisers and now Senior Consultant to the Department of the Treasury. Using historical figures, reported in constant dollars, for the amount of nonresidential capital formation per person added to the labor force, he estimates that commitments in the United States during the 1970's are 22 percent below the level reported in the 1956 to 1965 decade. In terms of business capital investment per worker, the United States still maintains a considerably higher capital-to-labor ratio than in Europe and Japan. However, our advantage has declined as other nations have increased their capital investments per worker. The Department of Commerce estimates that since 1960 the existing base of plant and equipment assets has nearly doubled in France and Germany and more than tripled in Japan.[1] The cumulative total of such assets in the United States increased at most by about 50 percent during the same period.

[1] *An Overview of Investment: The United States and Major Foreign Economics,* International Economic Policy and Research Report, U.S. Department of Commerce, Domestic and International Business Administration, October 1974, p. 9.

Gross nonresidential fixed investment per person added to civilian labor force

[In 1958 dollars]

Period	Amount
1956–1960	49,500
1961–1965	55,300
1966–1970	46,400
1971–1974	*41,000

*Estimate based on incomplete data for 1974.

Source: Statement of Paul W. McCracken before the Committee on Ways and Means, Jan. 29, 1975. Basic data from the Departments of Commerce and Labor.

Factors influencing U.S. rate of capital investment

In evaluating the relatively slower rate of capital investment in the United States, several moderating factors should be considered.

First, the unusually large size of the U.S. economy and its relatively advanced stage of development, including the accumulated total of previous capital investments, creates a different investment environment. In 1974, the U.S. national output was $1.4 trillion, which is approximately equal to 90 percent of the combined total for the nine countries in the European Economic Community and Japan. Having already created such an impressive productive capacity it is to be expected that our rate of additional growth might be lower than the development rates of other nations who are striving to achieve our relatively advanced level of economic activity.

A *second* and even more important influence has been the historical priority placed on consumption within the U.S. economy. We are a consumption-oriented society and this pattern has been developing for several decades. The emphasis on consumption has undoubtedly caused much of the rapid development of the U.S. economy because it has created a strong demand for goods and services needed to sustain output, employment, and investment. In 1974 personal consumption totaled $877.0 billion, or 63 percent of our gross national product; total Government purchases of goods and services totaled $308.8 billion, or 22 percent; gross private domestic investment, which includes the change in inventories, was $208.9 billion, or 15 percent; and net exports of goods and services amounted to $2.0 billion or 0.1 percent of total national output. Personal and government consumption outlays have long dominated the GNP totals, and this pattern of economic activity is deeply ingrained in our society. As a result, despite our high per capita incomes, the accumulations of gross savings flows required for capital investment are lower in the United States than elsewhere. It is also important to note that the level of gross private savings in the United States has remained stable throughout the postwar era.

Average annual gross savings flows as a percent of gross national product

[Percent]

	1955–59	1960–64	1965–69	1970–74
Gross private saving	15.9	15.4	15.9	15.8
Personal saving	4.5	3.8	4.5	5.5
Undistributed corporate profits	3.4	2.8	3.1	2.8
Inventory valuation adjustment	−.3	0	−.3	−1.2
Capital consumption allowances	8.3	8.8	8.7	8.7
U.S. Government surplus	−.1	.2	−.2	−1.1
State and local government surplus	−.3	.1	0	.5

Source: Department of Commerce, Bureau of Economic Analysis.

These figures are subject to differing interpretations. Some analysts have claimed that it will not be possible to attract enough savings to meet future investment needs. This negative conclusion assumes that the capital needed to increase plant and equipment capacity will be preempted or diverted to meet the consumption preferences of the private and public sectors. I would hope that the severe output, inflation, unemployment, and balance of payments distortions of the past decade would be a useful warning against such a result. It should be apparent from the experience of recent years that we must invest adequate funds in new plant and equipment—as well as in education and training—in order to increase our Nation's productivity and thereby raise our standard of living. Failure to provide necessary productive capacity to meet the Nation's economic goals is certain to have undesirable effects upon our society over the long run.

Other analysts have used the same gross savings figures to claim that there will not be any particular strain in handling our future investment needs. They believe that as investors are provided with a sufficiently high return on their investments, they will increase savings to meet the higher demand for capital. This conclusion seems to be based on two questionable assumptions: (1) That the existing savings ratio of the past decade is adequate for both past and future capital investment needs; and, (2) that each sector in the economy can obtain its minimum investment needs within the total outlays financed.

I do not agree that past investment levels have been fully adequate. Experience has demonstrated that inflation and unemployment problems have been created in part by capacity shortages. Many of our current difficulties are the direct result of the energy and raw materials strains that developed in early 1974 and eventually contributed to our current recession and related unemployment. The continuous deterioration of our international trade balance during the 1960's, when the dollar was overvalued, was also at least partly the result of the loss of competitiveness for U.S. products and increased reliance on foreign sources of goods. As you will see in a moment, I think there is also clear evidence that in order to meet future needs, the Nation must increase its capital investment as a claim against national output. Unfortunately, specific investment needs have not been adequately fulfilled in many sectors of the economy, even though general outlays have increased. We must also be concerned about the capacity of our capital markets to provide adequate financing. Economists often assume that the supply of investment funds will automatically match the demand for capital if interest rates and equity yields are attractive. Our financial markets are very efficient in collecting savings and allocating the funds. However, we should be more sensitive to the disruptive impact of high interest rates. Even though financial markets may be functioning well in allocating the available capital, specific sectors of the economy may not be able to obtain the investment funds needed, particularly at interest rates they can afford. The periodic problem of providing adequate mortgage financing at reasonable interest rates is one example of the limitations within the markets. The difficulty in obtaining equity financing is another. Whether or not industry will be able to acquire the investment funds needed will be heavily influenced by future actions of the Government. National policies cannot ignore financial realities by diverting capital into deficit financing and disrupting the goals of stable monetary policy without inhibiting the necessary process of capital formation. The costs of capital and its availability for private sector needs are heavily dependent on these public fiscal and monetary actions. While the financial markets are very resilient and responsive to changing credit and equity needs, they are not entirely immune to the disruptive impact of Government policies.

A *third* important factor affecting the pattern of U.S. investment compared with other nations is the relatively large share of total capital outlays we commit to the "services" category, which includes housing, government, and other services. According to a study published by the OECD, the United States allocated 70 percent of its total investment to the services category during the 1969 to 1971 time period. The U.S. figure is significantly higher than that reported by the other five major industrial nations included in the study. Accordingly, the U.S. share of investment committed to the manufacturing sector, 19.7 percent, was considerably lower than the figures reported by France (27.8 percent), West Germany (25.2 percent), Japan (26.8 percent), and the United Kingdom (23.8 percent). Our heavy investment in the services category tends, of course, to emphasize consumption and moderate the growth in productivity. This arrangement may satisfy immediate consumer preferences, but we must weigh those preferences against long-term concerns about domestic productivity and international competitiveness.

A *fourth* influence on the pattern of capital investment in the United States is the relatively large share of our investment that must be used for replacement and modernization of existing facilities. It is estimated that 62 percent of U.S. capital investment during the time period 1960 to 1971 was used for replacement needs, compared to the United Kingdom, 61 percent; Canada, 52 percent; France, 54 percent; West Germany, 53 percent; and Japan, 31 percent.[2] The divergent pattern reflects the advanced status of economic development in some nations and the postwar experience of Europe and Japan in restoring their devastated industrial facilities following World War II. The Department of Commerce estimates that 60 to 70 percent of the U.S. stock of plant and equipment has been added since 1960, compared to approximately 75 percent of the capital goods of West Germany and France and 85 percent of Japan's industrial capacity. It should be emphasized that this heavy replacement requirement does provide a continuing opportunity to introduce new technology into the U.S. economic system. Since the annual value of U.S. capital investment is so large, it cannot be assumed that the entire U.S. industrial system is technologically obsolete, even though some specific sectors have suffered a sharp competitive deterioration. Nevertheless, the otherwise imposing outlays for replacement and modernization do not add to the total productive capacity of our economy.

A *fifth* and final factor influencing the national rate of capital investment is the pattern of government policies. Government can affect investment either directly through the incentives it provides or indirectly through various tax and regulatory policies and its own pattern of spending.

A review of the diversified economic incentives available in other nations indicates the very active investment role played by many foreign governments. Basic industries are frequently controlled by the government with total, or at least dominant, public ownership. Special financial and operating assistance is also frequently provided for preferred private companies to assist their development if it is considered to be in the national interest. The United States has avoided most of the capital allocation and special incentive programs used in other countries. I strongly favor this private sector approach and believe that it has been a positive factor in the development of our economy.

There are some Federal programs which provide direct financial support through the Economic Development Administration, the Small Business Administration, and 169 different Government credit programs, but the major influence of Federal Government on capital investment comes through the Federal budget. Government budget decisions now represent approximately one-third of the total GNP, and this figure will rise even higher if spending trends of the past 20 years are continued. The Government also influences private sector activities by providing capital grants, research funding, and other incentives which stimulate investment. For example, the fiscal year 1976 budget prepared by the President calls for outlays of $4.6 billion on general science, space, and technology programs, $2.2 billion on energy activities, and $9.4 billion for environmental and natural resources. Part of these outlays will involve capital investment needs.

The Government is also exercising increased influence over private investment decisions through the growing number of safety, health, and environmental standards. Precise estimates are difficult, but it has been estimated that during 1972, 8 percent of the textile industry's capital investments and 12 percent of the steel industry's investments were related to health and safety standards mandated by the Government. While such standards may be highly desirable, we should recognize that these investments do not increase the Nation's total productive capacity.

Many State and local governments also provide special incentive programs to attract capital investment into specific geographical areas. Such incentives include capital grants, advantageous credit arrangements, relocation and manpower training grants, special site and building assistance, infrastructure investments, and preferred tax and utility arrangements. While such incentives have influenced the location of some facilities, the total amount of capital investment has probably not been increased.

The private sector continues to be the best means of increasing capital investment in the United States and our government has fortunately not attempted to control the pattern of such investments.

Negative results of inadequate capital investment

While the historical pattern of capital investment in the United States may satisfy our immediate goals, there are serious economic risks in having a slow rate of capital investment for an extended period of time. The emphasis on im-

[2] Ibid. Figure 1B.

mediate consumption has occurred because American consumers have historically preferred to spend 91 percent of their disposable after-tax income. The Government has basically supported this independence of choice although its tax and spending policies have unfortunately exercised an increasing influence on private decisions. But we must now question the future adequacy of past investment patterns if we are to adequately prepare for the economic future of our great Nation.

Various studies have indicated the close relationship between capital investment and various measures of economic growth and productivity. A dynamic economy is needed to create jobs by applying new technology and expanding production capacity. A productive labor force is also necessary for producing goods and services to meet rising demands for an improved standard of living and as a means of holding down inflation. When productivity increases, the effects of rising wages are offset so that unit labor costs can be held down and prices are more stable. Inadequate capital investment also limits new job opportunities and creates unemployment. Specific examples of production capacity shortages became painfully apparent to the Cost of Living Council (COLC) as it administered the program of wage and price controls from August 1971 until June 1974. Recognizing the inflation pressures created by these numerous capacity constraints. the COLC followed a definite policy of requiring specific capital investment commitments from private industry as a basis for price decontrol decisions. The COLC also became very concerned about future inflation problems that could result from raw materials shortages and increasing capacity shortages in several basic industries as economic growth occurs. Unfortunately, productivity gains in the United States have been disappointing, particularly when compared with the experience of other leading nations.

Productivity growth, 1960–1973

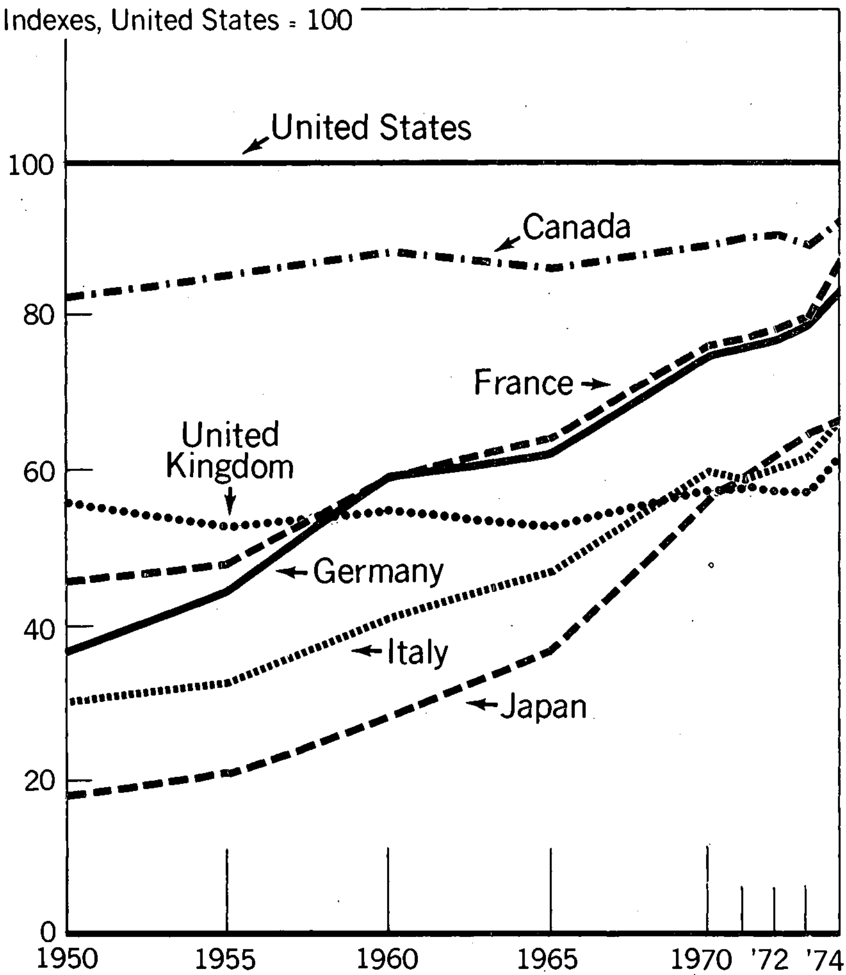
[Average annual rate]

Country	Gross domestic product per employed person	Manufacturing output per man-hour
United States	2.1	3.3
Japan	9.2	10.5
West Germany	5.4	5.8
France	5.2	6.0
Canada	2.4	4.3
Italy	5.7	6.0
United Kingdom	2.8	4.4
11 OECD nations	*5.2	6.1

*Average for six OECD countries listed.

The rapid growth of the U.S. economy to its present size and the relatively low level of inflation until the late 1960's has been based on the creativity and productivity of the system. Americans have greatly benefited from this growth, not only in personal economic gains but in terms of national security and international leadership. Continued prosperity, however, cannot be taken for granted; it must be earned. We must be willing to allocate more of our resources to the future and fewer to satisfying immediate demands. This is a difficult concept for some to accept because they prefer current consumption. With so many needs still unsatisfied in a land of relative plenty, this feeling is understandable. Our ability to fulfill these needs will only be restricted, however, if we now fail to prepare for the future. The simple truism that we cannot consume more than we produce should be obvious, but we sometimes ignore it in setting national priorities. And we can no longer afford to ignore the fact that as the real output of other nations has increased more rapidly than our own, our competitive advantage has gradually been eroded.

Real Output per Employed Civilian
1950-'74



II. Future Capital Investment Requirements

Economic projections are always difficult, but estimating future capital needs is particularly uncertain at this time because costs and priorities continue to change rapidly. It is obvious, however, that future capital requirements will be enormous—larger than anything we have ever faced before. Clearly we will need to increase the quantity and quality of housing; develop new energy resources; improve the quality of our environment; rehabilitate the existing transportation system and develop a better urban transportation system; continue the mechanization of agriculture; construct new office buildings, communications systems, medical facilities, schools and other facilities; and meet the massive needs for new plant and equipment. In all of these sectors we must not only replace and modernize existing facilities but also add new capacity, particularly in many of our most basic industries.

The Department of Commerce estimates that capital requirements for producers' durable equipment and nonresidential structures will total $3.4 trillion during the 1974 to 1985 period. If annual outlays for residential construction, which have averaged $50 billion during the past 4 years, are added to this figure, the total capital needs rise to well over $4 trillion. Details of their estimate include:

Gross private domestic nonresidential fixed investment

[Billions of current dollars]

	1974	1985	Cumulative 1974–1985
Total producers' durable equipment	100.0	276.7	2,188.8
Nonresidential structures	54.7	151.3	1,197.3
	154.7	428.0	3,386.0

A similar study performed by the General Electric Company confirms the massive size of future capital requirements. Assuming a real GNP growth rate of 4 percent and an inflation rate of 5 percent, General Electric expects gross private domestic investment, including residential housing, to total $4½ trillion over the 1974 to 1985 time period.

The General Electric and Commerce studies are consistent if housing outlays are added to the Department of Commerce totals. Both estimates are limited to private investment and exclude the large Government expenditures required for roads, dams, government facilities, schools, pollution abatement outlays, and many other projects.

Assuming, then, that the cumulative investment needs between 1974 and 1985 will range from $4 to $4½ trillion, the point to remember is this: Over the most recent period of the same length, 1962 through 1973, our total outlays for capital investment in the United States were $1½ trillion. Thus, our capital investment needs in coming years are approximately three times the level of the recent past. That is perhaps our best measure of our challenge ahead.

Both of the studies I have mentioned are necessarily based on many uncertain projections and arbitrary assumptions about a continuing close relationship between investment and economic growth. But even if some of these assumptions prove to be erroneous—as they will—and new investment requirements arise—as always happens—the actual results will not materially change the following conclusions:

1. Capital requirements for gross private domestic investment will be in excess of $4 trillion during the 1974 to 1985 time period.
2. The future rate of inflation will be a crucial factor in determining the amount of future investment because it will influence both the price of assets acquired and the economic incentives for future investment.
3. The achievement of national capital investment goals is possible if we are willing to increase the share of national resources committed.

Energy investment requirements

One area of capital investment that is particularly critical for the future is energy. To achieve greater self-sufficiency in energy, enormous capital investments will be required. We basically have two alternatives. The first one is to meet our increased energy investment requirements by reducing outlays in other sectors. While energy priorities are indeed important, it would be most unfortunate to disrupt the entire economic system in this way. A second and more desirable approach is to include these new requirements within an enlarged total investment goal. Our purpose should not be to redistribute the economic pie, but to continue enlarging it so that everyone will have a bigger share.

Recognizing that the ultimate cost of energy investment needs will be influenced by many variables, it appears that capital requirements over the next decade will total about $1 trillion stated in current dollars to include the effects of inflation. Energy investments will comprise an important share of the total capital requirements discussed above but their financing is manageable if they are given a high priority as part of a comprehensive national energy program. The specific amounts to be spent in each category will depend upon the energy policies adopted and dynamic developments within the economy. Nevertheless, the range of possible needs is indicated in four separate studies prepared by the Federal Energy Administration, National Petroleum Council, National Academy of Engineering, and Arthur D. Little, Inc. All four studies are stated in constant 1973 dollars to make them comparable. If necessary adjustments are made for potential inflation and the increased needs that have been identified since the studies were prepared, the resulting capital needs, expressed in current dollars, will approximate $1 trillion between now and 1985.

Comparison of capital requirements estimates: Total dollars, cumulative 1975–1985

[Billions of 1973 dollars]

	National Petroleum Council [a]	National Academy of Engineering [b]	Arthur D. Little Inc. [c]	Federal Energy Administration accelerated supply
Oil and gas (including refining)	133	149	122	98.4
Coal	8	18	6	11.9
Synthetic fuels	10	19	6	.6
Nuclear	7	93	84	138.5
Electric power plants (excluding nuclear)	137	53	43	60.3
Electric transmission	42	125	90	116.2
Transportation	43		43	[d] 25.5
Other [e]			8	2.2
Total	380	457	396	454

[a] "U.S. Energy Outlook," a summary report of the National Petroleum Council, Washington, D.C., December 1972 (Average of four supply cases).
[b] "U.S. Energy Prospects, An Engineering Viewpoint," National Academy of Engineering, Washington, D.C., 1974.
[c] Arthur D. Little, Inc. estimates based upon an energy conservation scenario.
[d] Does not include investments required for tanker fleets, but does include $5.5 billion targeted for trans-Alaska oil pipeline.
[e] Solar, geothermal, municipal waste treatment plants, and shale oil.

Source: Federal Energy Administration, "Project Independence Report," November 1974.

The overall impact of energy requirements is summarized in a special report issued by the Chase Manhattan Bank in March of 1975. The Energy Economics Division of the bank is noted for the quality of its special reports. Over 20 years ago that division predicted that an energy shortage would develop in the United States if certain policy adjustments were not made. One of the major concerns of these reports over the years has been the chronic underinvestment in energy resources which became apparent in the late 1950's. The conclusion of the most recent Chase Manhattan Bank report is particularly perceptive:

"Although the relationship between investment and supply of energy is an elementary principle that applies to any and all sources of primary energy, it is nevertheless one that is not well understood. In fact, the lack of understanding was responsible for the incredibly unenlightened regulation and many other political actions about the world that had the two-pronged effect of preventing the generation of sufficient capital funds and discouraging the investment of money that actually was available. And the current energy shortage is the consequence. Yet, even today, after so much damage has been done, there is still a widespread failure to recognize the relationship between investment and supply. Instead, two distinctly different attitudes generally prevail. Many apparently continue to believe they can somehow again have enough energy without paying all the associated costs. Others, obviously, are resigned to the prospect of a permanent shortage and see conservation as the only avenue of partial relief. Neither attitude is realistic, of course. The world still does not lack basic energy resources remaining to be developed. And it is conceivable that eventually there can again be enough to serve all its needs but only if the necessary investment is made first. If it is not, a permanent shortage will indeed be the certain outcome." [1]

The report goes on to emphasize—correctly, I believe—that a permanent

[1] Source: The Chase Manhattan Bank, Energy Economics Division, "How Much Oil—How Much Investment," a special petroleum report, March 1975.

shortage is intolerable because it would so constrict total economic growth that the growth in labor force—even at the more moderate pace expected in the 1980's—could not be absorbed. The resulting unemployment problems would cause severe economic problems in addition to threatening our political and social stability.

Future investments in energy resources will naturally be determined by total demand over time. Estimates have already changed dramatically as costs have risen and conservation efforts have increased. However, these developments are so recent that it is difficult to predict future demand until a national energy policy is agreed upon and the various energy incentives and disincentives are identified. The Chase Manhattan analysts had originally projected a continued growth in the world's demand for energy at an average annual rate of 5 percent which is the same pace as recorded from 1955 to 1970. Admitting the unusual degree of uncertainty, the bank has now lowered its projection to an annual rate of 4.2 percent with a strong warning that energy forecasts have historically erred on the conservative side. Oil consumption is expected to grow at a more rapid annual rate of 4.5 percent over the 1970 to 1985 period, resulting in a cumulative consumption of 375 billion barrels, nearly two and a half times more than in the 1955 to 1970 period. North America is expected to remain the world's largest consumer of total energy and oil, but the growth rate for this area may be lower because of a slower population growth and our potential for conservation savings.

Turning to the financial requirements for the petroleum industry, Chase Manhattan Bank estimates a worldwide need for $400 billion to find 600 billion barrels of oil between 1970 and 1985. This is more than two and a half times the actual investment for this purpose during the 1955 to 1970 period. An additional $370 billion will be needed between 1970 and 1985 for worldwide development of refineries and processing facilities, tankers, pipelines, environmental equipment, and the necessary marketing facilities. The total of $770 billion is nearly three times the actual commitment in the preceding 15-year period. Finally, another $400 billion will be required for other investments, payment of dividends, debt repayments, and additions to working capital.

The total financial needs of the world's petroleum industry from 1970 to 1985 are estimated by the bank to be $1.2 trillion stated in constant 1970 dollars. Inflation will of course increase the dollar amounts required. If inflation averages 5 percent over the time period, the world petroleum industry financial needs would rise from $1.2 to $1.6 trillion. With 10 percent inflation, the figure would increase to $2.2 trillion.

With regard to financing these worldwide petroleum industry requirements, the bank estimates the following distribution of potential sources based on the $1.2 trillion constant dollar estimate: (1) Communist nations, $225 billion; (2) new capital market issues, $240 billion; (3) capital recovery allowances, $260 billion; and (4) profits, $460 billion. These figures must be adjusted upward according to whatever rate of inflation occurs.

This brief listing of sources obviously conceals many difficult financial challenges. The world's capital markets will already be absorbing large public and private financing demands. Government policies may reduce capital recovery allowances permitted for computing tax liabilities. And the assumption that oil industry profits will be large enough to cover such a large share of the total is questionable. Commenting on the public's reaction to oil industry profits in 1973 and 1974 after 15 years of average performance, the bank report states:

"As emphasized earlier, there cannot possibly be enough energy of any kind without adequate investment. And investment cannot be adequate without sufficient profits. But profits are labeled excessive and restraints are proposed without apparent consideration of the need for profits as a source of investment funds. As indicated earlier, the industry will need at least $845 billion of profits between 1970 and 1985 if the world experiences a 10 percent rate of inflation. But in the first four years of the period the industry generated no more than $60 billion of profits, only 7 percent of the required amount. Even in the highly unlikely event of no further inflation, the $60 billion would represent but 13 percent of the industry's total needs for the fifteen year period."

III. Government Policies

While our economy is capable of financing its large private capital investment requirements, our success in meeting that goal is heavily dependent upon the shape of Government policies. It is absolutely imperative that Government policies become more supportive. A continuation of the severe fiscal and monetary distortions of the past decade would undoubtedly prevent the achievement of our basic goals. Inflation must be controlled, and the Government must avoid disrupting the capital markets if the private sector is to obtain the financing required. In fact, public officials must balance the Federal budget over time and record occasional surpluses in order to free up capital resources to fulfill existing private investment claims. Instead of reducing private investment to release resources for Government social programs, we should concentrate on balancing the budget over time so that the future flow of savings is not diverted away from private investment.

Unfortunately, the Federal Government has reported a deficit in 14 out of the past 15 years ending with fiscal 1975. During the single decade fiscal 1966 through fiscal 1974, the cumulative Federal deficits totaled $103 billion. Net borrowings for supporting over one hundred off-budget Federal programs totaled another $137 billion during that decade. As a result, the Federal Government withdrew one-quarter of a trillion dollars out of the capital markets. But this record is only a prelude to our present situation when Treasury financing requirements will total about $75 billion in calendar year 1975 in order to finance the massive Federal deficits expected. While much of the current deficit results from the recession, which has caused tax revenue losses, increased unemployment compensation benefits and other outlays resulting from the "automatic stabilizers" used to fight recession, a review of the budget details indicates that traditional spending programs are also rising rapidly and new programs are proposed almost every day. The spending figures included in the original budget submitted by the President last February called for outlays of $313.4 billion in Federal spending in fiscal 1975 and $349.4 billion in fiscal 1976. Recent projections by the Office of Management and Budget indicate that fiscal 1975 outlays will be $324.2 billion, an increase of 20.8 percent over fiscal 1974 outlays. It should be obvious that Government spending—both for temporary stimulus and traditional programs—is increasing at a rate that is creating serious resource allocation problems far into the future and that these pressures will not conveniently disappear as we gradually emerge from the recession later this year.

Looking beyond the recession problems of 1975, we seem to face the dilemma of having an apparently irresistible force of growing Government spending meeting the immovable object of future capital investment requirements. But we should no longer consider the growth of Government spending and related deficits to be an irresistible force. To do so will inevitably lead to even more serious economic problems of unemployment, reduced real gains in our national standard of living, and even more inflation resulting from inadequate physical capacity and reduced productivity. We must recognize the basic reality that when we apply too much pressure on our capacity to produce goods and services, the inevitable result is inflation and shortages. The underlying growth trends of the U.S. economy will continue to provide for further economic progress, but we cannot realistically expect to satisfy every new claim within our economy by simply shifting resources from the private to the public sector. Adding new Government commitments is not feasible if the total productive capacity of the economy is exceeded. This guideline has been frequently violated as total demand has increased too rapidly for the economic system to absorb. When this happens the economy begins a boom and bust sequence with severe inflation and unemployment distortions. Nor can we wish away the problem by claiming that there is plenty of slack in the 1975 recession and that we can ignore problems of overheating the economy until later years. The escalation of Government spending levels has already seriously eroded our future fiscal flexibility and the lagged impact of current spending decisions will directly affect the future. In short, if we are to achieve our crucial goal of adding at least $4 trillion of private capital investment by 1985, we must first establish more moderate and sustainable fiscal and monetary policies.

Tax policies

Federal tax policies affect capital investment decisions by determining the after-tax earnings available for investment and by establishing incentives or disincentives for future investment. An OECD study of tax policies indicates that total Government tax collections in the United States during the years 1968-

1969, and 1970 were a smaller proportion of the gross national product than in most other industrial nations. The U.S. figure of 27.9 percent for those 3 years was above that of Switzerland (21.5) and Japan (19.4 percent) but below the levels reported for many European nations, ranging from Italy (30.1 percent) to Sweden (43.0 percent). Since the study was completed, the United States undertook major tax policy changes in 1971 and in March of 1975, but the comparative relationships have probably not changed very much. There is, however, a major difference in the distribution of the tax burden. Only 18.1 percent of the U.S. tax revenues in 1971 were provided by taxes on the consumption of goods and services. Other industrial nations relied much more heavily on consumption taxes: France, 34.8 percent; West Germany, 28.1 percent; United Kingdom, 26.6 percent; Canada, 28.7 percent; and Japan, 20.7 percent.

The definite tilt toward personal and corporate income taxes in the United States is consistent with our historical preference for immediate consumption. It is not my purpose to criticize this historical priority, but the future requirements for capital investment indicate that tax policies should be reviewed. Just such a review has been underway in the Department of the Treasury in preparing for the tax law changes completed last month and in anticipation of a joint review with the Congress in the coming months of possible tax reform initiatives. I do not want to make any specific recommendations this morning because we are still working on our analysis and recommendations. We will want to review the options with Congress before specific actions are suggested. I will merely refer to some of the policy areas that need to be reviewed:

1. *Corporate income tax.*—These taxes directly influence the cash flow available for investment. The rate has vacillated slightly above or below the 50-percent level for many years. While a reduction in the rate of taxation would probably be the most straightforward approach to enhancing investment incentives, any change would represent a major shift in policy and would require extensive congressional consideration. The Tax Reduction Act of 1975 did increase the corporate surtax exemption from $25,000 to $50,000 and decrease the "normal" tax from 22 to 20 percent on the first $25,000 of earnings. These changes, however, do not affect the tax impact on the great bulk of corporate earnings subject to the corporate surtax.

As part of this ongoing review of tax policies we also need to consider the influence on investment of our two-tier system of corporate taxation in which income is taxed once at the corporate level and again at the shareholder level. This approach discriminates against corporate investors generally and small equity investors particularly. An individual in the 20-percent tax bracket in effect pays 48 percent at the corporate level and then an additional 20 percent on what is left for a total tax burden of 58.4 percent, or nearly three times his individual rate. If the individual is in the 70-percent bracket, he pays 48 percent at the corporate level and then an additional 70 percent on what is left. His total tax burden is 84.4 percent. If the same business could be conducted in a noncorporate form, the investors would pay only 20 and 70 percent respectively.

Our tax system puts a great penalty on companies that must incorporate. Companies that do incorporate are those that have large capital needs that must be raised from many persons. We should keep in mind that our system of taxation bears more heavily on corporations than do the tax systems of almost every other major industrial nation. In the last few years our major trading partners have largely eliminated the classical two-tier system of corporate taxation. Through a variety of mechanisms they have adopted systems of integrating the personal and individual income taxes so that the double taxation element is radically lessened.

2. *Investment tax credit (ITC).*—Business firms have strongly supported the ITC as a major stimulus to additional capital investment. Empirical studies do indicate that the amount of investment in machinery and equipment has increased when the ITC has been put into effect and has declined when it is suspended. Some critics believe, however, that the ITC simply influenced the timing and types of investment rather than increasing the total amount. Whichever view is correct, there was strong support for the investment tax credit provision in the Tax Reduction Act of 1975 which increased the credit to 10 percent for 2 years and removed the lower percentage limitation for utilities. Unfortunately, the investment tax credit has had an uncertain status once it was initiated January 1, 1962, and businessmen are justifiably concerned about the stability of an incentive which has already been removed twice and then reinstated.

3. *Depreciation guidelines.*—The amount of capital recovery charges permitted for tax purposes also influences the after-tax earnings available for private investment. In 1954 the Internal Revenue Tax Code was changed to permit depreciation charges to be made on an accelerated basis. The official guidelines were again liberalized in 1962, and in 1971 the Asset Depreciation Range (ADR)—along with the investment tax credit—were added to the regulations. The ADR rules allow companies to select a time period for calculating depreciation within a range of 20 percent above or below the Treasury guideline which specifies useful life periods for various assets. Despite these adjustments, American businesses complain that they have a competitive disadvantage compared with some other nations. American firms using both the ADR and the investment tax credit can recover 55 percent of the value of new investments during the first 3 years. By comparison, the allowances in other nations are as follows: Canada, 100 percent; France, 90.3 percent; Japan, 63.9 percent; United Kingdom, 100 percent; and West Germany, 49.6 percent. It should be added that the U.S. position becomes more comparable by the 7th year. Various business groups have proposed further liberalization, such as a wider ADR percentage, but further consideration should be part of the general tax reform analysis involving the Department of the Treasury and the Congress.

4. *Special incentives.*—The Government is frequently asked to provide special incentives in the form of reduced or delayed taxes, accelerated depreciation schedules, capital grants or other benefits to enhance the rate of return on capital investments. While such incentives are usually requested on the basis that they will contribute to the achievement of some national priority, it is usually difficult to justify such special treatment. When special advantages are given to a specific industry or geographical region, others become relatively disadvantaged and it is very difficult for Government authorities to determine which claims should be favored, particularly in a dynamic economy where priorities can change rapidly. While there may be a few specific situations where the Government should intervene in the allocation of resources which is now handled efficiently by the private markets, my overwhelming preference is to avoid the economic distortions which are found to occur.

Corporate profitability

The final area of concern that I want to address here is the future outlook for corporate profitability. Such profits are, of course, the major incentive for additional investment and an important source of funds for financing outlays, along with various external sources. In a fundamental sense profits are the driving force of our system—the engine that pulls the economic train for the 85 percent of our work force still in the private sector—and they are just as much a cost of doing business as payments to workers, supplies of materials and services, taxes, etc.

Unfortunately, corporate profits are too often thought of as an unnecessary claim required by greedy businessmen rather than the basic incentive in our economic system. Public opinion surveys in the 1930's and in more recent years are consistent in indicating that the general public thinks that profits account for approximately 28 percent of the sales dollar. The fact is, however, that profits account for approximately 5 cents out of each dollar of sales. Actual earnings of business firms are thus far below what the general public—and some Members of Congress—perceive them to be. In fact, corporate profits will have to improve substantially in order to provide the necessary incentives and to make the necessary contribution to future investment outlays. My concern is that the negative attitudes about profits held by many Americans might become an unfortunate part of public policy. We must avoid legislation and regulation that is punitive of profits honestly earned. The result could only be that capital formation would be inhibited, and the real purchasing power of wage earners would rise more slowly. We must always be alert to the fact that profits translate into jobs, higher wages, and an increased standard of living for all of our people.

One important reason why there is so much misunderstanding about corporate profitability is that our accounting system has not yet been able to adapt to the disruptive effects of the double-digit rate of inflation we have suffered. Inflation hurts investment by increasing the prices of new assets and eroding the purchasing power of corporate earnings. Taxes must be paid on reported earnings even though these figures are exaggerated by inventory valuation profits and the inadequacy of capital recovery allowances, which are based on the historical costs of existing assets rather than the inflated outlays required for new assets. Inflation also disrupts investment by discouraging savings once the general public recognizes that the purchasing power of such commitments is eroded so quickly.

Fortunately, the Department of Commerce publishes figures which attempt to adjust for the distorting effects of inventory valuation, the effects of accelerated depreciation methods, and the understatement of capital recovery allowances based on historical cost asset values. These figures clearly indicate that adjusted after-tax profits of nonfinancial corporations as a share of national income and of the value of corporate output are far lower than the public opinion polls would suggest. Furthermore, from a peak in 1965 through 1973 the relative share of corporate after-tax profits has declined by one-half according to both measures. The same discouraging pattern results when these adjusted earnings figures are compared to the replacement value of capital assets to determine the rate of return on invested capital. From a peak rate of return of 10 percent in 1965 this measure declined to 5.4 percent in 1970 before recovering to a level of 6.1 percent in 1973. The sluggish economy of 1974 and 1975 will further reduce this figure. It is not unfair to say that the United States has been and remains today in a profits depression. Since the incentive for new investments ultimately depends upon sustaining an attractive rate of return on capital, this trend is particularly disturbing. It should be emphasized that all of these comparisons have been stated in current dollars which conceals the negative impact of inflation on the purchasing power of retained earnings. Professor John Lintner of Harvard University recently reported that the retained earnings of U.S. nonfinancial corporations were 77 percent lower in 1973 than in 1965 if the figures are converted into constant dollars in order to remove the effects of inflation and if adjustments are made to remove the effects of inventory valuation gains and the underreporting of depreciation changes based on historical costs. Without these adjustments, reported retained earnings in 1973 were 46 percent above the 1965 figure.[3]

Because business firms cannot use "phantom" earnings to acquire capital assets, the future pace of private investment will depend upon the growth of real profits. The Government can influence the economic incentives needed to stimulate investment through its tax policies, regulatory and administrative practices, and various spending programs, but the private investment decision ultimately depends upon the rate of return expected and the availability of adequate financing at a reasonable cost. Government officials and the general public must recognize the basic importance of corporate profitability and the disruptive effects of excessive government spending pressures—pressures which create deficit financing requirements that take precedence over private investment needs in the capital markets. This problem has not received adequate attention.

IV. Summary

As we strive to end the most severe economic recession in our postwar experience, my deep and abiding concern about the future adequacy of capital investment will perhaps appear to be ill-timed to some analysts. There is extensive slack in our economy with an unemployment rate near 9 percent and reduced rates of plant capacity utilization in many specific industries. The economic slide, however, will not last much longer, and we will again be reporting real growth gains before the end of the year. As the pace of economic activity accelerates, we will likely rediscover shortages of labor and production capacity. In fact, some industries still have high plant capacity utilization ratios, and many types of skilled labor will be difficult to find even in the early stages of economic recovery. In 1971 it was widely believed that extensive slack existed but the economy was again operating at a very high rate of capacity by 1972 and shortages and explosive inflation soon occurred.

Our statistics on plant capacity have always been uncertain measures, and current economic conditions have motivated the Department of Commerce to give top priority to a comprehensive survey of production capacity as a basis for preparing more meaningful estimates of plant capacity utilization rates. It is ironic that such a fundamental factor in preparing national economic policies has been based on such uncertain economic statistics.

[3] Lintner, John, "Savings and Investment for Future Growth: 1975–6 and Beyond," presented at a colloquium on "Answers to Inflation and Recession: Economic Policies for a Modern Society," conducted by The Conference Board, Washington, D.C., Apr. 8–9, 1975.

Dr. Pierre Rinfret, president of a well-known economic consulting firm, Rinfret Boston Associates, Inc., has published an impressive study of the national production capacity which indicates that our current Government statistics grossly underestimate the rate of capacity utilization in American industry and that there is virtually no reserve capacity. His study estimates that the capacity utilization rate for manufacturing industries was 86.6 percent in 1974, a figure well above the Government's estimate for 1974, of 78.9 percent. It should also be emphasized that the concept of operating at 100 percent of physical capacity is misleading. Over the last 15 years the Government figures indicate that manufacturing capacity utilization has averaged only 83 percent despite some periods of intense output. The highest figure reported by the Government during these 15 years was 91.9 percent for 1966. Most companies need to preserve some reserve capacity to handle unexpected output requirements and to substitute for operating assets which need repairs or replacement. Therefore, the existing Government figures do not accurately measure the realistic level of capacity utilization.

Looking beyond the current problems of recession and sustaining an economic recovery, the additional capital investment of at least $4 trillion from 1974 to 1985 represents a major challenge to the future growth of our economy. We must also give careful attention to the problems of specific industries in attracting needed investment for balanced growth. I am confident that these basic goals can be accomplished. But the desired results will require Government policies which will moderate inflation and balance the Federal budget over time in order to avoid diverting needed capital away from investment and into the financing of chronic Government deficits. A continuation of the fiscal and monetary distortions of the past decade will only frustrate our capital investment efforts and lead to still more serious economic problems in the future.

Thank you.

Exhibit 21.—Other Treasury testimony published in hearings before congressional committees

Secretary Simon

Statement on the oil industry, before the Subcommittee on Government Regulation of the Senate Select Committee on Small Business, August 13, 1974.

Statement at the first hearings of the Senate Budget Committee to implement the Budget Reform and Impoundment Control Act of 1974, August 15, 1974.

Statement at the first hearings of the House Budget Committee to implement the Budget Reform and Impoundment Control Act of 1974, September 17, 1974.

Statement on the President's economic program, before the Joint Economic Committee, October 11, 1974.

Statement on the Federal budgetary process at a continuation of the August hearings of the Senate Budget Committee, December 17, 1974.

Statement setting forth Treasury views on H.R. 212, the "Lower Interest Rate Act of 1975," before the Subcommittee on Domestic Monetary Policy of the House Banking Committee, February 4, 1975.

Statement on the economic situation and possible remedies, before the Joint Economic Committee, February 5, 1975.

Statement on legislation to reduce taxes and stimulate the economy, before the Senate Finance Committee, March 5, 1975.

Statement on national economic priorities, before the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee, April 3, 1975.

Statement on H.R. 6676 concerning credit, before the House Banking Currency and Housing Committee, May 12, 1975.

Statement on debt ceiling, before the Senate Finance Committee, June 25, 1975.

Deputy Secretary Gardner

Statement setting forth Treasury views on S. 4212 and S. 4130 which provide constructive suggestions for improving productivity, before the Senate Committee on Government Operations, December 16, 1974.

Statement setting forth Treasury views on variable rate mortgages and proposal of the Federal Home Loan Bank Board to regulate such mortgages, before the Subcommittee on Financial Institutions, Supervision, Regulation and Insurance of the House Committee on Banking, Currency and Housing, April 10, 1975.

Statement on H.R. 3386, a bill amending the Equal Credit Opportunity Act, before the Subcommittee on Consumer Affairs of the House Committee on Banking, Currency and Housing, April 22, 1975.

Statement on H.R. 6078, a bill to establish a National Center for Productivity, before the Subcommittee on Economic Stabilization of the House Committee on Banking, Currency and Housing, April 29, 1975.

Statement supporting Appropriation Request for the National Commission on Productivity and Work Quality, before the House Committee on Appropriations, May 1, 1975.

Enforcement, Operations, and Tariff Affairs

Exhibit 22.—An act to authorize the Secretary of the Treasury to change the alloy and weight of the one-cent piece and to amend the Bank Holding Company Act Amendments of 1970 to authorize grants to Eisenhower College, Seneca Falls, N.Y.

[Public Law 93–441, 93d Congress, H.R. 16032, October 11, 1974]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 3515 of the Revised Statutes (31 U.S.C. 317) is amended by inserting "(a)" immediately prior to "The minor coins" and by adding at the end thereof the following new subsections: Penny, composition change; Eisenhower College, N.Y., grants.

"(b) Whenever in the judgment of the Secretary of the Treasury such action is necessary to assure an adequate supply of coins to meet the national needs, he may prescribe such composition of copper and zinc in the alloy of the one-cent piece as he may deem appropriate. Such one-cent pieces shall have such weight as may be prescribed by the Secretary.

"(c) (1) The Secretary of the Treasury may change the alloy of the one-cent piece to such other metallic composition as he shall determine— 88 Stat. 1261 88 Stat. 1262

"(A) whenever he determines that the use of copper in the one-cent piece is not practicable;

"(B) after he issues an order stating the pertinent physical properties, including content, weight, dimensions, shape, and design; and in determining such physical property takes into consideration the use of such coins in coin-operated devices; and

"(C) after he notifies in writing, on the same day as the issuance of the order under subparagraph (B), the Committee on Banking and Currency of the House of Representatives and the Committee on Banking, Housing and Urban Affairs of the Senate of the contents of the determinations and orders made under paragraph (1), and a period of sixty calendar days of continuous session of Congress commencing after the date of such notification elapses.

"(2) There shall be no coinage pursuant to this subsection after December 31, 1977.

"(3) For purposes of this subsection—

"(A) continuity of session is broken only by an adjournment of Congress sine die; and

"(B) the days on which either House is not in session because of an adjournment of more than three days to a day certain are excluded in the computation of the sixty-day period."

SEC. 2. (a) Except as provided by subsection (b) and after receiving the assurances described in subsection (c), the Secretary of the Treasury is authorized to take one-tenth of all moneys derived from the sale of $1 proof coins minted and issued under section 101(d) of the Coinage Act of 1965 (31 U.S.C. 391(d)) and section 203 of the Bank Holding Company Act Amendments of 1970 (31 U.S.C. 324b) which bears the likeness of the late Presi- 31 U.S.C. 391 note.

dent of the United States, Dwight David Eisenhower, and transfer such amount of moneys to Eisenhower College, Seneca Falls, New York. Transfer of funds.

(b) For the purposes of carrying out this section, there is authorized to be appropriated not to exceed $10,000,000. 88 Stat. 1262 Appropriations.

(c) Before the Secretary of the Treasury may transfer any moneys to Eisenhower College under this Act, Eisenhower College must make satisfactory assurances to him that an amount equal to 10 per centum of the total amount of moneys received by Eisenhower College under this Act shall be transferred to the Samuel Rayburn Library at Bonham, Texas. Samuel Rayburn Library, Tex. Transfer of funds.

Approved October 11, 1974.

Exhibit 23.—Address by Assistant Secretary Macdonald, September 10, 1974, before the American Importers Association, New York, N.Y., on modernization of Customs entry and clearance procedures

It is both an honor and a pleasure to be with your association today for my first major speech as Assistant Secretary of the Treasury. I had a profitable exchange of views with your president, Mr. Katz, and Messrs. O'Brien, Gitkin, and Casey during their recent trip to Washington, and I look forward to similar exchanges in the future.

As a lawyer before joining the Government, I specialized principally in public offerings, private corporate financing, mergers and acquisitions, and other corporate legal problems. It probably is not obvious to you, therefore, why I was appointed Assistant Secretary in charge, among other things, of tariff affairs and of the 185-year-old Customs Service. I can only say that having Customs, Secret Service, Alcohol, Tobacco and Firearms, the Mint, the Bureau of Engraving and Printing, not to speak of Foreign Assets Control and the Consolidated Federal Law Enforcement Training Center, George Shultz thought I would make a good utility infielder. When I took office, my income dropped in the same proportion as the size of my office increased—which Secretary Simon advised me was a fair exchange, considering that I was also being granted the privilege of working for the Treasury Department. Having been here for 5 months, I must say that I agree with him.

There is, however, one way in which my being unfamiliar with the Customs Service, its procedures and policies, may be helpful. The lack of any preconception regarding Customs operations brings into immediate and sharp relief those facets of the Customs Service which are unique. The sight of a missionary boiling in a pot may be old hat to the cannibals, but it will probably leave a sharp impression on first-time visiting missionaries. In the same way, those who deal daily with Customs may have become inured to its unique statutory procedures. To a newcomer like myself, however, the entire process, governed by a statute originally enacted in 1789 and revised only in piecemeal fashion since that time, resembles a scene from the 19th century. . . .

Customs laws and procedures are antiquated relics from another era—the era of the California gold rush, the three-masted square rigger, and the pony express. This is not to say that the ancient Customs practices have never produced anything worthwhile. Nathaniel Hawthorne was inspired to write "The Scarlet Letter" as a result of working as a customs weigher and grader in Salem, Mass. The experience of Chester Alan Arthur as Chief of the New York Customs Port undoubtedly stood him in good political stead when he later became President. Despite these intangible benefits, something has to be done in order to bring the Customs entry and clearance procedures out of the rigging and into the air-conditioned business offices of the 20th century.

This is not to criticize the people at Customs who are involved in the process of clearing merchandise for entry. The fact that the process works as well as it does under existing primitive ground rules is a compliment both to the thousands of dedicated customs officers and to the importers and customs brokers with whom they deal. It is conventional wisdom that the personal element is always able to botch up the most artfully and accurately designed program. The fact that the present Customs entry and clearance procedure works as well as it does, in my opinion, is proof that the reverse is also true—that people can make things work in spite of design deficiencies.

I am here today to discuss possible remedies for these design deficiencies and to solicit your help in bringing them to fruition. The remedies presently contemplated are two-pronged. First, there is involved the controls over the physical entering of the goods. The incredibly complex entry procedures must be simplified without threatening the revenue or sacrificing the administration of the 200-odd laws, in addition to the Tariff Act, that Customs must administer at ports-of-entry and along land and sea borders. Second, the legislatively mandated procedure for reporting, paying duties, and enforcing duty payments must be brought into line with the automated practices presently utilized by most businesses. The modernization of the entry procedure, as many of you know, has already been commenced under the leadership of the present Commissioner of Customs, Mike Acree. Briefly, the streamlining of the entry procedure involves three main functional Customs areas: immediate delivery control, automated entry screening, and collection processing.

The immediate delivery control portion of the program involves the creation and maintenance of an automated inventory of all merchandise released under current Customs' bonding procedures. This procedure allows expeditious entry of the goods while tracking and reporting to Customs any subsequent failure to file the required entry documentation. It relieves the customs import specialist of many clerical functions, permitting him to concentrate on more complex and difficult entries, thereby improving Customs' efficiency. The system provides the capability for prompt final action regarding entry transactions, which is accomplished by producing daily bulletin notices of liquidation rather than weekly postings that currently are experiencing a 3-week delay. We believe that the daily bulletin notices of liquidation will give a more timely notification of trade community financial liability to Customs, in addition to removing the redtape that surrounds the physical movement of goods at the docks.

This system was inaugurated at Philadelphia, with the immediate delivery control successfully installed and operational since April 1974. Present plans are to implement the system in New York in 1976.

The automated entry screening procedures verify, and perform calculations on, data obtained from formal entries filed by customs brokers and importers. Many of the procedures of entry processing currenty performed clerically will, upon adoption of the system, be automatically performed. Duty computations will be made and merchandise subject to quota provisions or internal revenue taxes will be identified. Additionally, methods will be used to identify merchandise which, by past experience, may require extensive review by import specialist teams.

The collection processing subsystem, the third function, will automate the billing and cashier functions and establish an accountability for all collected funds.

Thus, under the proposed system, assuming that an appropriate bond is on file with Customs, the importer can obtain release of his merchandise after customs examination without the payment of duty. Customs will produce a monthly statement that will allow the importer to make one payment for transactions performed at various U.S. ports. Paperwork which presently prevents entries from being liquidated for 4 weeks or more will be completed in a matter of days.

Perhaps the most significant result of the program will be that importers will be able to deal with Customs as a single service instead of dealing separately with separate ports, with the concomitant variation in requirements and procedures.

From our standpoint at Treasury, we believe this system will remove many of the routine clerical tasks from our inspectors and import specialists and will, therefore, allow them greater time to perform their professional judgment functions. It will simplify Customs' relations with the many other Government agencies that they serve. Almost an incidental result is the faster and more accurate management information which is generated in order to make better decisions for improved service. Of great importance to us, of course, is that Customs can develop this system within their current capabilities. It does not require massive reorganization or the appropriation of huge amounts of additional funds.

There are many details of this system which remain to be worked out. Customs must and will work with importers, brokers, bonding companies, common carriers, and others. In this connection, I note that a general briefing between Customs and the AIA regarding this entire concept was held last month.

Just as important to the people in this room as the modernized physical entry procedures is a related legislative program which we presently contemplate proposing to Congress. The substantive details of this program have not been worked out, and will not be worked out without an opportunity for importers, brokers, freight forwarders, and other interested parties to be heard. The essence of the program as now envisaged, however, would be the replacement of the entry-by-entry payment system with a procedure whereby customs duties would be reported and paid on a periodic basis by those importers, and only those importers, who qualify for such treatment. In order to adopt this procedure without threatening the revenue, a statutory basis which enables Customs to audit the declared tax liability of the importer is necessary. Thus, the proposed legislation would require the maintenance of books and records by the importer relating to his business, would grant the Secretary of the Treasury or his delegate the right to audit those books, and would empower the Secretary or his delegate to require their production as well as the appearance of the importer himself for the purpose of giving testimony regarding his import activities.

I would like to emphasize here and now that any existing bookkeeping system maintained by an importer which is sufficient to reveal his financial condition and results of operations should also satisfy the proposed legislative requirement to maintain books and records. We have enough paper and forms in the Government now to satisfy the most discerning bureaucrat. No duplicate bookkeeping system should be required and, in fact, all those who presently pay income tax must meet similar legal requirements under the internal revenue laws. Our experience, however, has led us to conclude that existing civil enforcement powers are so truncated and that existing discovery procedures are so inadequate that the ability of Customs to find out the facts in an orderly manner is severely hampered. The result has been to turn the process into an adversary contest with, as you know, extremely high stakes. We anticipate creating effective methods of proceeding to collect the correct duty by the civil administration of the laws without resorting to procedures which are more nearly akin to criminal procedures.

At the same time, we propose, without endangering the revenue, to reduce the myriad of procedures and documentation required by filing repetitive entry documents and duty payments. As business practices become more and more technologically oriented, the retention of these green eyeshade procedures becomes not only an anomoly, but also an unnecessary obstacle to further modernization. The Internal Revenue Service, along with countless private businesses, long ago recognized that benefits in terms of efficiency and economy, without weakening verification controls, could be obtained from a system of periodic account reporting. This system is equally suitable to the processing of repetitive, large-volume imports. However, without the recordkeeping and verification authority proposed in the legislation, any change from entry-by-entry reporting to a periodic return system would, in our view, endanger the revenue. In addition, the proposed alternative method of reporting and paying customs duty would be entirely voluntary with the importer. We do not expect to require the importer to bypass the entry-by-entry method of importing unless he believes it to be advantageous to himself. In this way both we at Treasury and the importing community can experiment, with a view to ascertaining whether the new procedures will be beneficial to each of us.

Philosophically speaking, I do not personally believe that the proposed periodic reporting and payment concept can be successfully inaugurated unless the system of reporting is geared to existing business reporting methods of the importer. The success of the voluntary filing system of the Internal Revenue Service is, in my view, based upon the fact that income tax reporting is built around an existing business bookkeeping and financial reporting system which is normally audited and utilized for shareholder reporting and internal management use. This is why we feel confident that we can assure you that no new bookkeeping requirements will be instituted. To do so would, in and of itself, defeat the system. In fact, the ultimate purpose of the new system would be to work toward a single set of records which businessmen can maintain that will be adequate for all governmental reporting and taxpaying functions. You should be aware that transactions between related importers and exporters as reported to Customs will be examined on an integral basis with the same transactions as reported, for example, to the Internal Revenue Service.

The question may have occurred to you by now whether the penalty provisions of section 592 would be retained for those imports brought in under the new procedures. I can only say at this time that we would listen to any suggestion that would result in more sophisticated enforcement procedures *which are equally effective in protecting the revenue.* I underline that condition.

Speaking of section 592, I should mention that we intend to publish major portions of the Treasury guidelines governing mitigation procedures in the relatively near future. At the same time, while we are always willing to listen to suggestions for procedural improvements, I would not anticipate any change in the manner of use of section 592 beyond those changes which were suggested by the AIA and others and were subsequently adopted by Treasury. Until adequate medical help is available, the in terrorem effect of exorcising duty violations by Customs witch doctors will have to remain in place.

We also look forward to seeing your representatives in Washington. We at Treasury and Customs desire to work with you who are closely involved in the importing process to improve that process. Having worked in what I now call the "private sector" for many years, I am well aware that a continuing dialog must be maintained between industry and Government in order to promote a clearer perspective of importing activities by Customs and of Customs' activities by the importing community. . . .

Exhibit 24.—Press release, January 9, 1975, announcing a notice listing complaints received under the countervailing duty law

Assistant Secretary of the Treasury David R. Macdonald today announced that pursuant to provisions of the Trade Act of 1974, signed by President Ford on January 3, 1975, the Treasury will publish shortly a notice listing all complaints which have been received under the countervailing duty law and in which the Treasury has not yet published notice of an investigation. Under previous Treasury procedures, no public notice was made until after an inquiry had been conducted establishing the probable validity of the allegations. Now, however, the act requires that all complaints alleging that goods exported to the United States have benefited from bounties or grants in the country of export be published, when received in proper form, and that complaints pending on the date of enactment of the act be treated as if received on the day after that date.

Mr. Macdonald said that the notice would list 30 separate cases from 19 different countries, involving a variety of products. He emphasized that under the new procedures, publication of the notice, which will appear in the Federal Register sometime next week, is a procedural step required by law, and does not indicate that Treasury has made any decision on the validity of the allegations contained in the complaints. In these cases, the Treasury will have up to 6 months to investigate these charges and to make a preliminary determination, and then up to an additional 6 months before deciding whether the imposition of additional, countervailing duties is warranted. He added that while no notice of investigation has previously been published in any of these cases, Treasury has in several instances already conducted inquiries and engaged in discussions with the governments concerned. For instance, in the case of dairy products from the European Community considerable progress has already been made toward resolving the issues in that complaint.

In addition to these 30 cases there are 4 other countervailing duty investigations which were formally opened prior to enactment of the act, which are pending. Those investigations should be completed in the near future.

CASES WHERE NOTICE OF RECEIPT OF COMPLAINT WILL BE ISSUED

Commodity	Country	Commodity	Country
Float glass	Belgium	Steel products	West Germany
Do	Italy	Do	France
Do	France	Do	Netherlands
Do	West Germany	Do	Luxembourg
Do	United Kingdom	Do	Belgium
Processed asparagus	Mexico	Do	United Kingdom
Dairy products	EC member states	Do	Austria
Ferrochrome	South Africa	Cotton textiles and manmade fibers.	India
Footwear	Taiwan	Dried apples	Italy
Cheese	Austria	Cast iron soil pipe and fittings	India
Do	Switzerland	Tie fabrics	Korea
Leather handbags	Brazil	Do	West Germany
Nonrubber footwear	Korea	Do	Japan
Canned hams	EC member states	Oxygen sensing probes	Canada
Shoes	West Germany		
Leather products	Argentina		

Exhibit 25.—Report of investigation of effect of petroleum imports and petroleum products on the national security pursuant to section 232 of the Trade Expansion Act, as amended

January 14, 1975.

Memorandum for the PRESIDENT

Subject: Report on Section 232 Investigation on Petroleum Imports

This report is submitted to you pursuant to Section 232 of the Trade Expansion Act of 1962, as amended, and results from an investigation that I initiated under that Section for the purpose of determining whether petroleum* is being imported into the United States in such quantities or under such circumstances as to threaten to impair the national security.

At the present time, the demand for petroleum in the United States is 18.7 million barrels per day. Of this amount, imports provide 7.4 million barrels daily. The deficit in petroleum production compared with demand has grown since 1966, when the United States ceased to be self-sufficient.

Our increasing dependence upon foreign petroleum had, by 1973, created a potential problem to our economic welfare in the event that supplies from foreign sources were interrupted. Its adverse contribution to our balance of payments position had also significantly increased, and for the year 1973 the outflow in payments for the purchase of foreign petroleum was running at $8.3 billion annually, only partially offset by exports of petroleum products.

In September 1973, the worsening petroleum import situation was further seriously aggravated by an embargo on crude oil imposed by the Organization of Petroleum Exporting Countries, which effectively kept 2.4 million needed barrels of oil per day from U.S. shores. After the initiation of the embargo, the price of imported oil quadrupled from approximately $2.50 per barrel to approximately $10.00 per barrel and has since that time risen somewhat further. Simultaneously, the balance of payments problem deteriorated by reason of the increased oil bill paid by United States consuming interests. Today the outflow of payments for petroleum is running at a rate of $25 billion annually.

As a result of my investigation, I conclude that the petroleum consumption in the United States could be reduced by conserving approximately one million barrels per day without substantially adversely affecting the level of economic activity in the United States. Any sudden supply interruption in excess of this amount, however, and particularly a recurrence of the 2.4 million barrel per day reduction which occurred during the OPEC embargo, would have a prompt substantial impact upon our economic well-being, and, considering the close relation between this nation's economic welfare and our national security, would clearly threaten to impair our national security.

Furthermore, in the event of a world-wide political or military crisis, it is not improbable that a more complete interruption of the flow of imported petroleum would occur. In that event, the total U.S. production of about 11 million barrels per day might well be insufficient to supply adequately a war-time economy, even after mandatory conservation measures are imposed. As a result, the national security would not merely be threatened, but could be immediately, directly and adversely affected.

In addition, the price at which oil imports are now purchased causes a massive payments outflow to other countries. The inevitable result of such an outflow is to reduce the flexibility and viability of our foreign policy objectives. For this reason, therefore, a payments outflow poses a more intangible, but just as real, threat to the security of the United States as the threat of petroleum supply interruption. On both grounds, decisive action is essential.

FINDINGS

As a result of my investigation, I have found that crude oil, principal crude oil derivatives and products, and related products derived from natural gas and coal tar are being imported into the United States in such quantities as to threaten to impair the national security. I further find that the foregoing products are being imported into the United States under such circumstances as to threaten to impair the national security.

*The term "petroleum," as used in this report, means crude oil, principal crude oil derivatives and products, and related products derived from natural gas and coal tar.

RECOMMENDATIONS

I therefore recommend that appropriate action be taken to reduce imports of crude oil, principal crude oil derivatives and products, and related products derived from natural gas and coal tar into the United States, to promote a lessened reliance upon such imports, to reduce the payments outflow and to create incentives for the use of alternative sources of energy to such imports. I understand that a Presidential Proclamation pursuant to Section 232 of the Trade Expansion Act of 1962 is being drafted by the Federal Energy Administration consistent with these recommendations.

(Signed) WILLIAM E. SIMON.

REPORT OF INVESTIGATION UNDER SECTION 232 OF THE TRADE EXPANSION ACT, AS AMENDED, 19 U.S.C. 1862

I. *Introduction and summary*

This investigation is being conducted at the request of and on behalf of the Secretary of the Treasury pursuant to his authority under Section 232 of the Trade Expansion Act (the "Act"), as amended, 19 U.S.C. 1862. The purpose of the investigation is to determine whether crude oil, crude oil derivatives and products, and related products derived from natural gas and coal tar are being imported into the United States in such quantities or under such circumstances as to threaten to impair the national security. Under 31 CFR 9.3, the Assistant Secretary of the Treasury for Enforcement, Operations, and Tariff Affairs is responsible for making this investigation.

The Secretary of the Treasury has determined pursuant to Section 232 that it would be inappropriate to hold public hearings, or otherwise afford interested parties an opportunity to present information and advice relevant to this investigation. He has also determined pursuant to his authority under 31 CFR 9.8 that national security interests require that the procedures providing for public notice and opportunity for public comment set forth at 31 CFR Part 9 not be followed in this case.

In conducting the investigation, information and advice have been sought from the Secretary of Defense, the Secretary of Commerce, and other appropriate officers of the United States to determine the effects on the national security of imports of the articles which are the subject of the investigation. Information and advice have been received from the Departments of State, Defense, Interior, Commerce, Labor, the Council of Economic Advisers, and the Federal Energy Administration.

In summary, the conclusion of this report is that petroleum *is* being imported in such quantities and under such circumstances as to threaten to impair the national security of this country.

Petroleum is a unique commodity: it is essential to almost every sector of our economy, either as a raw material component or as the fuel for processing or transporting goods. It is thus essential to the maintenance of our gross national product and overall economic health. Only a small percentage of present U.S. petroleum imports could be deemed to be secure from interruption in the event of a major world crisis. The quantity of petroleum imports, moreover, is now such a high percentage of total U.S. consumption that an interruption larger than one million barrels per day at the present time would adversely affect our economy. If our imports not presently deemed to be secure from interruption were in fact kept from our shores, the effect on the U.S. economy would be staggering and would clearly reach beyond a matter of inconvenience, or loss of raw materials and fuel for industries not essential to our national security. The outflow in payments for petroleum also poses a clear threat not only to our well-being, but to the welfare of our allies. As the State Department has concluded, the massive transfer of wealth greatly enhances the economic and political power of oil rich states who do not necessarily share our foreign policy objectives, and correspondingly tends to erode the political power of the United States and its allies.

The purpose of this investigation under Section 232 of the Act is to determine the effects of our level of imported petroleum upon our national security and not to fashion a remedy. Nevertheless, it would appear that we must, over the longer term, wean ourselves away from a dependence upon imported oil, conserve our use of petroleum, promote the use of alternative sources of energy, and at least in part, stanch the outflow of payments resulting from our purchases of this commodity. As Secretary Kissinger states:

Clearly, decisive action is essential. We have signalled our intention to move toward energy self-sufficiency. We must now demonstrate with action the strength of our commitment. In the short-term, our only viable economic policy option is an effective program of energy conservation. A vigorous United States lead on conservation will encourage similar action by other consuming nations. Consumer cooperation on conservation now and then development of new supplies over time will deter producer aggressiveness by demonstrating that consumers are capable of acting together to defend their interests.

II. *Statutory considerations*

This investigation has proceeded in recognition of the close relationship of the economic welfare of the Nation to our national security. As required by Section 232, consideration has been given to domestic production of crude oil and the other products under investigation needed for projected defense requirements, the existing and anticipated availability of these raw materials and products which are essential to the national defense, the requirements of the growth of the domestic petroleum industry and supplies of crude oil and crude oil products, and the importation of goods in terms of their quantities, availabilities, character and use as those affect the domestic petroleum industry and the ability of the United States to meet its national security requirements.

In addition, other relevant factors required or permitted by Section 232 have been considered, including the amount of current domestic demand for petroleum and petroleum products which is being supplied from foreign sources, the degree of risk of interruption of the supply of such products from these countries, the impact on the economy and our national defense of an interruption of such supplies including the effects on labor, and the effect of the prices charged for foreign petroleum and petroleum products on our national security.

III. *Imports of petroleum and petroleum products*

During the first eight months of 1974, the United States imported approximately 5.8 million barrels per day of petroleum and petroleum products. This figure amounted to 35.6 percent of total United States demand for such products during this period. The latest data available indicates that United States dependence on imported oil is growing. For the four weeks ending December 13, 1974, the United States imported about 7.4 million barrels per day of petroleum and petroleum products, which represented 39.5 percent of total United States demand for such products during the same period.

Imports into the United States may be divided into two major sources, the nations belonging to the Organization of Petroleum Exporting Countries (OPEC) and other nations. The OPEC nations have far more production capacity than the non-OPEC nations. Of the world's total production of approximately 55 million barrels per day, OPEC members produce 30 million barrels, Communist countries 11 million and the balance of 14 million barrels per day is produced by other countries including the U.S. Moreover, the OPEC countries have over 8 million barrels per day of production potential which is not being utilized while virtually no unused capacity exists in the rest of the world.

Most recent indicators show that 3.5 million barrels per day of crude oil and petroleum products are being imported by the U.S. directly from the OPEC member states. In addition, as much as 850,000 barrels per day of finished products imported into the U.S. from third country sources may originate from OPEC nations. In total, 4.35 million barrels per day of the 1974 U.S. demand of approximately 17.0 million barrels per day came from OPEC sources. In percentage terms, U.S. imports from OPEC members account for over 25 percent of domestic demand.

The major Western Hemisphere suppliers of petroleum to the United States are Canada and Venezuela. The latter country provided the United States with approximately 1.1 million barrels per day from January through October 1974. For the same period, Canada exported to the U.S. over 1,000,000 barrels per day or slightly over 17 percent of our imported supplies.

The Canadian Government has recently conducted a study of its own energy potential. It concluded that steps should be taken to reduce exports of oil with a view to conserving petroleum for future Canadian requirements. Accordingly, on November 22, 1974, the Canadian Government announced its intention to limit exports to the U.S. to 650,000 barrels per day by the end of 1975. Further reductions in exports will take place after annual reviews. As a result, it appears that the U.S. can no longer count on the availability of large volumes of oil from

Canada but may have to increase our reliance on OPEC to make up for the reduction of Canadian imports.

In summary, 60 percent of current imports of crude oil comes directly from OPEC members and another 15 percent is refined by third countries using OPEC crude oil. At least 85 percent of the imported petroleum, however, whether from OPEC or non-OPEC countries, appears to be subject to the threat of interruption in the event of a crisis. Moreover, the outlook in the short run is for the percentage of imports derived from OPEC members to increase as a result of limitations on Canadian exports.

IV. *Effect of 1973-74 embargo on the domestic economy*

The interruption of the supply of a major part of U.S. imports of petroleum during the Winter of 1973-74 had a serious adverse impact on the economy of the United States.

In his memorandum, Secretary Dent stated:

> The experience of the Arab oil embargo last year, even though it halted only about one-half of our oil imports, confirms the risk of disruption to the economy which is implicit in dependence on imports of oil to this degree. The oil embargo is believed to have produced a reduction in U.S. GNP by some $10 to 20 billion. All sectors of the economy were adversely affected, with the consumer durables sector and housing construction most heavily hit. Further, it is estimated that a substantial part of the inflationary rise of prices during 1974, particularly in the first half, is attributable to the direct and indirect effects of the rise in overall energy costs which followed the rapid escalation of costs for Arab oil. In view of this record of injury caused by loss of foreign oil supply and our continuing vulnerability to future injury of even greater impact, it is my opinion that imports at current and projected levels do constitute a threat to impair the national security.

The Federal Energy Administration noted in its Project Independence report that the embargo's impact was serious as a result of the nation's high level of dependence upon foreign petroleum imports. In the years 1960 through 1973 U.S. production did not keep pace with U.S. consumption of petroleum. The resulting gap represented the level of U.S. imports, which increased drastically:

U.S. production and consumption of petroleum (1960-73)

[Millions barrels/day]

Year	Production	Consumption	Gap (imports)
1960	8.0	9.5	1.5
1965	8.8	10.8	2.0
1970	11.3	14.7	3.4
1972	11.2	16.4	5.2
1973	10.9	17.3	6.4

The impact of the embargo on imports can be shown by a comparison of import figures for both crude and refined oil imports for each of the months September 1973 through February 1974, and the percent change reflected in such figures from the same months of the preceding year:

Monthly imports before and during the oil embargo

[Millions barrels/day]

	Crude oil	Percent change from previous year	Total refined products	Percent change from previous year
September, 1973	3.47	+47	2.65	+26
October	3.86	+49	2.67	+9
November	3.45	+50	3.14	+30
December	3.99	+45	2.90	+1
January, 1974	2.46	−13	2.85	−4
February	2.10	−22	2.55	*+17

*The indicated positive balance in this month is reflected by the disproportionately large imports of motor gasoline, to accommodate critical shortages of this refined product.

Both the National Petroleum Council and the Federal Energy Administration have made detailed analyses of the impact of the 1973–74 embargo. A demand reduction of over 1 million barrels per day has been attributed to curtailment and conservation. These savings occurred in areas which caused minimum individual or collective hardship. However, many such savings were the result of one-time only reductions in usage patterns, such as lowering of thermostat levels. Once accomplished, by voluntary or other restraints upon energy usage, such savings cannot thereafter be duplicated.

The cost of the embargo to the economy, in terms of both increased energy costs and adverse impacts on the labor market, was severe. During the first quarter of 1974, the seasonally adjusted Gross National Product fell by 7 percent and the seasonally adjusted unemployment rate changed from 4.6 percent in October 1973 to 5.1 percent by March of 1974. Of course there were other factors at work in the economy during this period and it is difficult to isolate those declines attributable solely to the embargo. However, according to the FEA, increased energy prices during the embargo period were responsible for at least 30 percent of the increase in the Consumer Price Index with the long-term effects of the embargo and the subsequent price rises continuing after the embargo was lifted. As the FEA has pointed out, a comparison of the nation's economic performance for the two years preceding the embargo with the first quarter of 1974 demonstrates a clear and uninterrupted upward historical trend (albeit a reduced rate of increase beginning in the second quarter of 1973) followed by a sudden sharp decline during the relevant period:

Gross national product statistics (1972–1974)

	Real GNP [a]	Present changes in GNP from preceding quarter (annual rate)
1972—I	768.0	
II	785.6	9.5
III	796.7	5.7
IV	812.3	8.0
1973—I	829.3	8.6
II	834.3	2.4
III	841.3	3.4
IV	844.6	1.6
1974—I	831.0	−6.3

[a] Seasonally adjusted at annual rates in billions of 1958 dollars.

A similar effect has been identified by FEA with respect to real personal consumption expenditures and real fixed investments. These are set forth in detail in the appendix to the Project Independence Report, and are not set forth in detail herein.

Following the embargo, the Department of Commerce reduced its forecast of real output for the first quarter of 1974 by $10.4 billion, and its forecast for the first quarter of 1975 by $15 billion. Again, studies showing detailed effects upon the labor market and contributions to changes for selected items within the CPI have been analyzed in detail by the Department of Commerce and the Federal Energy Administration, and set forth in the Project Independence Report.

The adverse change of 0.5 percent in the seasonally adjusted national unemployment rate between October 1973 and March 1974 represents an increase of approximately 500,000 unemployed people. The Department of Labor has estimated that during the period of embargo 150,000 to 225,000 jobs were lost as a direct result of employers' inability to acquire petroleum supplies. An additional decline of approximately 310,000 jobs occurred as an indirect result of such shortages in industries whose products or processes were subject to reduced demand as a result thereof (most notably, the automobile industry). The Department of Labor estimates that 85 percent of the total jobs lost were those of semiskilled workers, 5 percent clerical and 3 percent professional, technical and skilled.

The Federal Energy Administration has projected the loss in economic activity (GNP) which could be reasonably correlated to a shortfall in oil supplies. The pattern of this correlation indicates that at any given time, the economy can absorb a modest reduction in consumption before painful reductions in economic activity occur. After this reduction in nonessential uses of oil is made, further reductions of oil supplies will result in sharply increasing losses in the GNP. Based on such models, the FEA has determined the impacts of interruption of imports under several conditions. For example, a recently calculated situation shows that a 2.2 million bbl/day import reduction for 6 months' duration is estimated to cause a $22.4 billion reduction in GNP.

The Federal Energy Administration estimates that a reduction in consumption of approximately 1 million barrels per day can be managed without imposing prohibitive costs on the economy. While recognizing that a figure of 1 million barrels per day is not precise, it does approximate a reasonable estimate of the short-term reduction beyond which more severe economic readjustments would take place. Of the 17 million barrels per day current demand, it is estimated that 16 million is the proximate quantity required to prevent progressive deterioration of the economy at the present time.

It should also be noted that the impacts of any supply interruptions will be disproportionately felt in the various regions of the country. The major determinants of the impact within any given region is the amount of imports into that region, climatic conditions of the region, and the industries located there. The northwestern and northeastern parts of the country import large amounts of their petroleum requirements, the climatic conditions require them to use more energy for heating than other regions, and they have more energy using manufacturing industries in general than other parts of the country (this is especially true of the Northeast).

The direct effects of an embargo would be concentrated in PAD (Petroleum Administration for Defense) Districts 1 and 5. PAD District 1 includes the Eastern Seaboard of the U.S. where it is estimated that 83 percent of the 1975 crude petroleum demand will be imported. In PAD District 5, the West Coast of the U.S. including Alaska and Hawaii, imports are 43 percent of total uses. The East Coast problem is especially difficult because of the high fuel oil demands in the New England area and the fact that approximately 98 percent of the residual fuel oil for PAD District 1 is imported as a refined product or made from imported crude.

V. *Vulnerability of U.S. economy to oil and development of alternate energy sources*

The vulnerability of the U.S. economy to petroleum supply interruptions is highlighted by (1) the fact that it is the backbone, not only of our defense energy needs, but also of our economic welfare, and (2) the difficulty of bringing in alternate energy sources immediately.

Although there may have been some recent minor changes, the 1973 figures show that petroleum accounted for 46 percent of domestic energy consumption, natural gas for 31 percent, coal for 18 percent, hydropower for 4 percent and nuclear for 1 percent.

The degree to which other energy forms can in the short run be physically substituted for oil is limited. Residual oil used in heating or utilities can be replaced with coal only after conversion of the plant's combustion facilities has taken place. Other energy sources are limited in supply or feasibility of use. Supplies of natural gas are declining and an interstate pipeline curtailment of 919 billion cu. ft. is expected in the 1974–75 heating season. The natural gas reserve/production ratio has declined from 21.1 in 1959 to 11.1 in 1973, indicating the production potential is seriously impaired. It does not appear that we can substitute natural gas for oil. On the contrary, the prospects are that either oil or coal may have to be substituted for natural gas. The nation's ability to increase its hydroelectric power generating capacity is severely limited. Other energy sources such as nuclear electrical generating power require long lead times for development and will not be available in materially increased quantities for a number of years. For example, nuclear power is not expected to reach a significant percentage (12 percent) of our total energy capacity until 1985. The availability of coal is subject to further mine development, expansion of transportation systems and convertibility of furnaces and boilers, all of which require significant development time. Moreover, both the production and combustion of coal is currently subject to environmental restrictions which further limit its accelerated development as an energy source.

The outlook for increasing production of crude oil from domestic sources is not favorable for the near term. Domestic production has declined from 9.6 million barrels per day in 1970 to 8.7 million barrels per day in December 1974. A further gradual decline is anticipated until oil from the North Slope of Alaska becomes available in late 1977, or until oil is produced from presently undeveloped areas as the Outer Continental Shelf. Nevertheless, the sharp increase in the price of oil should stimulate increased exploration which, in the intermediate or longer term, if combined with conservation efforts should ameliorate the present threat to our economy.

Also, long-term energy sources such as the development of geothermal and oil shale energy resources and the practical utilization of solar energy require major advances in the technology involved. This technology may take several years to develop, but should assist in the solution of the domestic shortage of energy sources if sufficient incentive is provided.

VI. *Threat to the national security of future supply interruptions*

Section IV has described the serious impact on the national economy and consequently on the national security of the winter 1973–1974 embargo. It is reasonable to expect similar or even worse effects of an interruption of supply in the future, particularly in light of increasing dependence on foreign sources of supply. U.S. production is declining and alternative sources of energy supply require a long lead time for development. Moreover, supplies from the most secure Western Hemisphere sources are likely to decline as illustrated by the Canadian action to reduce oil exports to the United States.

The Department of Defense has described the risks to our national security posed by the threat of a future supply interruption. The Department of Defense, in its memorandum to me of January 9, 1975, stated:

> The Department of Defense holds that this nation must have the capability to meet the essential energy requirements of its military forces and of its civil economy from secure sources not subject to military, economic or political interdiction. While it may be that complete national energy self-sufficiency is unnecessary, the degree of our sufficiency must be such that any potential supply denial will be sustainable for an extended period without degradation of military readiness or operations, and without significant impact on industrial output or the welfare of the populace. This is true because the national security is threatened when: (1) the national economy is depressed; (2) we are obliged to rely on non-secure sources for essential quantities of fuel; (3) costs for essential fuels are unduly high; and (4) we reach a point where secure available internal fuel resources are exhausted.
>
> As you know, the Mandatory Oil Import Program was established in 1959 for the express purpose of controlling the quantity of imported oil which at that time had been found to threaten to impair the national security. In the intervening years we have observed with growing concern the decline in domestic and western hemisphere petroleum productive capacity in relation to demand. The result has been a rapid expansion in our dependence on eastern hemisphere sources for the oil which is so essential to our military needs and the nation's economy. By 1973 that dependence had reached a level which risked substantial harm to the national economy in event of a peacetime supply denial. In event of general war, those risks would be substantially greater because of the sharply increased level of military petroleum consumption which would require support from domestic petroleum resources. The 1973 Arab oil embargo offered proof, if proof were needed, of the deterioration in our national energy situation.
>
> Energy conservation efforts and expanded use of alternate fuels halted the growth in crude oil and product imports during much of 1974. However, production of both oil and gas in the United States continues to decline, and indications are that import growth has resumed. Projections for 1975 indicate that imports may exceed seven million barrels a day, sharply higher than in 1974 and equal to near 19 percent of the probable total energy supply in 1975. To the extent that demand for petroleum imports causes increasing reliance on insecure sources of fuel, then such demand/reliance is a severe threat to our security.

Although oil exporters vary in their specific national goals and from time to time make unilateral decisions in regard to oil policies, oil exporters have the potential to bring about concerted actions which can explicitly deny the U.S. needed imports through such actions as last year's embargo. The loss in GNP growth and the significant unemployment created have on their face a significant impact in terms of the overal strentgh of the national economy. Continued reliance on foreign sources of supply leaves the U.S. economy vulnerable to further disruptive, abrupt curtailment or embargo of supplies, as well as to further increases in prices. Consequently, it is only prudent from a national security standpoint to plan for the possibility that another embargo, or other type of supply interruption, could occur.

VII. *The excessive reliance on imported oil as a source of weakness in a flexible foreign policy*

The dependence of the United States on imported petroleum can also adversely affect the ability to achieve our foreign policy objectives.

A healthy and vital domestic economy coupled with modern and adequate defense forces are the basic elements of strength in protecting our national security, but equally important in today's interdependent world is the continued smooth functioning of the international economic system and, in particular, the economic strength and viability of our Allies. The economies of many of these countries are almost totally dependent on imported oil and are therefore much more vulnerable to the threat of a new oil embargo. This could adversely affect the extent to which we can rely on those Allies in the event of a serious political or military threat to this country.

The risk to our Allies and to ourselves comes not only from the possibility of disruptions of supply and the impact this could have on foreign policies but also from the effect on their domestic economies of the high cost of oil imports. Individual consumer states, faced with balance of trade deficits and having difficulties in financing them, could attempt to equilibrate their trade balances through "beggar-thy-neighbor" actions.

For example, deliberate measures could be taken to interfere with markets so as to increase exports and/or decrease imports from non-oil exporting countries. Specific examples would include export subsidies, import tariffs, quotas, and perhaps other non-tariff barriers to trade. Such action would, of course, be infeasible as a concerted policy by all deficit nations and therefore irrational. Indeed, should all embark on such a course, a severe economic loss would result through income reductions to all. Exports would be reduced for all oil importing countries with loss in economic activity.

A slowdown in economic growth and consequent unemployment resulting from such a course could have economic and social effects that could have serious political implications for our own security.

These potential problems could arise from the continued high levels of oil imports in conjunction with the price of oil, which generate large current account surpluses for OPEC. Given the limited absorptive capacity of some of these countries the increased oil revenues to these countries will not be immediately translated into increased imports. A recent estimate of the OPEC 1974 current account imbalance is about $60 billion. In contrast, the 1973 OPEC current account balance was only $13 billion. Projections of these balances through time indicate continued reserve accumulations at least until 1980, as some OPEC members will only gradually adjust their import levels to higher export revenues. An estimate of these accumulations as of 1980 is on the order of $200 to 300 billion (in terms of 1974 purchasing power) for OPEC as a group. Such a massive transfer of wealth would enhance the economic and political power of oil rich states which do not necessarily share our foreign policy objectives.

It is our expectation that these funds will be held and invested in a responsible manner. There is every economic incentive for the owners of these resources to take this course. The United States' basic economic position strongly favors maximum freedom for capital movements and we believe there is no reason to change this policy.

However, in view of the possible problems noted above, it is imperative that we join with our Allies in a concerted program of conservation, reduced reliance on imported sources of oil and development of alternative energy supplies. In this way we promote market forces that will work against further rises in already monopolistic oil prices and exert some downward pressure on world oil prices.

The Department of Defense confirms these conclusions:

> The appropriate restriction of oil imports will also impact favorably on the balance of payments and, more importantly, will permit the United States to make a significant contribution to international efforts to reduce total world oil demand which, through its recent rapid growth, has contributed to harmful increases in world oil prices. Those increases have posed serious threats to the economic and military viability of NATO and other friendly nations, as well as to the United States. Reduced dependence on imported oil can also minimize the adverse impact on the United States, NATO

and other friendly nations of boycotts such as that imposed by the Arab nations in 1973.

The Federal Energy Administration has pointed out that reduction of reliance on imported oil and conservation are essential to U.S. participation in the International Energy Program. Administrator Zarb states:

> Given the inability to create effective emergency supplies in the short run, it is important that the U.S. actively support and participate in international security agreements such as the International Energy Program (IEP), or a producer-consumer conference, with the objective of establishing future world oil prices acceptable to the U.S., the other importers, and the OPEC countries; and to decrease the likelihood of politically or economically motivated supply disruptions.
>
> The IEP particularly is an important component of the U.S. energy supply security program. It would coordinate the responses of most major oil importing nations to international supply disruptions, provide guidelines for conservation and stockpile release programs, and avoid competition for available supplies, and thus limit the oil price increases likely to result from an oil shortage.
>
> The IEP deters the imposition of oil export embargoes because it diminishes the ability of oil exporters to target oil shortfalls on particular oil importers, or greatly increases the cost of doing so. For example, under an IEP, a U.S. import shortfall of 3 MM B/D would require a much larger export cutoff, and increase the political and economic costs exporters would incur in imposing an embargo.
>
> These measures do not exhaust the options available to the U.S. Government. They seem to us, however, to be among the most effective programs which the U.S. can implement at this time, given the character of the international energy market. As such, these options offer attractive prospects for minimizing the threat to our national security resulting from our need to continue to rely on imported oil.

VIII. *Findings and recommendations*

As a result of my investigation, I recommend that the following determinations and recommendations be made by the Secretary of the Treasury and forwarded to the President:

FINDINGS

As a result of the investigation initiated by me, I have found that crude oil, principal crude oil derivatives and products, and related products derived from natural gas and coal tar are being imported into the United States in such quantities as to threaten to impair the national security. I further find that the foregoing products are being imported into the United States under such circumstances as to threaten to impair the national security.

RECOMMENDATIONS

I therefore recommend that appropriate action be taken to reduce imports of crude oil, principal crude oil derivatives and products, and related products derived from natural gas and coal tar into the United States, to promote a lessened reliance upon such products, to reduce the payments outflow and to create incentives for the use of alternative sources of energy to such imports. I understand that a Presidential Proclamation pursuant to Section 232 of the Trade Expansion Act of 1962 is being drafted by the Federal Energy Administration consistent with these recommendations.

David R. Macdonald,
Assistant Secretary (Enforcement, Operations, and Tariff Affairs).

Exhibit 26.—Address by Assistant Secretary Macdonald, January 31, 1975, before the ABA National Institute on Customs, Tariffs and Trade, San Juan, P.R., on the "Future of the Countervailing Duty and Antidumping Laws"

The State of Health and Future Prospects of the Antidumping and Countervailing Duty Laws, as Reported by David R. Macdonald, Resident Physician

It's an honor to appear before this select body of distinguished practitioners for the purpose of reporting on the "Future of the Countervailing Duty and

Antidumping Laws." When that title was given to me as the subject of my speech, it seemed to me to imply something other than a legal or economic assessment. In fact, the more I thought about it, the more I came to the conclusion that a medical view was called for. I hasten to add that I have not taken the Hippocratic oath. . . . I find, however, that my medical friends have never hesitated to pass their legal opinions on to me as ex cathedra; you will pardon me, therefore, for unabashedly volunteering my services as resident M.D.

Health of countervailing duty law

The countervailing duty law, as most of you know, is an 1897 statute which provides that whenever a bounty or grant is paid or bestowed on dutiable merchandise exported to the United States, there shall be levied and paid ". . . an additional duty equal to the net amount of such bounty or grant. . . ."

After a lengthy coma, I can now report that this law is reviving and presently ambulatory. A number of consultants helped to bring it back to health, not the least of which was Congress, which in the Trade Act of 1974 performed surgery on the law in a manner which I will presently describe.

In addition to the assembled medicos who have ministered to this patient, there are several more basic considerations which have created an atmosphere which was bound to focus attention on the countervailing duty law.

First, there has been, in recent years, as tariffs have generally dropped, a new interest in nontariff trade barriers and distortions to trade which has brought export subsidies into prominence.

Second, oil payments flowing to OPEC and other countries have promoted a fight for world capital that brings with it a temptation to subsidize exports.

Third, developing countries in recent years have moved away from home manufactures as a means of import substitution and toward exports of manufactures in order to develop new industries and balance trade.

Fourth, there is a sense of frustration by domestic industry in this country because of increasing effects of import competition, which frustration has been forcefully expressed to Congress and the administration.

Fifth, a major segment of U.S. labor has, to some degree, switched from an aggressive internationalist posture to more of a defensive posture.

Finally, social, environmental, and safety legislation in this country, although perhaps beneficial for its intended purpose, has tended to restrain improvements in productivity and thus raise domestic prices, inviting competition from abroad. Some manufacturers, looking for a defense, correctly or incorrectly envisage foreign subsidies as a primary cause of their problems.

Health of Antidumping Act

The Antidumping Act is an international price discrimination statute. Under its provisions if it is determined that the sale of products in the United States is at a lower price than the exporter sells the same product in his home market, Treasury issues a determination to that effect and the Tariff Commission (now the International Trade Commission) determines whether the domestic industry has been or is likely to be injured.

In the event that the Commission does determine that injury has occurred or is likely to occur, a dumping finding is entered by Treasury, and Treasury and Customs proceed to levy "dumping duties" equal to the amount of the price discrimination, or "dumping margin." Many price adjustments are provided in the statute and regulations in order to determine whether sales at less than fair value have occurred, and, if they have, what the size of the dumping margin is. I will not go into these adjustments, except to say that all are designed basically to make a fair comparison of the export sales price with the home market sales price of the product, in order to bring both of them down to a "mill net" price.

The antidumping law has been extensively analyzed in law review articles and has not been radically changed by the Trade Act. My annual checkup reveals that it is in continuing health, although relatively inactive, possibly in part because world shortages of raw materials have removed the incentive to dump those products. In addition, injury may be difficult to prove in cases where demand has been rising in relation to supply, as was occurring until the last few months.

Since I wish to address myself primarily to the countervailing duty law today, I will not dwell on details of the antidumping statute, except to point out that Treasury has, over the past year, together with the International Trade Commission, developed a means of taking a new look at dumping findings in those cases in which sales at dumping margins may be continuing, although injury or likelihood of injury no longer appears to exist. In such situations, upon a new application Treasury renews its less than fair value determination and sends the case to the International Trade Commission for a de novo injury inquiry.

Recent amendments to the countervailing duty law

The purpose of the countervailing duty law is to equalize competition between American and foreign manufacturers in order that the latter will not, by reason of governmental or other assists, have a competitive headstart in producing and selling products to American consumers. Written before the economic sophistication associated with the stimulation of exports in today's world, the breadth of this simple statute cuts across a multitude of export assists and subsidies which characterize the present aggressive competition to promote exports, and generally stimulate economic activity.

The terms of the statute are mandatory. Whenever a bounty or grant is found within the meaning of the law, there *shall* be levied and paid a countervailing duty. More importantly, the law demands that, "The Secretary of the Treasury *shall* from time to time ascertain and determine, or estimate, the net amount of each such bounty or grant, and *shall* declare the net amount so determined or estimated." With the new time limits enacted as amendments to the countervailing duty law in the Trade Act of 1974, the mandatory nature of the statute is amplified. Each valid complaint of unfair subsidies brought to the attention of the Treasury must now be published promptly after receipt. A tentative decision on the complaint must now be made 6 months after receipt and a final determination is now required within a 12-month period. If bounties or grants within the meaning of the law are found, appropriate action *must* be taken by the Treasury.

Injury considerations.—Under the law when dutiable merchandise is benefiting from bounties or grants, there is no need to establish a link between the imports of subsidized merchandise and injury incurred by U.S. industry. This feature of the U.S. statute would contravene GATT Article VI, to which the United States is a signatory, because the GATT permits the imposition of countervailing duties *only if* the subsidized imports cause or threaten to cause material injury to a domestic industry. The United States, however, does not have to comply with this GATT article by reason of the "Protocol of Provisional Application," better known as the "Grandfather Clause," which exempts preexisting, inconsistent national legislation from the terms of Article VI. In the Trade Act of 1974, the countervailing duty law was expanded to cover nondutiable as well as dutiable merchandise. With continuing tariff reductions and the implementation of the Generalized System of Preferences for developing countries, more and more of our imports will be entering duty free. With this amendment, the law was revised to require an injury determination (so long as our international obligations require such a finding) before countervailing duties can be imposed on nondutiable merchandise. With this injury requirement, the United States maintains formal compliance with Article VI.

Definition of a bounty or grant.—The very simplicity of the law confounds a strict definition of what constitutes a bounty or grant. One general rule of thumb to judge whether a program is a bounty or grant is to ascertain whether a foreign economic program ordinarily contributes to the promotion of exports. For a more precise delineation, however, one must turn to the body of precedents accumulated over decades of administration of the law. In order to provide an idea of the kind of export assistance programs which have been considered bounties or grants, I shall cite examples of practices that Treasury has either directly countervailed or has been prepared to countervail.

Direct subsidies.—Whenever payment of a bounty is made according to the volume or value of the exported merchandise, a direct subsidy is involved and the countervailing duty is assessed in a like amount. For example, if the equivalent of $1 per ton is paid as a premium by a government upon exportation of a raw material, a countervailing duty will be assessed at $1 per ton.

Multiple exchange rates.—Sometimes a direct subsidy is found in the form of multiple exchange rates. A country will grant an exporter a more favorable exchange rate for dollars received from exports than the exchange rate which is more generally available for commercial transactions. Treasury has determined that favortism of this sort constitutes a bounty or grant.

Tax rebates.—One of the most complex issues in the administration of the law concerns the treatment of direct and indirect taxes. The rebate of direct taxes, e.g., income taxes, has long been recognized as countervailable, and under economic theory and GATT principles the assumption is made that a direct tax is borne by the producer and not the product. Therefore, any rebate or noncollection of a direct tax results in increased income for the exporter.

In contrast, the rebate or noncollection of indirect taxes, i.e., sales taxes, excise taxes, et cetera, which are directly related to and borne by the product have not been considered as countervailable. Under the principle of taxation by destination, which was adopted in GATT at U.S. urging, such a rebate is considered justified since the tax is assumed to be passed forward to the final purchaser. The rebate of such tax on exports would in theory only affect the price of the product, and not the profit of the producer, therefore offering no incentive to export. Furthermore, under this theory, the product is then subject to imposition of indirect taxes in the country of importation, thus equalizing the tax burden on it with that borne by domestic producers.

These theories are no longer accepted by economists with the same universality as was once the case, and I personally can see many reasons why "shifting" may not occur in this way. In addition, two ancient Supreme Court cases state that any rebate of any indirect tax is a bounty or grant. Nevertheless, Treasury precedents and international agreements executed subsequent to these decisions are founded on these principles, subscribed to over a long period of time, and we cannot therefore lightly discard them. Furthermore, the measurement of the actual absorption and passthrough of direct and indirect taxes would be extremely difficult and would be founded on data that would be tentative, and conclusions that would be arbitrary at best. While the latter consideration is of an operational nature and could be surmounted, the former is an issue for courts and/or the Congress to review if present policies are to change.

A major issue in administering present policy is the treatment of indirect taxes which are either overrebated or not directly related to the production or manufacture of the merchandise in question. When a manufacturer receives 10 percent in tax rebates after having paid indirect taxes of 7 percent, for example, this overrebate results in increased income for the seller and is countervailable.

The rebate or noncollection of indirect taxes which are not directly related to the production, manufacture, or export of the merchandise has also been considered countervailable, since the tax is not deemed to be borne by the product. For example, while taxes on the tanning of the leather contained in a pair of exported shoes are obviously directly traceable in the final product, excise taxes on real estate transactions by a manufacturer of the merchandise concerned are not. The process of ascertaining that portion of a tax which is unrelated requires a vast amount of pertinent business data, which may not always be available.

Indirect government assists.—Even when a government provides assistance to domestic producers which is not directly related to exports, a countervailing situation may still exist. The type of program to which I am referring includes development authority grants of free land or subsidized plant construction, labor training payments, preferential loans at reduced rates, government sales of supplies at reduced prices, price support or guarantee systems and accelerated depreciation provisions, not solely applicable to exports. Whether or not those types of subsidies constitute a bounty or grant within the meaning of the countervailing duty law has turned on the proportion of production that the plant is expected to or does in fact export. In the case of Canadian steel-belted tires for instance, a countervailing duty order was issued when it was shown that the plants in question which had received benefits of this nature were designed to export about 80 percent of their output. At the same time, a country which promotes investment in a plant in an undeveloped region with a primary view to production for domestic consumption will probably escape countervailing on these same subsidies if only a small portion of its output is exported. Needless to say, there is a gray area here that must await future decisions for clearer delineation.

One point is often overooked when discussing countervailing duties. The statute specifically includes within its purview bounties or grants bestowed by nongovernmental sources. So, for instance, an association of producers which establishes a fund to encourage exports by making up any losses suffered by members in their export transactions would create a countervailable situation. Other cartellike arrangements in this area have not yet been ruled on by the Treasury Department.

Time limits for determinations.—The Trade Act of 1974 establishes strict time limits for action to be taken under the countervailing duty law. According to the act, the Secretary of the Treasury is required to publish a notice initiating an investigation upon the filing of a petition alleging the payment of bounties or grants and an explanation of this allegation. I do not consider this provision as calling for the automatic initiation of an investigation on the slightest pretense of an allegation. A substantial prima facie case will have to be alleged before the normal course of trade is distracted by a countervailing duty investigation and the Treasury expends a considerable amount of time and energy pursuing the petition. Nevertheless, the new law guarantees that bona fide petitions will be treated expeditiously, with the formal initiation of a full-scale investigation.

The act requires the Treasury to make a preliminary determination within 6 months of a filing of a petition; final action is required within 12 months. By the nature of any time limitations on an investigatory process, these time constraints in the countervailing duty law may present some administrative difficulties in larger or more complex cases. This is especially the case when the inquiry is largely dependent upon factual information within the control of foreign governments. However, we will make preliminary and final actions within the maximum periods allotted even if in some cases investigations cannot be as thorough as we might like, and failure of foreign governments or exporters to provide information may require us to rely more than we might otherwise upon the allegations of the petitioner.

Processing of old petitions.—Under the act and its legislative history, we are required to treat all pending petitions as if received on the day following enactment (that is, January 4, 1975). We have already begun processing these pending cases and on January 15, we published in the Federal Register notices opening 30 investigations. Four other pending investigations had formally been initiated prior to enactment. In all of these cases, preliminary decisions must be made by July 4, 1975, and final determinations by January 4, 1976.

Future of countervailing duty law

Although a beehive of activity presently exists regarding investigations under the countervailing duty law, the law is also in a state of flux. A new round of GATT-sponsored negotiations over both tariff levels and nontariff trade barriers is about to commence. The authority for the U.S. participation in these negotiations is provided by the Trade Act. Among the nontariff distortions to be discussed are subsidies, or bounties, granted to exporters by their home countries. The object of such a discussion will be to better define permissible and nonpermissible subsidy practices in international trade. There is, of course, no assurance that the new negotiations on this subject will be successful. If these talks do result in an international agreement and if Congress is in accord with it, the countervailing duty law may well have to be again amended to bring the United States into conformity.

In the meantime, in order to avoid the difficult problem of countervailing against a country's subsidies while negotiating to determine whether those subsidies are legal, Congress has provided that for 4 years following enactment of the Trade Act countervailing duties need not be imposed, in the discretion of the Secretary of the Treasury, even though there has been a determination that bounties or grants exist. Three tests must be met before the discretionary power may be used:

(1) The exporting country must take steps to reduce or substantially eliminate the adverse effect of the bounty or grant;

(2) Successful nontariff barrier agreements are reasonably likely;

(3) Countervailing in the case under consideration would be likely to seriously jeopardize negotiations.

The Secretary's decision not to impose additional duties may be overridden in either house of Congress by a majority vote within 90 days after the decision is notified to Congress.

During these NTB negotiations, our special trade representative will keep in mind that other countries often achieve import restrictions and trade distortions in a more informal manner than our published and open policies. It reminds me of the old saw about the difference between a doctor and a lawyer—a lawyer publishes his mistakes, while a doctor buries his. This country has a way of publishing those policies which affect international trade, while other countries often bury theirs in bureaucratic confidentiality. Be that as it may, during the very delicate negotiations that are about to begin, we at the Treasury will be there with our scalpels (some have accused us of using pickaxes), in order to administer both the law and the discretionary power not to impose duties as impartially and as expeditiously as possible.

Exhibit 27.—Address by Deputy Assistant Secretary Suchman, March 11, 1975, before the International Trade Committee of the Federal Bar Association, Washington, D.C., on "The U.S. Antidumping Law: After the Trade Reform Act"

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Major revisions in the Trade Reform Act

The Trade Reform Act of 1974 contains some of the most substantial revisions in the antidumping law since its original passage as part of a package of emergency tariff measures in 1921. Certain provisions in the new law alter the focus of the Antidumping Act and make it more applicable to today's economic realities.

Multinational corporations

Multinational or transnational corporations have become an increasing topic of interest in recent years. Among the discussions of the benefits and difficulties created by such large corporate entities arises the problem of whether their size and international relationships permit them to thwart the intention of certain statutes concerning commercial matters. The Senate Finance Committee recognized this potential problem in the antidumping law and added a provision dealing with exports from multinational corporation subsidiaries. The amendment will permit Treasury to uncover and take action against exports of a subsidiary which have been subsidized by a related firm in another country. The present statute does not allow a subsidiary's prices to third markets to be disregarded even though the entire operation has benefited from assists from a related firm which enable it to sell at abnormally low prices.

Sales below cost

Prior to the Trade Act, home market prices had to be used in making price comparisons if the merchandise had been sold to all purchasers at wholesale regardless of whether or not it reflected the cost of production. Thus, if the cost of production of an item were $10 and it was sold in the home market for $5 and for export for $7, no dumping margin would occur. The House Committee on Ways and Means justifiably considered this a loop-hole in the statute. They reasoned that a U.S. industry should not have to compete with a foreign producer operating from a protected home market that was selling to the United States at a price which was below the cost of production.

The Trade Act provisions will permit Treasury to disregard certain sales below cost which, "(1) have been made over an extended period of time and in substantial quantities, and (2) are not at prices which permit recovery of all costs within a reasonable period of time in the normal course of trade. . . ." Disregarding these sales will allow Treasury to compare export prices with realistic commercial prices which reflect production costs in the home market. In the example, the home market price of $5 would be disregarded and $10, the cost of production (constructed value), would be compared with the $7 export price revealing a margin of $3.

Merchandise imported and resold in a changed condition

With the increasing trend of companies importing semifinished goods from related foreign suppliers, a question had arisen as to whether such merchandise which had undergone further processing before being sold in an arm's-length transaction was covered by the Antidumping Act. In its administration and formulation of regulations, Treasury has considered this merchandise subject to the provisions of the law and calculated an import price of the semifinished good by netting out additional processing costs and expenses. This practice has been codified in the Trade Act. The Ways and Means Committee, however, added an important clarification to this provision by stating that, ". . . When a process of manufacture or assembly is performed on the imported merchandise, the resultant product must contain at least a significant amount, by quantity or value, of the imported merchandise . . ." to be subject to scrutiny under the antidumping law.

State-controlled-economy merchandise

Another regulatory practice codified by the Trade Act is the provision dealing with merchandise from a state-controlled-economy country. In the typical investigation, home market prices are used as a standard for fair value. In state-controlled-economy countries, however, the domestic prices are not reflective of market forces and therefore could not permit a proper price comparison. Given this situation, Treasury compares the export price with the price at which similar merchandise is sold for consumption in a non-state-controlled-economy country. Again, with the growth of trade with these countries, the Congress has realized that special account had to be taken of these unusual circumstances in order to provide effective relief to the domestic industry from possible unfair trade practices.

Comparison with merchandise of another manufacturer

Under the old law if manufacturer A did not sell any of its production in the home market, but manufacturer B produced and sold identical merchandise in that market, the export price of A would have been compared with the home market price of B for the calculation of possible dumping margins. Although the theory of dumping, which envisaged a monopolist or oligopolists selling from a protected foreign market, may have rationalized the desirability of such comparisons, in application, absurd conclusions may result with a concomitant inequity. Not only would a firm not know the fair value standard with which it is being compared for investigatory purposes, but if it wished to revise its prices to avoid dumping in the future, it would have no control or knowledge of the other manufacturers' price without running afoul of antitrust laws or gaining access to business confidential pricing data.

The Trade Act eliminates this price comparison practice and permits comparisons to be made with the price of a manufacturer's sales of a comparable product in the home market or for export to third countries, or with the manufacturer's constructed value.

Injury considerations

As indicated earlier, the injury phase of the investigation is performed by the International Trade Commission. Although no substantive revisions have been made in this area in the Trade Act, . . . the Senate Finance Committee Report . . . states that the ". . . Antidumping Act does not proscribe transactions which involve selling an imported product at a price which is not lower than that needed to make the product competitive in the U.S. market, even though the price of the imported product is lower than its home market price. . . ." Thus, it appears that meeting competition, an issue raised in several cases in recent years, should not be considered as injury by the Commission.

Procedural revisions in the Trade Act

Several procedural revisions were contained in the Trade Act which will assist in an efficient administration of the law and increase awareness of the rationale for certain decisions made in antidumping proceedings.

Probably the most significant revision to the antidumping law is that the Treasury Department has been given the authority to refer a complaint to the International Trade Commission at the initiation stage of the proceeding if there is "substantial doubt" that injury to a U.S. industry is present. The Commission will have 30 days to determine whether there is no reasonable indication that an industry in the United States is being or is likely to be injured. If such a determination is rendered, the proceedings will be terminated. This procedure will permit a more efficient administration of the law by excluding superfluous complaints, allowing Treasury and Customs to concentrate their efforts in more worthwhile areas.

Investigatory time limits already present in our regulations have been incorporated in the statute. These time limits require that 30 days after a complaint is received in proper form an initiation of the investigation is required. During that 30-day period, the case may be referred to the International Trade Commission under the circumstances described previously. Six months from the date of initiation a preliminary decision is required, and 3 months later a final decision must be issued. The 6-month investigatory period can be extended an additional 3 months in complex cases, but Treasury must publish the reasons for the extension in the Federal Register. If Treasury has determined that sales are at less than fair value, the International Trade Commission has 3 months to conduct the injury inquiry. Of course, if the Commission's determination is in the affirmative, Treasury is required to publish a finding of dumping implementing the appropriate appraisement procedures.

More detailed determinations, mandatory hearings upon request, and a transcript of the hearings are also required in the new law. The latter two provisions will not necessitate a significant change in current procedures. . . .

The first provision of detailed determinations will be of substantial assistance to practicing attorneys in this field to understand why certain decisions are made in antidumping cases and will build up a body of precedent which may be referred to in future cases. . . .

Finally, a new provision had been adopted codifying the right of domestic industry to have recourse after a negative fair value decision has been issued by the Treasury Department. Although Treasury believes that it conducts a thorough and complete investigation, there is no need to assume that it is infallible in making negative decisions. Treasury, therefore, welcomes the opportunity, when appropriate, for more review of its decisions by the judiciary.

Contemplated regulatory revisions

The Trade Reform Act will necessitate substantial revision to current regulations. In addition to the statutory changes, other amendments are being contemplated which would either be the adoption of new practices or the codification of current administrative practices. I would like to list briefly some of these contemplated changes.

The present section regarding the treatment of confidential information will be revised. A fundamental revision in this area may be that confidential information must be accompanied by a nonconfidential summary of the data or else the confidential information will be disregarded for purposes of the antidumping proceedings.

A reconsideration of the utility and practicality of the regulation concerning reimbursement of special dumping duties is being undertaken. Some of you may be aware that we have already solicited public comments on this provision.

Treasury's revocation policy, which has not been clearly defined in the past, will be published for the first time. Procedures for the revocation of a dumping finding based upon reconsideration of the injury question by the International Trade Commission will be proposed. Also, Treasury's policy of excluding certain firms from antidumping actions will be set forth.

Exhibit 28.—Statement by Assistant Secretary Macdonald, April 23, 1975, before the Subcommittee to Investigate Juvenile Delinquency of the Senate Judiciary Committee, on proposed firearms legislation

Mr. Chairman, I am David R. Macdonald, Assistant Secretary for Enforcement, Operations, and Tariff Affairs, Treasury Department. I am pleased to be here today to discuss with you several legislative proposals which are being considered by the Treasury Department in the area of firearms regulation. Accompanying me are James B. Clawson, Deputy Assistant Secretary for Operations; James J. Featherstone, Deputy Assistant Secretary for Enforcement; Rex D. Davis, Director, Bureau of Alcohol, Tobacco and Firearms; and Marvin J. Dessler, Acting Chief Counsel, Bureau of Alcohol, Tobacco and Firearms.

This committee has undertaken the awesome task of isolating and legislatively addressing itself to one of the most basic and distressing national problems—that of rooting out the causes of juvenile crime. Handgun availability is undoubtedly a factor to be considered in pursuing the solution to this problem. Nevertheless, we believe that any discussion of gun control in the context of a growing problem of juvenile crime and delinquency may imply a simplistic and exclusive cause and effect relationship between the two. There is no doubt, in our opinion, that the easy availability of handguns does contribute to the opportunity to commit violent crimes and thus to the frequency with which they are committed. This may be particularly true in the case of adolescents, as indicated in tables 3 and 4, appended to this statement.

Nevertheless, efforts at gun control legislation may address more of a symptom than a cause of juvenile delinquency. This is not to say that any legislative effort in this area will be fruitless. I wou.d, however, qualify the importance of my testimony on gun control laws before this committee by pointing out that deeper, more basic roots may be found to the thorny tree of violent juvenile crime in a growing lack of confidence in the ability of State and local enforcement agencies to protect the public, and to loss of faith in the ability of the judicial system to bring criminals swiftly and certainly to trial and conviction, particularly in large metropolitan areas. This loss of confidence finds objective support in the low percentage of convictions to arrests, as indicated in table 5, appended to this statement.

This loss of faith leads naturally to a propensity on the part of citizenry to attempt their own protection from criminal elements—hence, a race to arms for self-protection. Even beyond the loss of confidence in our judicial system, there appears to be a deeper cause of anxiety and instability in a large section of our youth which has resulted from a weakening of our social institutions. The decline in stable social institutions historically appears to have gone hand-in-hand with a rise in violence.

Thus, the solutions to difficulties which the Treasury Department has experienced in administering the Gun Control Act of 1968 which I am about to discuss do not purport to present a "cure-all" legislative solution to the Nation's crime problem or to youthful involvement in it. Instead, the proposals represent what the Department tentatively considers to be realistic and administratively feasible responses to some of the more critical facets of the firearms dilemma and which responses should not engender unwarranted and deleterious side effects. These proposals have not been cleared with the Domestic Council or the President,

Generally speaking, it has been the experience of the Treasury Department that the basic precepts embodied in the Gun Control Act of 1968 present a workable format for regulating the sale of firearms in the United States. That is to say, the Federal dealer-licensee concept and its attendant recording provisions and restrictions upon the transfer of firearms have proved to be a viable approach to the firearms problem. Nevertheless, experience has also shown that existing law is inadequate in many respects. More specifically, the Department perceives the following to be the most critical deficiencies:

The absence of sufficient licensing standards to insure that Federal licenses will only be issued to responsible, law-abiding persons who actually intend to conduct a bona fide business;

The absence of controls upon the importation of parts for and the domestic manufacture and assembly of small, lightweight, easily concealable, and inexpensive handguns commonly known as "Saturday Night Specials"; and

The absence of an effective statutory means to prosecute and punish felons and other dangerous persons for the possession and use of firearms.

The legislative history underlying the licensing provisions of the Gun Control Act of 1968 reflects a major congressional concern that licenses would be issued only to responsible, law-abiding persons actually engaged in or intending to engage in business as importers, manufacturers, or dealers in firearms or ammunition. Unfortunately, it has become apparent in recent years that congressional aspirations in this regard have been frustrated by a proliferation of applications from individuals who never intended to engage in a bona fide firearms business, but who merely desire a Federal license in order to obtain firearms or ammunition for their personal use at wholesale prices or to receive firearms in interstate commerce for that purpose. Frequently, such individuals are undercapitalized and lack both the business experience and financial capacity needed to conduct a business. In many instances no business is conducted at all, or a marginal business is carried on which disregards Federal regulations.

Present Federal law requires every applicant for a Federal firearms dealer's license who pays his $10 annual fee to be issued a license within 45 days unless he is under indictment for a felony, convicted of a felony, a fugitive from justice, or a drug user or addict. Consequently, the Bureau of Alcohol, Tobacco and Firearms (ATF) has been compelled to issue literally thousands of licenses to individuals, not all of whom engage in the business of dealing in firearms full time. Under existing law, more than 156,000 individuals or entities are currently licensed to conduct firearms businesses in the United States. Since the passage of the 1968 act, this figure has increased yearly. Of this number, it is estimated that less than 30 percent actually conduct a bona fide firearms business. Due to the sheer magnitude of the number of licensees, it is impossible for ATF to monitor each licensee and it is becoming increasingly difficult to maintain a meaningful and effective compliance program based upon even random or periodic inspections.

Accordingly, the Department proposes a number of interrelated amendments to the Gun Control Act which are designed to tighten existing licensing standards in order to reduce the number of Federal licensees and discourage what might be called "nominal" applications.

First, we propose amending the existing licensing standards by including a provision which would permit the Treasury's Bureau of Alcohol, Tobacco and Firearms to inquire into each applicant's business experience, financial standing, and trade connections in order to determine whether the applicant is likely to commence the proposed business within a reasonable period of time and maintain such business in conformity with Federal law. The proposed provision has been utilized for a number of years in the issuance of liquor permits to persons engaged in liquor businesses under the Federal Alcohol Administration Act. In this regard, the provision has functioned fairly and effectively and has been reasonably construed by the courts. If incorporated into the firearms licensing area, the proposed amendment would be of significant value in weeding out "nominal" or disreputable licensees.

As an additional means of strengthening the licensing standards, we would propose an amendment which would require a finding that the business to be conducted would not be prohibited by any State or local law applicable in the jurisdiction where the applicant's premises is located. This provision would further a major congressional objective in enacting the Gun Control Act which was to provide support to State and local law enforcement officials and would furnish the Department with a specific statutory basis for denying a firearms application where State and local law would prohibit the business sought to be conducted.

A third proposal is to amend the act to create special license categories for ammunition dealers, gunsmiths, and dealers in long guns only. Experience has shown that a large portion of existing licensees (perhaps 20 to 30 percent) are engaged almost exclusively in selling ammunition. In fact, many of these licensees are small "mom and pop" stores which carry ammunition only as a convenience to their customers. Under existing law, separate categories do not exist for these persons and they receive the same dealer's license that is issued to firearms dealers. The establishment of these special licenses would restrict those persons to engaging in their limited activities. Hence, neither a gunsmith nor an ammunition retailer could lawfully sell firearms, and a long gun dealer could not sell handguns, but a firearms dealer would be permitted to sell all firearms, ammunition and to repair firearms. The new licensing structure would facilitate a more efficient and economical assignment of inspection priorities since these "limited" licensees would not require the same scrutiny as would unlimited firearms dealers.

We would also propose that the fee schedule be amended by increasing license fees generally, particularly for (1) firearms dealers handling handguns and (2) pawnbrokers dealing in firearms. Thus, we would raise the handgun firearms dealer's fee to a high multiple of the present $10 paid annually, which would assure that only those seriously interested in pursuing the business would pay it, and we would increase the pawnbroker-gun dealer's license to an amount which basically finances frequent inspections by ATF personnel. With regard to the increase in license fees for pawnbrokers, it should be noted that ATF's Project Identification, which involved the tracing of firearms used in crime in eight major urban areas, reflected that 30 to 35 percent of the handguns used in crime had passed through pawnshops. In order to encourage applicants to apply for a "limited" license, we would establish substantially lower fees for gunsmiths and dealers in ammunition only, and moderate fees for firearms dealers who do not deal in handguns.

We believe that the suggested fee modifications will be reasonable and would not impose an impediment to any applicant who is truly desirous of engaging in a bona fide firearms business. Rather, the increased fees would discourage the filing of license applications by those who would not or should not qualify for licensing. From a fiscal standpoint, the increased fees would, of course, absorb a portion of the Department's costs with respect to processing and investigating license applications.

We also find that there is a need for a greater range of penalties than presently exists with which to deal with firearms dealers who violate the laws. In this connection, we believe that ATF should have authority to suspend firearms licenses and accept monetary offers in compromise for such violations. Under existing law, licenses are subject to revocation if the holder has violated any provision of law or regulation. The only alternative to administrative revocation, however, is the criminal prosecution of the licensee for violations that frequently are only inadvertent. While any violation of the gun control laws may be deemed to be serious, some are less serious than others and do not warrant the institution of criminal or revocation proceedings. Even inadvertent violations, however, may warrant administrative action less severe than license revocation.

The "suspension" and "offer in compromise" authority would afford ATF a more flexible vehicle with which to equitably insure compliance. Ample precedent exists for the granting of suspension and compromise authority under other laws administered by the Treasury Department, including laws relating to regulation of distilled spirits and tobacco industries. This authority would appear to be equally appropriate in the area of firearms regulation.

Turning now to the matter of handguns, the problems engendered by the proliferation of handguns in American cities has become self-evident and requires no real elaboration at this point. Suffice it to say that recent estimates place the number of handguns in America at about 40 million while deaths by handguns have increased almost 50 percent in the last decade. Accordingly, the Department's proposals embrace a number of provisions which are directly at the handgun problem generally and more specifically at the proliferation of low-quality, inexpensive handguns known as "Saturday Night Specials."

In recent years the Department has carefully evaluated a number of legislative proposals which have had as their principal objective the eventual removal of the Saturday Night Special from the American scene. Although the various proposals have taken a wide range of approaches, all of the proposals are premised upon the fact that these small, lightweight, easily concealable, and inexpensive handguns present a unique danger to the American public.

Thus far, one of the difficulties encountered in these legislative attempts to address the Saturday Night Special problem has centered around the formulation of adequate criteria to define that term. Obviously, effective proscriptions cannot be implemented against such firearms unless the law also defines with precision what weapons are to be affected. In this regard, we propose that the so-called "factoring criteria" utilized under the Gun Control Act of 1968 for determining the eligibility of handguns for importation under the "sporting purpose" test be adopted, with certain modifications, for use in the Saturday Night Special area.

Thus, we would propose that it be made unlawful for any licensed manufacturer or licensed importer to manufacture, assemble, or import for purposes of sale in the United States any handgun that has not been approved pursuant to detailed specification criteria which would be set forth in the statute. Prescribing the criteria by statute would negate the objection that mutable standards determined by administrative officials govern the trade in handguns. Under such criteria, the key characteristic would be overall size: No handgun failing to meet certain minimum size standards would be acceptable for manufacture, assembly, or importation. In the case of revolvers, a barrel length of greater than 3 inches would be mandatory.

In addition, various safety features would also be required before a weapon would be acceptable. Other characteristics would be dealt with by means of a point system which would take into account such characteristics as size, frame construction, weight, caliber, safety features, and miscellaneous equipment. In addition to the prerequisites of size and safety features, a pistol and a revolver to be approved for manufacture, assembly, or importation must achieve a minimum point value (85 points in the case of a pistol and 60 points in the case of a revolver).

Although the Department's proposal adopts the same fundamental approach as the existing "factoring system," the existing system has been modified somewhat by increasing the point value which must be met before a handgun is acceptable. A wider variety of characteristics are provided, however, under which a particular handgun model can achieve points. It is believed that the revised point system is more objective and provides greater flexibility to allow quality handguns to meet the criteria for approval, while at the same time eliminating the same lightweight, easily concealable, cheap handguns which have no legitimate sporting purpose. Exceptions would be provided for sales to law enforcement agencies. Modification of handguns which causes them to lose their qualification would be prohibited.

Further, our proposal would include provisions for the notification of licensed importers and manufacturers of the results of handgun evaluations and would afford judicial review of adverse decisions by ATF. In order to provide an identical test to cover both foreign and domestic handguns, we would recommend that the import provisions of the 1968 act be amended to substitute the detailed criteria I have described for the general language of the "sporting purpose" test for importation.

Our proposals dealing with the so-called Saturday Night Special are directed primarily at licensed importers and licensed manufacturers and would, therefore, strike at the source of the problem. While these proposals would not rid the Nation of these firearms, they would effectively stop the yearly flood of cheap handguns into the domestic marketplace. In this connection, recent ATF studies disclose that handguns recently acquired are those largely used in the commission of violent crimes. Moreover, given also increased controls over interstate dealings in handguns, our proposal to remove the supply source of Saturday Night Specials could place the problem where it may be adequately further regulated by State governments as they see fit.

As the Gun Control Act now stands, second or subsequent offenders who are convicted of the offenses of carrying unlawfully or using a firearm in the commission of a Federal crime are subject to a mandatory minimum of 2 years' imprisonment and a maximum of 25 years' imprisonment. We believe that the act should be modified so that a mandatory sentencing provision would be applicable to first offenders as well as to recidivists. That is to say, we would propose for first offenders a mandatory minimum sentence of 1 year, with a discretionary 5-year maximum. The new penalty proposal would not be so harsh as to be counterproductive in terms of acceptability by courts and juries, but would serve as a more formidable deterrent to the misuse of firearms.

Finally, we propose new legislation which would prohibit felons and other classes of dangerous persons from possessing firearms. While existing law, enacted as title VII of the Omnibus Crime Control and Safe Streets Act of 1968, was intended by the Congress to proscribe mere possession, receipt, and transportation of firearms by such persons, this law was construed by the Supreme Court on December 20, 1971, in a 5-to-2 decision in *United States* v. *Bass* to require proof of an interstate commerce nexus with respect to these offenses. More specifically, it was held that the statutory language "in commerce or affecting commerce" modified each offense defined by the statute. In deciding the *Bass* case as it did, the Supreme Court rejected the Government's position that mere possession constitutes a crime under title VII, a position which was upheld by five of the six U.S. Courts of Appeals that had ruled on this issue.

A review of the legislative history of the existing staute convincingly demonstrates that the true intent of Congress to prohibit mere possession of firearms by certain classes of people deemed too dangerous to society to own them. This intent, however, was thwarted by the use of inartful statutory language which led to the narrow construction by a majority of the Court. Under the doctrine of *United States* v. *Perez*, 402 U.S. 146, moreover, we believe that a valid finding can be made by Congress that the possession of weapons by such persons itself poses a threat to interstate commerce, and thus that a commerce nexus need not be proved as to each violation. Accordingly, the Department would propose to delete the troublesome language from the statute. If amended in this manner, these laws could be enforced as Congress originally intended.

Additionally, we propose to repeal existing title VII and place the substance of its provisions, together with needed corrective amendments, within chapter 44 of title 18, United States Code (title I of the Gun Control Act of 1968). This chapter, of course, contains all other provisions of Federal law relative to the shipment, transportation, and receipt of firearms by felons and other proscribed categories of persons. It should also be noted that title VII was a floor amendment to the Omnibus Crime Control and Safe Streets Act, and it is obvious that less than normal consideration was given to conforming it to title IV of the act, the predecessor to chapter 44. As a result, the categories of persons who are prohibited by chapter 44 from shipping, transporting, or receiving firearms in interstate commerce and to whom Federal firearms licensees may not lawfully sell firearms are not in conformity with the proscribed categories of persons under title VII. Therefore, we propose to make these categories more closely conform.

Our proposals, Mr. Chairman, are addressed primarily to the question of interstate traffic in firearms and particularly handguns. We would like to preserve local control over gun regulation. Our studies have convinced us, however, that an interstate traffic exists with respect to guns used in crimes which deserves more Federal attention than it has received. We believe that the proposals in the area of dealer licensing are somewhat analogous to the regulation of brokers and dealers in investment securities under the Securities and Exchange Act of 1934. What we are attempting to do is place ATF in a position to control the "boiler-shops" in the handgun field and provide the necessary support to enable local law enforcement agencies to be effective instead of becoming engulfed in an uncontrollable interstate handgun traffic.

We also believe that these legislative proposals are acceptable to a majority of the people in this country. With the polarized state of public opinion on the subject of gun control, it is doubly important to structure laws regulating human endeavor in such a manner that the incentive to comply with the law is maximized and its enforceability is enhanced by its acceptance. A drastic extension of regulations in this area we believe can pose a real danger of creating substantial illicit traffic in handguns controlled by organized crime groups, unless the underpinnings of public acceptance accompany the regulations sought.

We appreciate your having provided us with an opportunity to appear here today and to present our views on the subject of firearms control. At this point, my associates and I would be glad to attempt to answer any questions which the subcommittee may have.

TABLE 1.—*Index of violent crime, United States, 1960–1973*

Year	Number of offenses				
	Violent crimes	Murder	Forcible rape	Robbery	Aggravated assault
1973	869,470	19,510	51,000	382,680	416,270
1972	828,820	18,550	46,480	374,790	389,000
1971	810,680	17,670	41,940	386,150	364,920
1970	733,530	15,890	37,690	348,460	331,480
1969	657,050	14,670	36,880	297,650	307,850
1968	590,640	13,720	31,410	261,780	283,720
1967	496,150	12,160	27,410	202,100	254,490
1966	426,830	10,970	25,620	157,350	232,890
1965	384,340	9,900	23,230	138,130	213,090
1964	361,350	9,300	21,250	129,860	200,940
1963	314,490	8,580	17,510	116,000	172,400
1962	299,150	8,480	17,410	110,410	162,850
1961	287,120	8,680	17,080	106,240	155,130
1960	286,220	9,050	17,050	107,410	152,720
Percent of change 1960–1973	+203.8	+115.6	+199.2	+256.3	+172.6

TABLE 2.—*Index of violent crime, United States, 1960–1973*

Year	Rate per 100,000 inhabitants				
	Violent crimes	Murder	Forcible rape	Robbery	Aggravated assault
1973	414.3	9.3	24.3	182.4	198.4
1972	398.0	8.9	22.3	180.0	186.8
1971	393.0	8.6	20.3	187.2	176.9
1970	361.0	7.8	18.6	171.5	163.1
1969	325.4	7.3	18.3	147.4	152.5
1968	295.5	6.9	15.7	131.0	142.0
1967	250.8	6.1	13.9	102.1	128.6
1966	218.2	5.6	13.1	80.4	119.1
1965	198.3	5.1	12.0	71.3	109.9
1964	188.9	4.9	11.1	67.9	105.0
1963	166.8	4.5	9.3	61.5	91.4
1962	161.0	4.6	9.4	59.4	87.6
1961	156.9	4.7	9.3	58.1	84.8
1960	159.6	5.0	9.5	59.9	85.2
Percent of change 1960–1973	+159.6	+86.0	+155.8	+204.5	+132.9

TABLE 3.—*Total arrest trends, 1960–73, violent crimes*

	Total all ages			Under 18 years of age			18 years of age and over		
	1960	1973	Percent change	1960	1973	Percent change	1960	1973	Percent change
Total all crimes	3,242,574	4,381,968	+35.1	466,174	1,138,046	+144.1	2,776,400	3,243,922	+16.8
Total violent crimes	92,997	215,540	+131.8	15,180	52,592	+246.5	77,817	162,948	+109.4
Criminal homicide:									
Murder and nonnegligent manslaughter	4,541	10,629	+134.1	337	1,197	+255.2	4,204	9,432	+124.4
Manslaughter by negligence	1,766	1,660	−6.0	132	216	+63.6	1,634	1,444	−11.6
Forcible rape	6,857	13,823	+101.6	1,185	2,753	+132.3	5,672	11,070	+95.2
Robbery	31,197	83,012	+166.1	7,352	29,336	+299.0	23,845	53,676	+125.1
Aggravated assault	50,402	108,076	+114.4	6,306	19,306	+206.2	44,096	88,770	+101.3

TABLE 4.—*Total arrest trends, 1972–73, violent crimes*

	Total all ages			Under 18 years of age			18 years of age and over		
	1972	1973	Percent change	1972	1973	Percent change	1972	1973	Percent change
Total all crimes	5,950,936	6,158,514	+3.5	1,555,288	1,630,722	+4.9	4,395,648	4,527,792	+3.0
Total violent crimes	255,504	277,116	+8.5	18,334	19,519	+6.5	58,182	63,698	+9.5
Criminal homicide:									
Murder and nonnegligent manslaughter	12,792	13,837	+8.2	1,382	1,442	+4.3	11,410	12,395	+8.6
Manslaughter by negligence	2,760	2,793	+1.2	250	327	+30.8	2,510	2,466	−1.8
Forcible rape	16,412	18,387	+12.0	3,202	3,632	+13.4	13,210	14,755	+11.7
Robbery	94,733	98,869	+4.4	30,227	33,712	+11.5	64,506	65,157	+1.0
Aggravated assault	131,567	146,023	+11.0	23,371	24,912	+6.6	108,196	121,111	+11.9

TABLE 5.—*Disposition of persons charged by the police, 1973*

Offense	Number of persons charged (held for prosecution)	Percent of charged			
		Guilty		Acquitted or dismissed	Referred juvenile court
		Offense charged	Lesser offense		
Total	2,141,347	58.8	4.9	17.9	18.3
Criminal homicide:					
Murder and nonnegligent manslaughter	3,234	39.7	19.9	29.1	11.3
Manslaughter by negligence	885	36.2	9.3	44.7	9.8
Forcible rape	4,657	28.5	13.0	36.3	22.2
Robbery	23,075	29.6	9.9	25.3	35.1
Aggravated assault	38,756	33.6	13.6	35.9	16.9

Tax Policy

Exhibit 29.—Statement of Secretary Simon, January 22, 1975, before the House Ways and Means Committee, on the administration's tax proposals and their impact on the economy

It is a privilege to appear before this committee as you begin the work of the 94th Congress. During the next 2 years, you will be considering many of the most significant issues facing the United States. There will be times when we will differ on those issues, but as in the last Congress, I want to work with you as closely as possible to ensure that those who are served best are those whom we all serve, the people of this country. Toward that end, I pledge to this committee the full cooperation of my office and of all who work at the Treasury Department.

President Ford, after considerable study and consultation, has proposed to the Congress an integrated and comprehensive program in both the economic and energy fields. In my view, the President's program represents the best means of dealing with those problems. In working with you, my first objective will be to obtain swift passage of legislation that is necessary to carry out our program.

The occasion for my appearance this week is to discuss two items: First, the President's tax proposals and their impact on the economy; and secondly, the need to raise the Federal debt limit. With the consent of the committee, I propose to discuss the first of these items today and to address the second tomorrow.

The President's program is designed to deal with three basic and urgent problems:

Inflation;
Recession; and
Energy independence.

These problems are difficult and complex, and their solutions will also be difficult and complex. To some extent, the remedies work at cross-purposes with each other. The answers are neither black nor white, but matters of balance and judgment.

Some say we can't solve all these problems, at least not all at the same time. I believe we can. The President believes we can, and has charted the course to do it. Indeed, we have no other choice, for the penalty for inaction could be frightening. We will ultimately be held responsible for the results, no matter what the pollsters say today about our approach.

The proposal for a temporary tax reduction to stimulate the economy has the very highest priority and we urge that you enact it immediately, even if that means separating it from the other elements of the President's proposals. However, all of the elements in the proposal are interrelated and, therefore, I need to deal with them all here today.

Inflation

Inflation, like interest, tends to compound. It reached an annual rate of more than 12 percent in 1974, the highest level in peacetime history. The damage has been extensive. The lifetime savings of many have shriveled in real terms. Interest rates have risen to alltime highs, with adverse effects on the livelihoods of millions, on the opportunity for families to own their own homes, and on the ability of others to start or stay in business. The uncertainties created by inflation undermined the confidence of both consumers and investors, with consequent damage to jobs and to the new investment and increased productivity which are required to stem inflation. I do not believe that our economic system, as we know it, could long survive such a trend. In 1919, J. M. Keynes wrote:

> There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose.

I'm told that statement was a followup by Keynes on a similar remark of Lenin, to the effect that inflation could destroy capitalism.

Inflation is popularly said to be caused by "too much money chasing too few goods." That is an oversimplification, but it captures the essential truth.

There have been many causes for this inflation, but, in my opinion, the biggest single factor has been a prolonged period of large Government deficits, including the off-budget lending and loan-guarantee programs.

The momentous growth in Federal expenditures and Federal deficits has been truly startling. It took 186 years for the Federal budget to reach $100 billion, a line it crossed in 1962, but then only 9 more years to reach $200 billion, and only 4 more years to break the $300 billion barrier. Revenues, of course, have not kept up with expenditures, so that when we close the books on fiscal year 1975, we will have had budget deficits in 14 of the last 15 years—and the accumulated debt for that period alone will exceed $130 billion.

There can be no doubt about the inflationary impact of such huge deficits. They added enormously to aggregate demand for goods and services and were thus directly responsible for upward pressures on the price level. Heavy borrowing by the Federal Government has also been an important contributing factor to the persistent rise in interest rates and to the strains that have developed in money and capital markets—a subject I will address in more detail tomorrow. Worse still, continuation of budget deficits has tended to undermine the confidence of the public in the capacity of our Government to deal with inflation. In short, when the Federal budget runs a deficit year after year, especially during periods of high economic activity such as the ones we have enjoyed over the past decade, it becomes a major source of economic and financial instability.

When the Government runs a deficit—when it spends more than it receives—it must borrow to make up the difference. Under our modern monetary system, that kind of borrowing almost always results, sooner or later, in the creation of too much money. It seldom results in the commensurate creation of additional goods and services.

Government borrowing does not necessarily require the immediate creation of too much money, for the Government can borrow existing money in the private capital markets. To that extent, it competes with private demands for capital, preempts funds that would otherwise be used for private investment, and, in a period of strong private demand, causes interest rates to rise.

If Government borrowing in the private capital market grows so large that it threatens to dry up credit for private borrowers or causes abrupt changes in interest rates, the Federal Reserve customarily steps into the market and purchases Government bonds for its own account. The Federal Reserve pays for that purchase not with money already in the system, but by setting up a new credit balance on its books. That almost immediately causes the total money supply to increase by several times the amount of the credit. In this way, the financing of large deficits causes the money supply to increase substantially, which creates more inflation. This has been a major part of the inflation explosion over the past decade.

In times of recession, private borrowing typically slackens as businessmen have fewer needs for credit. If additional Government deficits simply take up that slack, it does not jeopardize the needs of the private sector and does not drive up interest rates. In the current recession, however, there may be less slackening in private demands than usual because of the high debt-equity ratios that have become typical, the general illiquidity of business, the inability of corporations to raise capital in the equity markets, and the necessity to finance inventories and capital goods at inflated prices.

If we cannot finance the deficit within the recession-induced slack in the capital markets, then we shall have a credit "shortage" that will drive up interest rates significantly. The Federal Reserve could prevent that only by significantly increasing the supply of money. As we assess that situation, we must remember, too, that what appears to be slack at the moment may disappear as business bounces back and its demand for credit returns to normal. When the recession is over and goods and services have returned to their original prerecession levels, if the money supply has been significantly increased, we shall have created additional inflation.

There is no way to escape the basic dilemma presented by large Government deficits. On the one hand, if the deficits cause a significant increase in the money supply, we shall have further inflation. On the other hand, if deficits are not permitted to increase the money supply, we must be prepared to endure tight credit and high interest rates.

This is a very difficult circle to break. The only solution is to take a long-term view and resist the temptation to deal with each painful aspect of the cure as a crisis to be solved by short-term remedies, i.e., by more deficits.

A most important tool in beating inflation is increased productivity. We need to encourage and facilitate conduct that will increase the supply of goods and services, so that the increased money supply that will surely flow from these deficits will be chasing an amount of goods and services that has also increased. Just getting back to prerecession levels of goods and services is obviously not enough.

Recession

We are presently in a full-fledged recession. It is in substantial part attributable to our inflationary excesses. It is the hangover that follows the revelry.

One of the major factors in the current recession is the decline in the housing industry, which is a key component in our economy. The housing industry is especially vulnerable to high interest rates, and was thus hard hit when inflation caused interest rates to rise to alltime highs. Thus, so far as housing goes, it is inflation itself which caused the recession. We cannot expect the housing industry to regain its full health until we get inflation under better control.

It is tempting to believe that housing can be helped by driving down interest rates through a more rapid increase in the supply of money. That does not work in an inflationary climate, however, because the increase in the money supply further increases inflationary expectations, sometimes with a lag and sometimes almost immediately, and thereby sends interest rates not lower, but higher. Thus, housing is hurt, rather than helped, by such policies.

In the same way, inflation was a major factor—perhaps the major factor—in demolishing consumer confidence. Polls taken by the Survey Research Center at the University of Michigan show that the precipitous decline in consumer confidence began when prices started hitting new peaks—well before the effects of the recession were clearly felt. While the recession has driven confidence even lower, it was inflation that pushed it over the brink. This loss of consumer confidence has caused the biggest drop in consumer purchases since the Second World War and is a significant part of the current recession.

Some part of the recession is also attributable to the program to bring inflation under control. When we embarked on that program, we knew that it would dampen economic activity, for that is an inevitable side effect of the process of slowing inflation. The principal tool in winding down inflation has been a policy of monetary restraint, which was in effect most of last year. If the money supply had been permitted to increase fast enough to accommodate all of the price increases we were experiencing, the additional money would have caused the prices to spiral even faster. Thus, it was necessary to slow down the rate of growth in the money supply. Whenever that is done, some are caught in the crunch.

Those are the hard trade-offs. Inflation causes dislocations. And stopping inflation causes additional dislocations. Dislocations cause the economy to fall off.

To cure our economic problems, we will have to administer the medicine continuously over a period of years. We are a long way from full recovery. And we have to watch the patient carefully all the while, because the side effects of the medicine are strong and we may need to adjust the prescription from time to time.

Our goal must be to keep a balance. We want to do as much as we can to stop inflation without unduly hampering economic activity. At the same time, we all recognize today that recession has become a much more serious problem. causing widespread hardships and unemployment. Moreover, it has developed more rapidly and has been steeper than anyone expected. It is apparent that under these circumstances we must shift the balance of our policies more heavily in the direction of fighting the recession. The President's recommendations for a temporary tax cut are designed to ensure that the recovery we expect in the middle months of the year is sharper and stronger than would otherwise be the case.

We can and must have recovery from the current recession, but we must do that in a way that does not lead to an overheating of the economy again. We will lose the opportunity to achieve stable economic growth if we switch to excessively stimulative policies. That has been the repetitive pattern over the past decade. Every time the economy showed signs of hesitation, there was a pronounced shift to stimulative monetary and fiscal policies.

One of the best examples occurred only a short time ago. After a rapid acceleration in the rate of inflation during the late 1960's, a program of fiscal and monetary restraint was started in 1969. As a result, inflation peaked out at 6 percent and then declined slowly to about 3½ percent by 1972. The upward momentum of inflation had been stopped. But then, instead of maintaining the policies of moderation, we became more expansive again and we very swiftly propelled ourselves into the inflation that we are experiencing today.

The result of such stop-and-go policies is that we have pushed the inflation rate up onto higher and higher plateaus. In 1966, the peak inflation rate was about 4 percent; in 1970, it was about 6 percent; and now prices are rising at about a 12-percent rate. The same process ratchetted interest rates higher and higher. In 1966, rates on long corporate bonds peaked at a little over 6 percent; in 1970, they reached almost 10 percent; and this past year, the high was 12 percent.

Energy independence

Energy independence is both a political and an economic problem for the United States.

Oil is an extremely important and pervasive commodity in our economy. In recent years, our consumption has risen rapidly but our production has declined. We are now dependent on foreign sources for nearly 40 percent of our needs Major foreign suppliers have organized a cartel and, at least at present, have the power to bring about political and economic spasms of the kind which we have recently experienced. In the last year and half, the Arab embargo created major disruptions throughout our economy, and the quadrupling of foreign oil prices has contributed significantly to both the inflation and the recession we are now experiencing.

Our economic system is strong and resilient and can undoubtedly survive almost any unfortunate development that is likely to occur in the near future with respect to oil. But many other nations are less fortunate, and our own economy is so interconnected with that of other nations that their problems are in substantial degree our problems. Trouble in one or more national economies abroad could have very serious effects on our own.

If we are to retain control over our own economic destinies, we must achieve independence. We can do it. And when it is clear that we intend to do it, we will regain a great deal of control over the situation. We will control very little from our knees.

The President's energy program is therefore designed primarily to reduce our dependence on imported oil. In order to do that, we will need to develop alternatives for oil and we will also need to reduce our total demands for energy of all kinds.

We are dealing with a long-term program. We believe we can achieve virtual independence in 10 years, but only if we start promptly, work hard and continuously, and make significant reductions in our demands for energy.

Rationing is one way of curbing demand and a number of national leaders have proposed it. Public polls also show a surprising amount of support for rationing. I cannot imagine, however, that the American public will really want it once they think it through or would live with it if they got it. Remember that we are talking about a permanent program. If we should opt to travel the rationing route, we will not get rid of it. If we were to let it go we would—overnight—be again non-self-sufficient.

We could perhaps live with rationing in a period of temporary emergency. But as a way of life, I suggest it is fundamentally inconsistent with our system and with the spirit of the American public.

Even in times of emergency, rationing has never worked fairly or efficiently. To cut a million barrels a day from our consumption by rationing only gasoline for private households, we would have to hold drivers to an average of less than 9 gallons per week—a reduction of about 25 percent from today. To reach the 1977 goal of a 2 million barrels a day reduction would require a second 25-percent reduction. Some persons would obviously need more, which means that the basic ration for ordinary persons would have to be even less. But gasoline accounts for only part of each barrel of oil, and we would clearly need to ration the remaining products, too—fuel oil, jet fuel, diesel fuel, refinery products going into petrochemicals, et cetera. Who would decide which persons needed more and which needed less of each of these things? Every family, every car and motorbike, every store, school, church, every manufacturer—everything and everybody—would have to obtain a permit for a certain quantity of gasoline, electricity, natural gas, et cetera. Those allocations would have to be changed every time someone was born or died or moved or got married or divorced, and every time a business was started, merged, sold out or bought another, or the church or school added on a new room. And some Government official would have to approve it.

What would the rationing bureaucracy do about such cases as:

- The low-income worker who owns an old car that gets only 9 miles per gallon but can't afford to trade it in? His affluent neighbor who buys a new car that gets 22 miles per gallon?
- The low-income family that heats with oil a small but poorly insulated house, while their wealthy neighbor heats a large, well-insulated house with gas?
- The Montana rancher who drives nearly 600 miles per month and the Manhattan apartment dweller who drives less than 100 miles?
- The family that has to move from New York to California and use up several months' coupons in making the trip? One out of every five families moves every year.
- The family with sick members? The family that does turn off the heat in empty rooms and the family that does not? The family with few children and many rooms to heat and the family with many children but few rooms?
- The migrant worker who drives large distances every year but can't afford a more economical car?
- The shortages that would inevitably develop in areas where the coupons happen not to match the gasoline supplies?
- The gas stations, with limited quantities to sell, that maintain only limited services and are always closed on evenings and weekends?
- The collusion, counterfeiting, and illegal activities that would inevitably develop?

Last year, when we considered the feasibility of rationing gasoline, we concluded that while it could be implemented, it would take 4 to 6 months to set up, employ about 15,000 to 20,000 full-time people, incur $2 billion in Federal costs, use 40,000 post offices for distribution, and require 3,000 State and local boards to handle exceptions. When we consider the problems of just getting the mail delivered, are we really ready to trust an army of civil servants—however able and well intentioned—to decide who deserves just what of this basic commodity?

People should ask themselves which they prefer: the suggested increase in prices, or a system in which someone else could tell them now and for the indefinite future where and when they might drive or how warm they might keep which rooms.

Does anyone honestly believe that the American public is willing to trade these basic freedoms—in perpetuity—for 10 cents a gallon?

The President has proposed instead that we reduce consumption of oil by the most neutral and least bureaucratic system available—through the price system. The energy proposals would raise the price of oil. At the same time, income tax cuts would increase the disposable incomes of every household. Taxpayers could, if they wish, continue to purchase more expensive oil and oil products. And they would have extra money to do it with. The question they would face is whether they wish to spend that extra money for more expensive oil or whether they wish to use it for some other purpose. A great many will choose to use it for other purposes. That is particularly true of businesses, which alertly switch to alternative products when a price advantage appears. The economic data available, updated by the experience of the last year, indicate that a tax of 10 cents a gallon spread across all the products manufactured from a barrel of crude oil will reduce consumption enough to meet our goals.

There has been a great deal of talk about the public being willing to make sacrifices. I believe they are. But for the average consumer this program should involve little sacrifice. For most, it would not even involve inconvenience or extra expense. The average consumer would be faced with higher oil prices, but he would also have additional money that would fully compensate him. He would retain total freedom of choice.

I realize that it is not immediately apparent to the average citizen how this program as a whole would reduce consumption and yet cost him little or nothing. Education is essential and I am counting heavily on the objectivity and expertise of this committee and its able staff to achieve it.

The need for business tax relief

The proposed program provides tax relief for both individuals and business. Individual income taxes account for about three times as much revenue as corporate income taxes, and relief would be allotted in that same 3-to-1 ratio.

Businesses, like people, have been badly buffeted by our economic difficulties. Many are in precarious financial situations. One need only look at the unemployment rolls in Detroit to see how important it is to all of us to maintain a healthy climate for business. Surely, the misfortunes of the auto industry have created many more hardships for auto workers than for auto stockholders. We will all be losers if our businesses are unable to earn reasonable profits and thus to make the investments that will mean more jobs and greater productivity in the future.

The suggestion in recent years that businesses have prospered while individuals have suffered is simply untrue. Corporate profits in the aggregate, realistically stated, are at an alltime low as a percentage of our total national income.

Reported profits may be higher than in the past, but they do not tell the full story. There are two major elements which substantially overstate reported earnings in periods of inflation. They are inventories and depreciation.

The inventory situation may be illustrated by assuming a company that normally maintains an inventory of 100,000 widgets. If inflation causes the price of widgets to increase by $1, from $2 to $3, under traditional FIFO (first in, first out) accounting the $100,000 increase in the value of the inventories is reported as profits, even though the company is no better off in real terms than it was before the inflation. Economists have long recognized that this increase is not a true "profit" and the Department of Commerce national income accounts have, from the inception of those accounts in the 1940's, separated it from profit figures.

For 30 years, business taxpayers have been permitted to exclude these amounts from taxable income, but only if they reported on the same basis to their shareholders and the public. Many businesses have preferred to pay higher taxes rather than report lesser earnings to their shareholders. With the rapid inflation which has occurred in the last year, however, the penalty in increased taxes on unreal income has become so great that there has been a major shift to LIFO (last in. first out) accounting. This is long overdue and I regret that it has taken the business world and the accounting profession so long to get there.

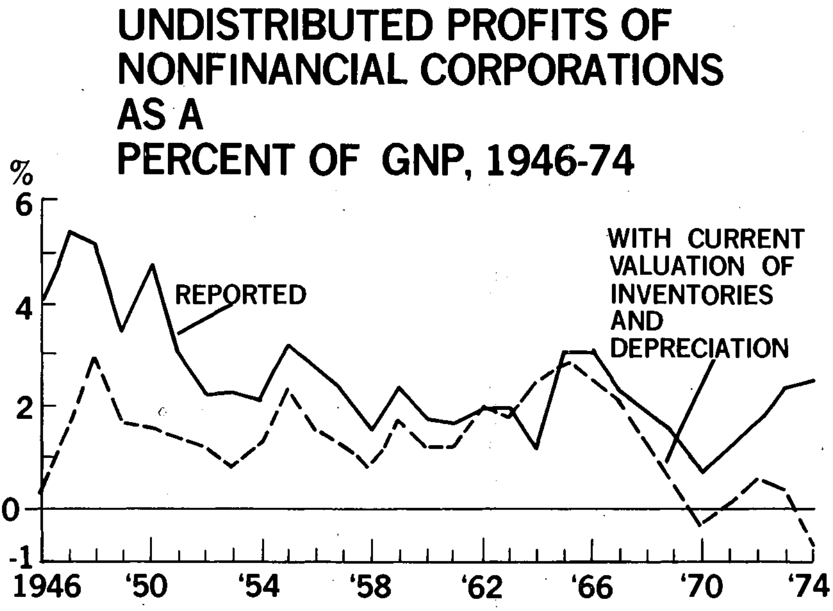
A similar situation exists with respect to depreciation. In a period of rapid inflation, depreciation deductions based on historical cost result in reporting as income amounts which do not represent an increase in wealth but which are required merely to stay even. In a period of constant and substantial inflation, this subject urgently needs reexamination. Under current tax and accounting rules, business management is powerless to deal effectively with this problem. Businessmen often complain that depreciation charges are too low for tax purposes because of this factor but their credibility is severely impaired by the fact that, more often than not, they report to their shareholders and the public less depreciation (and therefore more income) than that which they are permitted to deduct for tax purposes.

In fairness, I must note that the inventory and depreciation problems are more complex than meets the eye and raise further arguments about whether other items, too, should be adjusted.

Nonetheless, the effects of the inventory and depreciation adjustments by themselves produce dramatic overstatement of real income: Nonfinancial corporations reported profits after taxes in 1974 of $65.5 billion as compared to $38.2 billion in 1965, an apparent 71-percent increase. But when depreciation is calculated on a basis that provides a more realistic accounting for the current value of the capital used in production and when the effect of inflation on inventory values is eliminated, after-tax profits actually declined by 50 percent, from $37.0 billion in 1965 to $20.6 billion in 1974. A major factor contributing to this decline is that income taxes were payable on these fictitious elements of profits. That resulted in a rise in the effective tax rate on true profits from about 43 percent in 1965 to 69 percent in 1974. Thus, a realistic calculation shows that the sharp rise in reported profits was an optical illusion caused by inflation.

Since, in our economy, corporate profits are the major source of funds for new investment in productive capacity, all of this has grave implications for investment and growth. That is perhaps seen best in the figures for undistributed profits of nonfinancial corporations, restated on the same basis to account realistically for inventories and depreciation. It is the undistributed profits that corporations have left to fund additional *new* capacity (as distinguished from the replacement of existing capacity). In 1965, there were $20 billion of undistributed profits. By 1973—after 8 years in which real GNP (the rest of the economy) grew 36 percent—the undistributed profits of nonfinancial corporations had dropped to $6 billion. And for 1974, our preliminary estimate is that the figure for undistributed profits is a minus of nearly $10 billion. That means that there was not nearly enough even to replace existing capacity, and nothing to finance investment in additional new capacity.

The following chart shows with dramatic—and frightening—clarity the true state of affairs.



The business community is properly distressed that the public does not realize the seriousness of this situation. I have to say, however, that at least a portion of the blame can be laid at the door of business itself. Businesses like to report high earnings to their shareholders and to the public. Reported earnings are the "report card" for management. The willingness of business to continue using methods which overstate real economic incomes in an inflationary period leads the public to believe that business is a major beneficiary of rising prices. That causes the man in the street to believe that the total income pie is larger and that he has a legitimate claim on it, which, in turn, heightens the wage spiral and intensifies the squeeze on corporate profits and the difficulty of capital formation.

The fact that these overstated profits are also subject to tax presents a serious problem that we hope you will look into when you turn to tax reform later this year. The problem is too complex to deal with quickly, but it may affect the ultimate use of the revenues allotted to business relief.

While the deterioration of business profits may not be apparent to the man in the street, or even in the stockholders' reports, the professionals have not been fooled. The devastating effect of inflation on business profits has been reflected in sharp price drops in the equity markets. This decline in the stock market has rendered it practically impossible for most companies to raise money on favorable terms in the equity markets. As a result, corporations have been forced to rely more heavily on borrowed money, thus raising their debt-equity ratios to unusually high levels and driving up interest rates. Such interest rates become a major depressant on corporate earnings. Equally important, the lessening of the equity "cushion" leaves businesses inflexible and very vulnerable to bankruptcies in a business downturn.

The oil and environmental problems have been a further and major exacerbation. The past year's increase in the cost of petroleum products has rendered many business operations substantially less profitable, if not unprofitable. The airline, auto, travel, and electric utility industries—which are all closely related to oil usage—were hard hit. Increased oil prices have caused lower profits, lesser incomes, and fewer jobs in many businesses—which, stated another way, means that businesses were not able to pass on fully increased energy costs, and were required to absorb a significant portion in the form of lesser profits.

All of these developments argue strongly that tax relief for business is both deserved and required. We should also keep in mind that our system of business taxation bears more heavily on corporations than do the tax systems of almost every other major industrial nation. Our provisions for capital recovery are more restrictive than those in most other countries. More importantly, almost all our major trading partners have in the last few years largely eliminated the classical two-tier system of corporate taxation in which income is taxed once at the corporate level and again at the shareholder level. Through a variety of mechanisms they have adopted systems of "integrating" the personal and individual income taxes so that the double taxation element is eliminated or radically lessened. This has occurred in Canada, the United Kingdom, France, Germany, Japan, and Belgium. The European Economic Community is asking that all of its members adopt such a system. While the complexities of this subject are best left for another occasion, the point I am making does bear on the general question of whether the tax burden on our corporations is excessive and should be relieved in some degree.

The need for antirecession stimulus

The need for some form of stimulation must be apparent to every member of this committee. The recession is already serious and it will get worse before it gets better. Our latest estimates indicate that the rate of unemployment should rise to approximately 8 percent. We continue to believe, in fact, that even in the absence of further stimulation the economy should bottom out in the middle months of the year and that we should begin a recovery phase thereafter. The temporary tax cut would be of significant help in making the recovery more solid and more certain. It would also help to reduce the unemployment rate from what it might otherwise be. Moreover, since we are likely to have a margin of slack in the economy for some time, taxes can be cut temporarily without seriously compromising our efforts against inflation. Under these circumstances, we should do what we can to strengthen the economy through a temporary reduction in taxes.

$16 billion temporary antirecession tax cut

In order to provide the needed economic stimulus, the President proposes a one-time, temporary tax reduction of $16 billion, to be placed in effect within the next 90 days. Making it temporary avoids building into the system the larger deficits that would later refuel inflation.

The temporary tax reduction will be an across-the-board refund or tax reduction for all taxpayers. The total of $16 billion is allotted $12 billion to individual taxpayers and $4 billion to business taxpayers, which is the same 3-to-1 ratio that individual income taxes bear to corporate income taxes.

Refund of 1974 taxes to individuals.—Individual taxpayers will receive a refund of 12 percent of their income taxes for 1974, with a maximum refund of $1,000 per tax return. The great majority of taxpayers would thus benefit in proportion to the income taxes they pay for 1974, but high-income individuals would not receive excessively large refunds.

Taxpayers are now filing their income tax returns for 1974 and nearly all will be filed by April 15. All taxpayers will continue to file their returns and pay income tax in accordance with present law. After their returns are filed, the Internal Revenue Service will calculate the amount of their refund, which will then be paid to them by checks in two equal installments.

I cannot emphasize too strongly the point that individuals should continue to file their tax returns in accordance with existing law. The sooner they do that, the sooner the system will be able to process their returns and mail their refunds. They should, under no circumstances, try to compute and deduct their own refunds. If they do, they will face possible fines and penalties and, at a minimum, an Internal Revenue Service examination of their return will probably be necessary to straighten out their final liability.

If, as requested by the President, the 12-percent refund is enacted by April 1, 1975:

> Refund checks for the first installment—in total about $6 billion—would begin to be mailed in May and would continue through June as the later filed returns are processed; and
>
> Refund checks for the second installment of the remaining $6 billion would be mailed in September.

The effect of the tax refund can be illustrated for a family of four as follows:

Adjusted gross income	Present tax	Proposed refund	Percent saving
$5,000	$98	$12	−12.0
$7,000	402	48	−12.0
$10,000	867	104	−12.0
$12,500	1,261	151	−12.0
$15,000	1,699	204	−12.0
$20,000	2,660	319	−12.0
$40,000	7,958	955	−12.0
$50,000	11,465	1,000	−8.7
$60,000	15,460	1,000	−6.5
$100,000	33,340	1,000	−3.0
$200,000	85,620	1,000	−1.2

Taxpayers with incomes of less than $15,000 now pay 31 percent of the income tax, and they will receive 36 percent of the refund. Eighty percent of the refund will go to taxpayers with less than $30,000 of income who pay 68 percent of the income tax. At the upper extreme, 24 percent of the income tax is paid by taxpayers with incomes in excess of $40,000. These taxpayers will receive only 11 percent of the refund.

Adjusted gross income less than—	Percent of 1974 tax liability before refund	Percent of refund
$10,000	13.0	15.1
$15,000	30.8	36.0
$20,000	48.4	56.6
$30,000	68.5	80.0
$40,000	76.3	89.1
$50,000	80.8	93.4
$100,000	90.8	98.7

This proposed method of tax relief has the following advantages:

- Larger amounts can be returned faster by mailing refund checks based on 1974 taxes, than by reducing tax liabilities for the year 1975.

- A reduction in 1975 tax liabilities would be achieved through reductions in withholding. It would not occur for at least a month after enactment of the tax reduction and then only in relatively small weekly or biweekly amounts stretching all the way through December of this year.
- With a refund based on 1974 taxes, taypayers will know more precisely the total reduction they will receive and can plan accordingly, thus accelerating the stimulative impact.
- Receipt of two relatively large refund checks should have a greater psychological effect on family budget decisions and consumption attitudes than receiving the same total a few dollars at a time, thus increasing the impact of the $12 billion temporary tax reduction. This should also help the sales of cars, furnishings, and other big ticket items that have been depressed by the recession.
- With a refund based on 1974 taxes, taxpayers will be assured of getting the refund whether or not their incomes may be reduced or uncertain in 1975. Thus, taxpayers who had jobs in 1974 but are now unemployed would be assured of refunds; they would not receive such refunds if they were applied only to 1975 income.
- Paying the refund in two checks rather than one will ease the strains on the capital markets that would be caused by the Treasury's financing of the entire amount all at once.

Emergency 12 percent investment credit.—The remaining $4 billion of the total $16 billion temporary tax refund and reduction will go to corporations, farmers, and other business firms in the form of a 1-year increase in the investment tax credit. That should stimulate the demand for capital goods and help increase productivity and employment.

The investment tax credit would be increased temporarily to 12 percent for qualified machinery and equipment placed in service in 1975 or ordered by the end of 1975 and placed in service by the end of 1976. As under existing law, special rules apply to property constructed by the taxpayer or to his special order.

We propose that this increase in the investment credit be effective beginning January 1, 1975. That is extremely important, as we want businesses to move ahead promptly with new investment, and it would be most undesirable if they were to suspend purchases and orders until Congress has finally acted. For this reason, Congress has in the past adopted a retroactive effective date like that proposed, and based on our conversations with members of the tax-writing committees we are confident that it will do so here, too, if the proposal for an increase is ultimately enacted.

Because of the need for speedy enactment and because this emergency increase in the rate of the investment tax credit is for only 1 year, no other changes or restructuring of the present investment tax credit are proposed at this time, except for utilities. Because of the particular plight of the Nation's regulated public utilities, we recommend that the following additional changes be made:

- The discrimination against public utilities, which under current law are allowed only a 4-percent investment credit, would be eliminated permanently. Under the temporary emergency investment tax credit, and thereafter, public utilities would receive the same general investment credit rate as other businesses.
- The provision of present law which limits the maximum credit to 50 percent of liability for tax in excess of $25,000 would be modified in the case of regulated public utilities. The limitation would be increased to 75 percent in 1975, and be reduced by 5 percentage points each year through 1979, returning to 50 percent in 1980.

The proposed 12-percent rate would be extended for 2 additional years, through 1977, for property, not fired by oil or gas, that provides power to electric generating facilities, including property converted from oil or gas use. This 2-year extension will provide significant incentives for the development and use of nuclear, geothermal, coal, hydro, solar, and other petroleum-saving power sources.

Increasing the rate of the investment tax credit has proved very helpful in reversing adverse economic trends. When the investment tax credit was repealed and other provisions increasing the tax burden on business were enacted in 1969, there followed a period of rising unemployment and business stagnation. Subsequent to the reenactment of the credit in 1971, new investment increased by 9 percent in 1972 and 13 percent in 1973. Further, in the period 1972–1973 industrial production increased 19 percent and there was a significant decline in unemployment.

Energy taxes in general

The goal of the energy tax package is to reduce total consumption of oil and natural gas, which will reduce imports in like amount.

The package has three parts:

(1) An import fee increase ultimately settling at $2 per barrel on crude oil and products and a corresponding excise tax on domestic crude oil.

(2) Decontrol of crude oil prices and a windfall profits tax.

(3) Price decontrol of new natural gas and the equivalent of the $2 per barrel oil excise tax (namely, 37 cents per thousand cubic feet) on all natural gas, to curtail its use and discourage switching from fuel oil to natural gas.

This combination of fees, taxes, and decontrol will raise the prices of oil, and gas and related products relative to other prices. That will discourage their unnecessary use, encourage the substitution of other energy sources, and induce the replacement of existing energy-using devices.

Gasoline tax as alternative

Many persons have suggested that a gasoline tax would be preferable to taxes on crude oil.

There are several reasons for preferring tax on crude oil to a gasoline tax:

- A price increase in crude oil is far more effective in reducing consumption than a gasoline price increase. The increased prices under the proposals amount to about 10 cents per gallon, distributed across all of the products that come from a barrel of crude. It would take a gasoline tax of 45 cents to 50 cents per gallon to achieve the same reduction in consumption. There are two explanations for that. First, since the price of gasoline is higher than for other refinery products, a larger cents-per-gallon change is required to get the same percentage change. Second, gasoline accounts for only about 40 percent of the barrel of crude and a tax on only 40 percent must obviously be higher than a tax on 100 percent.
- With a 45-cent to 50-cent gasoline tax, gasoline prices would rise an aggregate of $45 billion. That compares with oil price increases of only $21 billion under the proposed program.
- Crude oil—not gasoline—is the problem. We want to reduce consumption of each of the elements in a barrel of crude.
- There is just as much opportunity to conserve other petroleum products and other forms of energy and energy intensive products as there is to conserve gasoline. For example, many thermostats could be turned down with no real discomfort. Our trash cans are heaped with direct petroleum products such as plastics, and other products that require large amounts of petroleum-related energy to create such as aluminum. We can conserve a little on a wide range of items and save a lot in total.
- It is fairer to let all petroleum users make a moderate adjustment than to impose a drastic increase on just gasoline users. And it is easier for the economy as a whole to accommodate a moderate, broadly distributed increase than a very large, more narrowly based increase. The proposals avoid devastating the automobile industry, the travel industry, and others which depend on gasoline for survival.

$2 license fee and excise

The United States now imports about 4.1 million barrels per day of crude oil and about 2.6 million barrels per day of fuel oil and other refinery products. An additional import fee of $2 per barrel on crude and products is to be imposed in stages of $1 each on February 1 and March 1 by Presidential proclamation under the authority of the Trade Expansion Act of 1962. In addition, if Congress has not enacted the excise tax on domestic oil by that time, the import fee will be raised another $1 on April 1, for a total increase of $3. Adjustments in the fees on imported products will be made to reflect obligations under the old entitlements program.

The $2-per-barrel increase in the fee will raise the average price of imported crude oil and its products by $2 per barrel. In the case of crude oil, that means an increase from around $11 per barrel to $13 per barrel. Domestic crude would also sell at about $13 per barrel, and the excise tax of $2 would leave the effective price to domestic producers also at $11 per barrel.

The import fees will bring in revenues of $3.2 billion in 1975 and $4.1 billion in 1976, and the excise tax will raise $4.8 billion in 1975 and $7.2 billion in 1976.

Decontrol and windfall profits tax

Last year the United States produced 9.2 million barrels of crude oil per day. We now produce only about 8.8 million barrels of crude oil per day, approximately 60 percent of which, or 5.3 million barrels, sell at an average price of $5.25 per barrel because of price controls. If present controls continue, this year's production will decline further to perhaps 8.6 million barrels per day. Our system of price controls is seriously counterproductive to our need for greater domestic supplies.

An illustration of the way that price controls discourage production occurs in connection with the "stripper well" exemption, which permits oil produced from leases which average fewer than 10 barrels per day per well to sell at the world price. The exemption encourages producers to let their wells decline from 15 or 16 barrels a day to 9.9 barrels per day. They actually make money by suffering a production decline.

Another illustration arises in connection with secondary and tertiary recovery processes, which are used to stimulate additional production after original production has declined. Those processes are costly and part of our production decline is attributable to the fact that they are uneconomic at controlled prices. Money will not be invested to produce more controlled oil at $5.25 per barrel if it can be invested in producing uncontrolled oil at $11 per barrel, or in some completely unrelated business at a higher rate of return. Regulation of prices drives people out of the regulated business and into other lines of business not so subject to uncalculable, nonmarket risks. Price controls were imposed as a means of preventing windfall profits, but clearly we must find a more sensible approach.

The combination of price decontrol and the windfall profits tax is a workable solution to the problem. In 1975, we estimate that a producer of controlled oil would receive $11 per barrel after decontrol (net of the $2 excise), or an increase in price of $5.75 per barrel ($11.00—$5.25=$5.75). The windfall profits tax proposed would average $4.53 per barrel, reducing the producer's net price increase to $1.22 per barrel. That $1.22 translates into about 76 cents per barrel after tax.

After decontrol, the price for all oil will be the same, thus eliminating all the inefficiencies of the two-tier pricing system. Producers of uncontrolled oil will begin to pay a windfall tax on the increased prices they have enjoyed for more than a year. As a result, they will pay $2.81 per barrel more tax on those increased profits than they paid last year. Producers of controlled oil will begin to receive the same increased prices but will be permitted to keep only 76 cents of that increase. Both controlled and uncontrolled oil will receive the same prices and pay the same taxes.

	Uncontrolled oil	*Controlled oil*
Price per barrel	$11.00	$11.00
Former price	11.00	5.25
Net price increase	0	5.75
Windfall profits tax	4.53	4.53
Gain, or loss (—)	—4.53	1.22
Income tax at 38 percent*	1.72	.46
Net effect after tax	—2.81	.76

*Corporate rate of 48 percent adjusted for percentage depletion and minimum tax.

Most significant producers have both controlled and uncontrolled oil and, compared with last year, they will net less on the uncontrolled oil and net more on the controlled oil. For the industry as a whole, net after-tax income will be reduced by $2 billion, which means that the benefits from decontrol will be more than offset—by $2 billion—by additional taxes paid to the Treasury. Those Treasury revenues are among those to be returned to taxpayers in the form of tax reductions.

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The concept of the proposed windfall profits tax is the same in general as the windfall profits tax proposed last year, although the new proposal has been structured to raise substantially higher revenues. In summary, the tax is designed to capture a windfall profit—that is, one which results from a sudden change in price caused by a circumstance which is accidental and transitory. It is difficult to separate ordinary market prices from prices which permit windfall profits (or "excess" profits if one wishes to think of it that way). We have made an estimate—a judgment—as to the "long-term supply price," i.e., the minimum price to producers that will be sufficient to induce an increase in our supplies of oil sufficient to make us energy independent by 1985. Our judgment is that the price required for this is around $7 to $8 at today's price levels, assuming the continuation of percentage depletion. The tax is designed to permit producers to retain an amount equal to the long-term supply price by the time additional oil supplies will be coming on line 3 to 5 years from now.*

The proposal does not include a credit for so-called "plowback" investments nor does it include exemptions for certain classes of producers. Plowback is not justified because the amounts oil producers will retain, after the tax as it is structured, will provide a price incentive sufficient to attain our energy independence goals. To put it another way, there is no convincing evidence that permitting a plowback credit will produce significantly more energy than not doing so. Further, a plowback credit means that persons already engaged in oil production can make investments with tax dollars supplied by the Government, while new investors must use their own money. We do not believe that kind of discrimination and anticompetitive effect can be justified.

In the case of different classes of producers, we simply believe that a windfall produced by cartel prices is a windfall to large and small producers, high- and low-cost producers, and producers located everywhere. Producers all receive a cartel price and not a free-market price.

The issue of plowbacks and special exemptions ultimately boils down to whether windfall profits should go to oil producers or to the public in the form of tax reductions. The permanent tax reductions proposed depend upon the Government receiving these revenues. If the revenues are curtailed, the tax reductions will need to be curtailed, too. We have tried to design a tax that will not inhibit those investments in oil production which are economic and which are needed to reach our goals. If we believed that the tax would inhibit needed investment, we would not propose it. Plowback credits and special exemptions would undoubtedly make existing oil producers wealthier than they would otherwise be, but would not significantly increase oil production. It is taxpayers generally who pay the prices that produce the windfall, and the revenues should go for the benefit of taxpayers generally.

Decontrol of new natural gas and excise tax

Natural gas shortages last year forced major curtailments of supplies to many industrial firms and denial of service to many new residential customers. Curtailments and denials are much greater this year and are causing not only extra costs and hardships, but, in many cases, business closedowns and loss of jobs.

New natural gas goes primarily into intrastate, uncontrolled markets where prices range around $1 per thousand cubic feet ("m.c.f."). Gas in the interstate market averages less than 40 cents/m.c.f. The result is that interstate supplies are insufficient, and the energy gap in nonproducing States is made up with imported oil, which on a BTU equivalent basis costs about $2, and with imported liquefied natural gas at $1.80/m.c.f. Deregulation will permit new domestic gas to flow into the interstate markets with an aggregate savings to existing customers in those markets, an end to curtailments, and a net saving in national resources.

Whether or not new natural gas is deregulated, the President proposes an excise tax of 37 cents/m.c.f. on natural gas. That is equivalent, on a BTU basis, to the proposed $2 excise tax on oil and will prevent fuel oil users from switching to gas. It will also bring the average interstate price close to the market clearing price (the price at which supply and demand will coincide), and end the careless use of this fuel by those for whom it is cheap at present prices.

* If percentage depletion should be eliminated, the net to producers from a $7 to $8 price would be reduced, a higher price would be required to produce the same net return and the same oil production, and the proposed windfall profits tax base and brackets would need to be revised upwards accordingly.

An equivalent tax, based on BTU content, will also be placed on natural gas liquids. Gas wells produce about 86 percent "wet" gases and 14 percent "dry" gases. The wet gases are treated to remove the natural gas liquids, such as propane and butane, and the dry gas goes on into the natural gas pipeline. The dry gas and liquids will thus be treated consistently. For example, the tax on natural gas liquids sold in mixed stream would be $1.43 per barrel.

The liabilities for this tax would be $6.3 billion in calendar 1975 and $8.5 billion in calendar 1976.

Effectiveness of energy package

The energy package will reduce consumption significantly, with modest adjustments by most of our citizens.

It is natural for businessmen and consumers to react to a sudden increase in price of particular goods with the thought: "This will merely increase my costs. It won't cause me to reduce my purchases." That reaction reflects the fact that we are creatures of habit. But we are also rational beings who adapt our habits to changing circumstances.

When meat prices rose sharply in the early months of 1973, the instantaneous response was a loud complaint as each of us found his grocery bill inflated. In time, we adjusted to the higher price by buying less meat. There is no doubt that the portions of meat being served by many families today are smaller than they were only 3 years ago. We didn't like it, but it had to be done. There was no other way to adjust to the new situation—no way that was better.

So it will be with energy. None of us relishes the prospect of higher oil and gas prices. We have all developed habits of energy use conditioned by two decades of declining relative prices of energy. As in the recent experience with meat, after the initial shock of resentment at the higher prices of petroleum products and gas, our rational selves will take over and we individually and collectively will find ways to reduce our usage of energy.

Immediately, we will slice smaller portions of the energy pie for ourselves:

- We will turn off the lights when we leave the room to save electricity bills.
- Thermostats will be adjusted downward in winter, upward in summer, and heat will be turned off in rooms not in use.
- Marginal trips in cars will not be taken; some second and third cars will be scrapped.
- Married couples will look closer in for their first home, and possibly settle for an apartment instead of a detached home; and owners of homes and buildings who formerly considered the fuel savings from insulation, weather-stripping, and otherwise improving the thermal efficiency of structures too costly to obtain will now reconsider.

Equally important, over the longer run:

- Industrial firms, ever on the lookout to cut costs, will speed up the replacement of energy-using machinery and processes that were perfectly adequate in the days when oil cost $3 a barrel and gas only a few cents per thousand cubic feet, with substitute equipment and processes that may have higher initial costs but which consume less energy and thus have lower overall costs of operation.
- Families will replace their present autos featuring comfort and speed at the expense of low mileage with lighter and more utilitarian cars that use less of the now expensive energy; and they may eliminate some of their most frivolous appliances while replacing others with initially more costly but more energy-efficient substitutes.
- Materials which require large amounts of energy to produce will be displaced by substitute materials which have become relatively cheaper because their production consumes less energy.
- More recycling will occur.
- The higher relative cost of oil and gas as energy resources will stimulate the development of other energy sources. Oil and gas will fill a smaller share of energy requirements. Just as coal displaced wood as our basic energy source, and oil and gas displaced coal, oil and gas will be displaced.

All of these examples are illustrations of what in the technical jargon of economics is known as "price elasticity of demand": Quantities of things consumed decrease when their prices rise relatively to other prices. Every food merchant knows he will sell more bananas and oranges when a crop failure causes the prices of apples and pears to be high, and vice versa. He may not have heard the term "price elasticity," but he knows how it operates.

Yet many remain skeptical that there is price elasticity in the demand for oil, or that if there is any, whether it is sufficiently large to make any difference in the volume of our oil imports. Experience since 1973 should put doubt to rest even if the findings of such major research efforts as those of the Ford Foundation energy project and the Federal Energy Administration do not.

For example, during the decade prior to 1974 when utility rates were steady, consumption of electric energy increased at a rate of 7.4 percent. Normally, one would expect any given period in 1974 to be 7.4 percent higher than the comparable period of 1973. But for the 6-month period April through September 1974 consumption was not 7.4 percent above 1973, it was 1 percent less, a swing of 8.4 percentage points below expectation. Some of this reduction in consumption could be attributed to the then just perceptible slowing down of the economy, but a major portion of the reduction can be attributed to the energy price effects on electric utility rates. Experience with oil demand and prices is similar. During the decade prior to 1974, total U.S. petroleum demand increased at an annual rate of just over 5 percent. But the April–September 1974 petroleum demand was *under* the comparable 1973 period by 2.7 percent, a swing of 7.7 percentage points below expectation.

We need another reduction in petroleum usage of about 5 percent in order to reduce consumption by a million barrels a day. All of the econometric data indicates that the proposed price changes are on target.

Econometric models of the economy, such as those underlying the Ford Foundation energy project report, "A Time To Choose," and the "Project Independence Report," suggest that the short-term responses to energy price increases that we have already seen are half, or less, of the long-term response we can expect after households and business firms have had an opportunity to adapt fully to the higher costs of energy.

Thus, we have confidence that the President's energy program will easily achieve the 1 million barrel reduction in consumption by the end of this year and an additional 1 million barrel reduction by 1977.

Permanent tax reduction and restructuring

The Treasury will collect an additional $30 billion in taxes from the windfall profits tax and the excise taxes and fees on oil and natural gas. The private sector will bear an estimated $25 billion of that in the form of higher costs of energy-related items they buy, and Federal, State, and local governments will bear the remainder.

The $25 billion paid by individuals and businesses will be returned to the economy by the permanent reductions in individual and corporate income taxes. Like the temporary antirecession tax cut, the $25 billion total is divided in approximately the ratio of individual and corporate income tax payments generally, so that about $19 billion is allocated to individuals and $6 billion to corporations.

These are major income tax reductions. They accomplish multiple purposes, rest on multiple foundations, and should be considered in that way.

First, the changes proposed in the individual and corporate income tax structures are desirable on their own merits. They have heretofore been too expensive to accomplish within existing revenue constraints.

Second, these tax reductions return to the economy the energy conservation taxes. Thus, the energy conservation measures reduce energy consumption without reducing the aggregate purchasing capacity of the private economy.

Third, these income tax reductions will provide energy consumers with additional after-tax spendable income to help meet higher energy costs if they still wish to consume the same amount of energy as before. Alternatively, they can buy more of other products and cut back on their energy consumption—and many will do that. The income tax reductions are such that most individuals in the lower and middle-income range, up to about $15,000, will receive tax reductions greater than their increased energy costs even if they should choose to continue consuming the same amount of higher cost energy. Taxpayers in higher income brackets will receive significant income tax reductions also, but generally less in proportion to their greater expenditures for energy.

Fourth, these permanent income tax reductions are approximately similar to what is required to offset the so-called "bracket and deduction compression" caused by inflation over the last 3 years. Because deductions and rate brackets are stated in dollar terms, when inflation causes money incomes to rise, deductions offset a lesser portion of the same real incomes and the remainder is taxable in higher brackets.

Benefit for individuals

For individuals, the President proposes an income tax reduction of $16½ billion beginning in 1975. This will be accomplished—

By increasing the low-income allowance from its present level of $1,300, to $2,600 for a couple and $2,000 for single taxpayers, which will provide benefits of $5 billion, and

By cutting in half, from 14 to 7 percent, the tax rate for the first taxable income bracket and making substantial, but smaller, reductions in tax rates in the next four brackets,[1] which will provide additional benefits of $11½ billion.

Low-income allowance.—The low-income allowance is the minimum standard deduction allowed to everyone regardless of his income level or the amount of deduction he actually has. In combination with the $750 personal exemption, the low-income allowance determines the minimum or base income on which no income tax is levied. In 1969, Congress defined the threshold taxability level by reference to so-called poverty level data, the assumption being that families with poverty level incomes did not have the requisite ability to pay and should be excused from liability. The low-income allowance was the mechanism adopted to achieve that result.

The low-income allowance is now $1,300. That means that a family of four with four $750 personal exemptions for a total of $3,000, plus a $1,300 low-income allowance, currently does not pay income tax if its income is $4,300 or less.

Because of inflation, the poverty level for a family of four is now estimated to be about $5,600. Nevertheless, under present law, this family would in 1975 be required to pay income tax of $185.

The proposed increase of the low-income allowance to $2,600 on a joint return will bring the nontaxable level for the family of four up to the new poverty level of $5,600, which is $3,000 of personal exemptions plus the new low-income allowance of $2,600. The proposed increase in the low-income allowance will also make comparable changes for single persons and families of other sizes, as shown by the following table.

Number in the family	Estimated 1975 poverty level	Tax-free income level	
		Present	Proposed
1	$2,850	$2,050	$2,750
2	3,686	2,800	4,100
3	4,382	3,550	4,850
4	5,608	4,300	5,600
5	6,618	5,050	6,350
6	7,446	5,800	7,100

Increasing the low-income allowance to the levels proposed will provide benefits of about $5 billion to low-income taxpayers and relieve from income tax altogether over 5 million presently taxable returns.

Reduction of tax rates.—In addition to the change in the low-income allowance, which benefits the lower income taxpayers, the proposals will reduce income tax rates for the 62 million remaining taxpayers in a generally progressive manner.

The present income tax rates for married persons filing jointly would be reduced as follows: The 14-percent rate reduced to 7 percent; the 15-percent

[1] Illustrates rate changes for married persons filing jointly. Comparable changes are made in other rate schedules.

rate reduced to 10 percent; the 16-percent rate reduced to 13 percent; the 17-percent rate reduced to 15 percent; and the 19-percent rate reduced to 17 percent for part of the present bracket and the balance of that bracket to remain at 19 percent. Rates for other income brackets would remain the same, except that the present 28-percent and 32-percent rates would be increased 1 percentage point each. Taxpayers with incomes falling in those brackets would still have a substantial net reduction in liability because a part of their income will also be taxed in the brackets in which rates have been reduced. Comparable reductions will be made in the tax rates for single returns and other types of returns also. The revised rate schedules are set forth in the appendix.[1]

Progressive income tax reduction

The effect of the two elements of the proposed income tax reduction for individuals, both singly and in combination, is progressive. The proposed tax reductions are proportionately greater in both dollar amounts and percentages toward the lower end of the income spectrum. Nevertheless, taxpayers at all income levels share significantly in the proposed reductions.

The benefits from doubling the low-income allowance are heavily concentrated in the adjusted gross income classes below $5,000, $10,000, and $15,000. The benefit of the reduction in tax rates goes 96 percent to persons with adjusted gross incomes below $20,000 and 89 percent to those below $15,000. When the two tax reductions are combined, 41 percent goes to persons with adjusted gross incomes below $10,000, 70 percent to persons with adjusted gross incomes below $15,000, and 86 percent to those below $20,000.

The following table shows the percentage reduction in the income tax by income class:

1975 levels

[Dollars in billions]

Adjusted gross income class	Income tax paid under present law	Amount of income tax reduction	Percentage reduction in income tax
0-$3,000	$0.3	−$0.25	−83.3
$3,000-$5,000	1.8	−1.20	−66.7
$5,000-$7,000	4.0	−1.96	−49.0
$7,000-$10,000	8.9	−3.38	−38.0
$10,000-$15,000	21.9	−4.72	−21.6
$15,000-$20,000	22.8	−2.70	11.8
$20,000-$50,000	44.4	−2.15	−4.8
$50,000-$100,000	13.5	−.11	−.8
$100,000 and over	13.3	−.03	−.2
Total	130.9	* −16.50	−12.6

* Does not include payments to nontaxpayers.

Some have suggested that there is no reason to cut taxes at all for upper bracket taxpayers. We believe, however, that fairness requires some—though lesser—relief in the upper brackets. It is important to remember that:

- Only about 12 percent of all taxpayers have gross incomes above $20,000, and they now pay about 52 percent of total individual income taxes. They will pay an even higher percentage of individual income taxes if our proposals are enacted.
- Upper income individuals have been adversely affected by inflation, just as lower income individuals. The prices of the things they buy have increased too, and since they buy more, the increase is greater. Also, "bracket and deduction compression" has adversely affected high-income taxpayers just as it has affected lower income taxpayers. Everybody has had, in effect, an income tax increase because of inflation.
- Upper income taxpayers play a disproportionately large role in providing the investments which help everyone's income to increase.

[1] Not included in this exhibit.

The following table illustrates the tax reductions that will be received by a typical family of four at various income levels.

Adjusted gross income	Present tax [1]	New tax	Tax saving	Percent saving
$5,600	$185	$0	$185	100.0
$7,000	402	110	292	72.6
$10,000	867	518	349	40.3
$12,500	1,261	961	300	23.8
$15,000	1,699	1,478	221	13.0
$20,000	2,660	2,450	210	7.9
$30,000	4,988	4,837	151	3.0
$40,000	7,958	7,828	130	1.6

[1] Calculated assuming low-income allowance or itemized deductions equal to 17 percent of income, whichever is greater.

Increased energy costs compared with tax reductions

The proposed changes in the structure of the individual income tax stand on their own merits and were not designed primarily to offset increased energy costs.

Solving the oil problem will require the public, and particularly large energy users, to make adjustments that will be unpopular and which in some cases will cost money. Nonetheless, the proposed tax reductions are very substantial for low- and middle-income taxpayers below the $15,000 income level and we believe are, on average, sufficient to more than offset the average increases in their energy costs. The Council of Economic Advisers has calculated that the increase in the Consumer Price Index attributable to this program will be 2 percent or less. Others have suggested different percentages.

The following table provides some guidance, by indicating how much the tax reductions add to after-tax disposable income. It is after-tax income which individuals have at their disposal to buy goods and services, including energy. If the cost of living goes up 1 percent, a 1-percent increase in after-tax income should leave the average taxpayer even. The table indicates that with a rise prices of 2 percent or less, average taxpayers through the $15,000 AGI class wi. be ahead.

Adjusted gross income class	After-tax income	Proposed tax reduction	Reduction as a percent of present after-tax income
	[Billions]		
0–$3,000	$21.7	$0.3	[1] 1.2
$3,000–$5,000	33.2	1.2	[1] 3.6
$5,000–$7,000	46.0	2.0	4.2
$7,000–$10,000	86.1	3.4	3.9
$10,000–$15,000	183.1	4.7	2.6
$15,000–$20,000	162.2	2.7	1.7
$20,000–$50,000	235.6	2.2	.9
$50,000–$100,000	36.5	.1	.3
$100,000 and over	21.7	(*)	.1
Total	826.1	16.5	2.0

*Less than 50 million.

[1] Many taxpayers in the two lowest income classes will benefit from the $80 special distribution.

$2 billion for payments to nontaxpayers

Individuals whose incomes are so low that they do not pay any income tax will not benefit from the income tax reductions. Because of their low incomes, these persons are likely to have the least flexibility in shifting their consumption patterns as energy becomes relatively more costly.

In order to avoid hardships from higher energy costs, an additional $2 billion of the energy tax revenues has been allocated to provide cash payments of $80 to each adult in this low income, nontaxpayer category. These persons will thus not be forced to reduce their energy consumption, although they, like others, will have the choice. In addition, very low income persons who now pay some income tax and who will receive some benefit from the proposed tax reductions will also be eligible to receive distributions in amounts approximately sufficient, when added to the income tax reduction, to give them a total benefit of about $80 per adult. In total, this payment system is estimated to involve about 26 million adults, 21 million of whom are nontaxpayers under present law, and to provide a total benefit to them of about $2 billion.

Payments will be made as early in 1975 as possible, and if the energy taxes are enacted by April 1, as the President requests, we believe that payments can be made in the summer. The payments will be made by the Internal Revenue Service and will be based on a return—comparable to a very simple income tax return—filed by those persons eligible. In designing this system for payments, emphasis has been placed on making it simple and speedy. While we should be generous in order to be certain that we have avoided genuine hardships, we should not create an additional welfare system or bureaucracy.

The essential details of this system for cash payments are as follows:

- Adults 18 years or older and not eligible to be claimed as a dependent on an income tax return would file with the Internal Revenue Service a simple income tax return showing their name, social security number, and their adjusted gross income for 1974.
- Adults are eligible to file and receive a payment if they are married persons filing a joint return and their adjusted gross income is less than $5,500 and if they are single persons and their adjusted gross income is less than $2,750.

To take account of the fact that some persons eligible for payments will also receive income tax reduction, payments will be made under the following schedule:

For married persons filing joint returns:

If their income is $4,500 or less, the payment is ---------- $160

If their income is more than $4,500, the payment is reduced by $4 for every $25 of income over $4,500.

For single returns:

If their income is $2,250 or less, the payment is ---------- $80

If their income is more than $2.250, the payment is reduced by $4 for every $25 of income over $2,250.

This schedule of payments will result in phasing out the payments as income rises to the level where the amount of income tax reductions that have been received equal $80, or $160 on a joint return. For example. a married couple with two children and income of $5,600 would have received $185 of income tax reduction and would therefore receive no additional cash payment.

Because the payment system is simple and distinguishes only between single returns and joint returns. there cannot be complete precision and some persons will receive payments which, when combined with income tax reductions. will vary somewhat from the $80-per-adult minimum. Imprecision is the price of simplicity. Precision can be obtained only with returns that report the number of personal exemptions and itemized deductions—i.e., a full tax return. Exemptions and deductions are major problems, even with higher income persons, and, as a practical matter, would be unpoliceable on these returns. The $80-per-adult minimum is an average and somewhat arbitrary (though generous) figure in the first instance, and it would be quixotic to construct a second and complicated tax system to see that no family, regardless of size or need, varied slightly from the figure.

The amount of $80 per adult appears adequate to compensate individuals in these low-income classes generally, with a margin for extraordinary situations. The total increase in energy cost for the households represented by the about 26 million adults who will participate in the $80 payment system is estimated to be $1.3 billion. an average of $50 per adult. This group includes 17 million single adults and 9 million married persons who would file jointly. Thus, the average increase in energy cost per filing unit, or roughly speaking, "household," in this category is about $60. Looked at another way, the increase in energy cost may induce an increase in the Consumer Price Index of as much as 2 percent. A 2-percent increase for a person with $2,000 income would be only $40, and for a family with an income of $5,000 would be only $100.

In contrast, total benefits of $2.1 billion are proposed for this group by the combination of cash payments and income tax reductions. The basic benefit will be $80 for a single adult and $160 for a married couple.

In addition there are another 7 million adults whose adjusted gross incomes are below $5,000, but who will receive $80 or more entirely through income tax reductions.

Residential conservation tax credit

To complete the total of $19 billion of tax and cash payment benefits for individuals, a residential conservation tax credit will be allowed for expenditures for thermal efficiency improvements for existing homes. Such improvements include storm windows and doors, and insulation and weather-stripping. The credit will be effective for years 1975, 1976, and 1977 and the maximum credit allowed over that 3-year period will be $150 per family. It is estimated that at least 18 million homes will be eligible for the credit and that the total credits will be $500 million annually for the 3 years.

Corporate tax rate adjustment

The President proposes that the corporate tax rate, which is now 48 percent, be reduced to 42 percent. This will provide benefits of approximately $6 billion. This reduction will be accomplished by reducing the corporate surtax rate on taxable income in excess of $25,000 from the present 26 percent to 20 percent. The basic or normal rate applicable to all corporate taxable income will remain at the present 22 percent. Thus, the first $25,000 of a corporation's taxable income will continue to be taxed at a rate of 22 percent. The balance will be taxed at a total normal and surtax rate of 42 percent. We propose that the reduction be made in the high surtax rate because that is where the excessively heavy double tax burden on corporate earnings falls. Corporations that pay only the normal tax rate of 22 percent are paying tax at about the average top marginal tax rate of individuals.

The reasons for recommending reduction in corporate taxes by means of a rate reduction instead of by some other means are as follows:

> Rate reduction is the most neutral way of reducing corporate taxes. Neutrality means that all corporations now paying at a 48-percent rate will share in the tax reduction, will have maximum flexibility in making business and investment decisions and can therefore operate most efficiently without regard to tax consequences.
>
> Reduction of the presently high corporate tax rate will be the most meaningful and symbolic signal to business, to investors, and to the market of a serious intent to assist business. This type of tax reduction will provide corporations the maximum assurance of continued more favorable climate for the long-term investment decisions that are necessary to ensure prosperity and control inflation.
>
> Rate reduction has a character of permanence. We have proposed to make the permanent tax reduction for individuals in large part by rate reduction. We should do the same for corporations.

The amount of the proposed corporate tax reduction of about $6 billion is approximately the 25-percent corporate share—when divided in the 75–25 percent ratio of corporate and individual tax payments—of the total of $25 billion of permanent tax reductions and payments we propose to make. This proposed corporate tax reduction of $6 billion reflects the fact that corporations, too, will have an additional burden from higher energy costs. Corporations will bear these additional costs in a variety of ways—higher energy costs reflected in costs of equipment they buy, not all of which they will be able to pass on to consumers; reduced sales and lower prices for some products as demand for energy is reduced; and the additional capital equipment and other costs that will be involved for many corporations in shifting over to lesser energy-using processes and products.

As their energy costs increase, business will be under pressure to pass these costs through to consumers and they will be successful in varying degrees. To the extent that this increase in cost is offset by a decrease in income tax cost, a part of that pressure to pass through energy costs to consumers will be relieved.

Corporate tax reduction is seldom politically popular, because it is levied against an inanimate entity. But corporate taxes are borne by people—in part by people generally in the cost of what they buy from corporations, and in part by shareholders in the form of a reduced return on the capital they have invested in the businesses.

In recent years other nations, including our principal trading partners, have recognized this and adopted various "integration" plans which move towards eliminating the double tax on income earned in corporate form. But the United States still imposes a double tax on income earned from a business conducted in corporate form, thus taxing that income more heavily than other income.

As you consider the President's proposal to reduce the corporate rate from 48 to 42 percent, you should have firmly in mind that income earned in a corporation would still be taxed at 42 percent, and then taxed again at rates going up to 70 percent when paid out as a dividend—producing a maximum tax of 82.6 percent.

I have already discussed the compelling reasons for a reduction in corporate taxes wholly apart from any increase in energy costs. These reasons are real and serious. While corporate tax reduction may be unpopular, the consequences of increasing unemployment and declining productivity will be even more unpopular. They already are.

Conclusion

It is clear that our country faces serious economic problems. I am confident that we can solve them. They are complicated problems and their solutions will require painstaking attention and balanced judgments. The President's program, which I have outlined to you, provides an integrated blueprint for action. I am confident that as we consider the problems in the objective and professional manner for which this committee is distinguished, we will be able to reach joint decisions that will set us back on the path to continued prosperity. I look forward to working with you.

Exhibit 30.—Statement of Assistant Secretary Hickman, February 20, 1975, before the Senate Select Committee on Small Business, on Federal taxation of small businesses

Mr. Chairman, and members of the committee, it is a privilege to appear before this committee in connection with your consideration of the impact of Federal taxation on small businesses. The administration is concerned about small businesses and small business taxes. In both 1970 and 1971, the administration submitted tax proposals that would benefit small businesses. None, however, was enacted. We anticipate that the tax-writing committees of Congress will this year consider various proposals to alter the tax treatment of small businesses. We look forward to working with them on these proposals.

This morning I have no new administration proposals to advance. I would like to talk with you first about broader issues germane to tax policies toward small business: what is meant by the term "small business," what the role of small businesses is in the economy, and how small businesses are affected by the major business tax problems stemming from inflation and the double taxation of income earned by corporations. Finally, I will comment on recent proposals for tax change as they are related to small business problems.

What is small business?

In 1970 the following businesses were reported on income tax returns:

	Number (millions)	*Percent*
Partnerships and proprietorships	10.33	86.0
Corporations	1.67	14.0
Subchapter S	.26	2.2
Other	1.41	11.8
Total	12.00	100.0

In general, partnerships and proprietorships are small and corporations are larger, as appears from the following:

TABLE 1.—*Number of firms by size of receipts and business form, 1970*

[Thousands]

Size of business receipts	Partnerships	Proprietorships	Subchapter S corporations	Other corporations
Under $25,000	502	7,247	58	394
$25,000 to $50,000	125	1,006	25	146
$50,000 to $100,000	120	661	40	180
$100,000 to $500,000	162	456	97	420
$500,000 to $1 million	17	23	22	119
$1 million to $5 million	9	7	14	122
Over $5 million	1	.2	.8	27
Total	936	9,400	257	1,408

The following points should be noted from table 1:

- The most common business form is the proprietorship. Seventy-seven percent of the proprietorships had receipts under $25,000.
- Among partnerships, 53.6 percent had receipts under $25,000.
- Corporations tended to be larger. The median Subchapter S corporation had receipts at the low end of the $100,000 to $500,000 class. The median of "other corporations" had receipts at the high end of the $50,000 to $100,000 class. Thus, the median for both classes of corporations is about $100,000.

Undoubtedly, a major reason for the relative largeness of corporations is that this business form is resorted to as a means of raising capital. The corporate form is a *response* to the advantages of bigness; it does not itself bestow bigness.

It is well known that businesses which employ large aggregations of resources—which utilize large amounts of capital and employ large numbers of workers—characteristically organize as corporations. They do so in order to ensure a continuity of management necessary for the agglomeration of resources. It is therefore not surprising to find that, over all private sector activities, and within particular industry classifications, the corporate form of organization is closely associated with business entity size. Among all entities encompassed by the 1967 Enterprise Statistics of the Bureau of the Census, only 19 percent* of all entities are incorporated but they employ 81 percent of all workers. Within manufacturing, which includes more than 50 percent of all workers covered by these statistics, the dominance of corporations is even more striking: 60 percent of manufacturing businesses are incorporated, and they employ 97 percent of all workers in manufacturing.

The basic conclusion from table 1 is that there is a pronounced bunching of firms in the classes with smaller amounts of business receipts. This bunching at the low end occurs no matter whether businesses are classified by sales, employment, assets, or value added. Beyond general observations about bunching, exact statements about "small business" are hard to make. The basic difficulty is that there is no real reason to lump all "small business" together and no clear criteria for classifying them by size.

The difficulty becomes apparent if one asks: How important is small business in the economy? The answer is arbitrary and depends on the cutoff chosen between "large" and "small," as can be seen from the following table.

* The percentage of corporations here is greater than the percentage reflected in tax returns because these statistics exclude finance, transportation, communications, utilities, and agriculture.

TABLE 2.—*Business receipts by size and business form, 1970*

[Millions of dollars]

Size of business receipts	Partnerships	Proprietorships	Subchapter S corporations	Other corporations
Under $25,000	3,290	43,830	391	1,715
$25,000 to $50,000	4,361	35,729	876	3,938
$50,000 to $100,000	8,436	46,278	2,886	11,160
$100,000 to $500,000	32,920	82,624	22,254	94,169
$500,000 to $1 million	11,545	15,142	15,480	79,149
$1 to $5 million	17,236	11,912	25,923	237,444
Over $5 million	12,420	2,211	8,287	1,117,213
Total	90,209	237,727	76,097	1,544,790

If one uses a cutoff of receipts of $500,000 to define "small business," then 20.3 percent of the receipts were accounted for by small business in 1970. Using a cutoff of $1 million of receipts, "small businesses" account for 26.5 percent of receipts. Using a cutoff of $5 million, they account for 41.5 percent. In looking at these data, it is useful to keep in mind that receipts may not be used to measure the contributions of firms to our gross national product. A small retailer, for example, may sell $100,000 of merchandise which he purchased for $90,000. His gross receipts would be $100,000, but the "value added" by him and his employees, which is their contribution to GNP, is only $10,000.

Analysis of small business literature is complicated by the bewildering array of definitions of "small business" that are used. Still worse, authors frequently fail to reveal, even in their footnotes, what definitions they are using. Unhappily, this is true of much of the testimony presented to your committee. Even the Small Business Administration's report fails to indicate what definitions are being used. In fact, the Small Business Administration is charged with administering several different programs, and there are eight different purposes for which small business must be defined, with different definitions for each. They range in complexity from a simple statement that a small business is one which employs fewer than 500 persons to an extensive listing of industry categories with corresponding employment and/or sales criteria. Many of the definitions are very generous, and, in combination, these overlapping definitions would account for more than 99 percent of all enterprises. One may question whether that is a useful definition of "small business" for analytic purposes.

Given that a definition of "small" is to be used, it might be well to agree on a percentile approach, using, say, the lowest 90 percent of firms classified by value added or by employment. A common definition would avoid the existence of confusingly different statistics on "small business." Such a definition would show something like the following:

TABLE 3.—*Percentages of economic activity accounted for by smallest 90 percent of entities*

Industry division	Percentage accounted for by smallest (measured by number of employees) 90 percent of business entities			
	Employment	Payrolls	Value added	New capital outlays
All	15	11	n.a.	n.a.
Retail trade	26	22	n.a.	n.a.
Selected services	18	19	n.a.	n.a.
Construction	22	16	12	17
Manufacturing	13	12	12	5
Wholesale trade	44	43	n.a.	n.a.
Mineral	27	22	26	24
Miscellaneous transportation	44	41	n.a.	n.a.

n.a. Not available.

Source: U.S. Department of Commerce, Bureau of the Census: 1967 Enterprise Statistics, part I.

In sum, generalizations about "small business" are very sensitive to the definitions used. A wide range of different conclusions may be reached by adopting different definitions. One thing, however, is very clear. No matter how small business is defined, it is the large agglomerations of capital which account for the great preponderance of our gross business product and our total employment. Because those enterprises employ such large amounts of capital, their ownership must be distributed widely among both large and small stockholders. Many of the largest enterprises purchase from literally tens of thousands of small suppliers, and their employees represent the purchasing power which sustains millions of small enterprises. Thus, the well-being of small business is directly related to the economic prosperity of the larger concerns.

The problem of business taxes

There are two major problems of business taxation which give increasing concern in the present economic climate. Both contribute to the difficulties which business is clearly having in financing the new investment which we must have if we are to sustain economic growth. Both affect large and small businesses alike, although in different degree. These problems are first, the overstatement of operating profits arising out of the effect of inflation on depreciation and inventory accounting and, second, the heavy anti-investment bias which flows from the two-tier corporate tax system.

Overstatement of operating profits.—There are two major elements which substantially overstate operating profits in periods of inflation. They are inventories and depreciation.

The inventory situation may be illustrated by assuming a company that normally maintains an inventory of 100,000 widgets. If inflation causes the price of widgets to increase by $1, from $2 to $3, under traditional FIFO (first in, first out) accounting the $100,000 increase in the value of the inventories is reported as profits, even though the company is no better off in real terms than it was before the inflation. Economists have long recognized that this increase is not a true "profit" and the Department of Commerce national income accounts have, from the inception of those accounts in the 1940's, separated it from profit figures.

For 30 years, business taxpayers have been permitted to exclude these amounts from taxable income by using LIFO (last in, first out) accounting, but only if they reported on the same basis to their shareholders and the public. Many larger businesses have preferred to pay higher taxes rather than report lesser earnings to their shareholders. Other companies, both large and small, concluded that in their particular cases the dollar advantages of LIFO were not sufficient to justify the somewhat more complicated procedures it required. With the rapid inflation which has occurred in the last year, however, the penalty in increased taxes on unreal income has become so great that there has been a major shift to LIFO accounting. This is long overdue. It is unfortunate that it has taken the business world and the accounting profession so long to get there.

A similar situation exists with respect to depreciation. In a period of rapid inflation, depreciation deductions based on historical cost result in reporting as income amounts which do not represent an increase in wealth but which are required merely to stay even. In a period of constant and substantial inflation, this subject urgently needs reexamination. Under current tax and accounting rules, business management is powerless to deal effectively with this problem.

The effects of the inventory and depreciation adjustments produce dramatic overstatement of real income: Nonfinancial corporations reported profits after taxes in 1974 of $65.5 billion as compared to $38.2 billion in 1965, an apparent 71-percent increase. But when depreciation is calculated on a basis that provides a more realistic accounting for the current value of the capital used in production and when the effect of inflation on inventory values is eliminated, after-tax profits actually declined by 50 percent from $37.0 billion in 1965 to $20.6 billion in 1974. A major factor contributing to this decline is that income taxes were payable on these fictitious elements of profits. That resulted in a rise in the effective tax rate on true profits from about 43 percent in 1965 to 69 percent in 1974. Thus, a realistic calculation shows that the sharp rise in reported profits was an optical illusion caused by inflation.

Some point out that, for the equity owners of corporations, the adverse effect of these items is offset by the fact that if the corporation has borrowed money, inflation permits it to be repaid with devalued dollars. This is essentially the same thing that has been happening to millions of homeowners. Inflation has caused the value of their homes and their incomes to rise very significantly, while the dollar value of their mortgage indebtedness stays constant. As a result, they have had a very real and major increase in their total wealth. Inflation has, in effect, caused a redistribution of wealth from creditors to debtors. Our tax system does not tax that increase, however, until the home is sold, and the mortgage lender never gets a deduction for the loss in value of the money which he lent. The taxation—or nontaxation—of these very real economic gains and losses introduces major distortions in a time of major inflation.

However, in the case of business taxation, it is necessary to separate what might be called the "financial" gains and losses from the "operating" profits. The capital required to run a business is supplied by both stockholders and lenders. In the long run, if a manufacturing business, for example, is to be healthy, its operations—the manufacture and sale of products—must produce a profit sufficient to compensate both shareholders and lenders for the capital which they have supplied. Thus, in a period of inflation, if we wish to see whether business is healthy we must restate the operating profits to reflect the fact that the costs associated with depreciation and inventories are, in fact, much greater than reflected under conventional financial accounting principles. If we are looking more narrowly to see whether the equity owners of the businesses are better or worse off, then we should also take into account the degree to which they have profited, like the homeowner, by a redistribution from wealth from creditors to debtors. The point is, however, that we should look at each of these elements separately and should try to correct for each to the extent practical. At the present time our overriding concern is with the operating profits, for in the long run they make the difference between financial health and financial sickness. Inflation is clearly causing operating profits to be overstated. That overstatement has several nontax consequences. To the extent that management relies on accounting data which do not reflect these real costs, bad management decisions, including underpricing, are likely to be made. Further, the public is left with the erroneous impression that business is profiting from inflation when in fact it is a major victim. That in turn leads to further wage and price demands, which further compounds both inflation and the business problem.

From a tax point of view, the overstatement of profits results in overtaxation, i.e., we are taxing more income than actually exists in the system as a whole. That is not true, at least on a current basis, with respect to the "financial" profits, because the increased wealth which goes to debtors is exactly offset by the losses of creditors, and neither is taken into account currently for tax purposes. On a periodic basis, there may also be overtaxation of the financial profits if stock which benefits from the devaluation of debt is sold or otherwise disposed of at a gain, as the gain will be taxed but the offsetting loss to others is not allowed as a deduction to them.

Since, in our economy, corporate profits are a major source of funds for new investment in productive capacity, all of this has grave implications for investment and growth. That is perhaps seen best in the figures for undistributed profits of nonfinancial corporations, restated on the same basis to account realistically for inventories and depreciation. It is the undistributed profits that corporations have left to fund additional *new* capacity (as distinguished from the replacement of existing capacity). In 1965, there were $20 billion of undistributed profits. By 1973—after 8 years in which real GNP (the rest of the economy) grew 36 percent—the undistributed profits of nonfinancial corporations had dropped to $6 billion. And for 1974, our preliminary estimate is that the figure for undistributed profits is a minus of nearly $10 billion. That means that there was not nearly enough even to replace existing capacity, and nothing to finance investment in additional new capacity.

The following chart shows with dramatic—and frightening—clarity the true state of affairs. (See exhibit 29.)

This problem of overstatement of earnings and the overtaxation which results from it is common to both large and small businesses. However, the lower the tax rate the less the problem. Thus, enterprises which pay little or no tax at the corporate level are the least affected, and to that extent there is less overtaxation of small businesses than there is of larger businesses. It is also true that the overtaxation element in the case of inventories may be corrected by any taxpayer who chooses to elect LIFO, but taxpayers can do nothing about the understatement of depreciation. It is in general the case that smaller companies have a larger percentage of their total investment in inventories and a lesser percentage in depreciable assets than do larger companies. Thus, smaller businesses tend to be less adversely affected than larger companies. It is true that use of LIFO accounting presents extra complications which can in some cases be burdensome for smaller companies, and the Treasury is working on proposals for a somewhat simpler system.

In sum, however, the overstatement of profits caused by inflation is a problem for all business. While small business tends to be somewhat less affected directly, the prosperity of smaller firms is inextricable from the prosperity of larger firms, and the overstatement and overtaxation of operating profits is a major threat to all business and, in the end, to all of us.

Anti-investment bias: the two-tier corporate tax system.—Our two-tiered system of corporate taxation in which income is taxed once at the corporate level and again at the shareholder level discriminates against corporate investors generally and small equity investors particularly. An individual in the 20-percent tax bracket in effect pays 48 percent at the corporate level and then an additional 20 percent on what is left for a total tax burden of 58.4 percent, or nearly three times his individual rate. If the individual is in the 70-percent bracket, he pays 48 percent at the corporate level and then an additional 70 percent on what is left. His total tax burden is 84.4 percent. If the same business could be conducted in a noncorporate form, the investors would pay only 20 percent and 70 percent respectively.

Our tax system puts a great penalty on companies that must incorporate. Companies that do incorporate are those that have large capital needs that must be raised from many persons. We should keep in mind that our system of taxation bears more heavily on corporations than do the tax systems of almost every other major industrial nation. In the last few years our major trading partners have largely eliminated the classical two-tiered system of corporate taxation. Through a variety of mechanisms they have adopted systems of "integrating" the personal and individual income taxes so that the double taxation element is radically lessened.

The problem of double taxation is substantially less for small business than for large business. Most of what the public thinks of as small business either pays no second tier tax at all or pays a second tier tax at a substantially lower effective rate than larger businesses. The reasons why that is so I shall discuss in a moment.

But here again, small business has a substantial stake in the overall problem, for the capital investments of the larger firms account for the bulk of the capital goods output, and their capital-raising difficulties become everybody's difficulties with alarming speed.

The taxation of small business: How much is it favored?

Estimates of Federal income taxes paid by incorporated and unincorporated business firms in 1971 are shown in table 4. Of the $36 billion of income taxes estimated to have been paid by U.S. businesses in 1971, $30 billion was paid by corporations other than Subchapter S corporations. The remaining $6 billion was paid by sole proprietorships, partnerships, and Subchapter S corporations.

Overall, about 21 percent of the business taxes come from businesses with receipts of less than $1 million. Such businesses account for most of the taxes paid by unincorporated businesses but less than half of the taxes paid by Subchapter S corporations and only 9 percent of the taxes paid by other corporations.

TABLE 4.—*Taxes on incomes of businesses, by size of business receipts and business form, 1971*

[Millions of dollars]

Size of business receipts	All returns	Sole proprietorships	Partnerships	Subchapter S corporations	Other corporations
All "small" businesses [1]	7,607	4,137	701	151	2,618
Under $25,000	850	726	17	(2)	107
$25,000 to $50,000	1,060	905	41	(2)	114
$50,000 to $100,000	1,443	1,119	101	5	218
$100,000 to $500,000	2,953	1,277	427	83	1,166
$500,000 to $1 million	1,301	110	117	61	1,013
"Large" businesses [1]	28,333	89	443	198	27,603
Total	35,940	4,226	1,144	349	30,221

[1] The "small" consist of those businesses with business receipts of less than $1 million, and the "large" consist of those with business receipts of $1 million or more.
[2] Not available.

Under the existing system small businesses do not pay more taxes than larger businesses. On the contrary, they pay substantially less. There are several reasons for that.

In the first place, most small businesses, as we have seen, are not incorporated. Thus, their profits are subject to tax only at the individual level, as distinguished from corporate income, which is taxed at both the corporate and individual level.

In the second place, about half of all corporations have no income subject to tax. In some cases that is because they have been unprofitable. But the absence of taxable income is in very large part attributable to two further facts: First, small closely held corporations frequently manage to pay out most of their income in the form of deductible wages or bonuses to their owner-managers, so that the income is simply taxed once at the individual level. Second, small closely held corporations may elect to be taxed under Subchapter S of the Internal Revenue Code, in which case all of their income is taxed directly to the owners without any tax at the corporate level—much in the same way that income is taxed to an unincorporated business operating as a partnership.

Finally, for corporations which have income subject to tax up to as much as $100,000 to $200,000, the corporate surtax exemption substantially lessens the effective rate of tax. That can be seen from table 5.

TABLE 5.—*The progressivity of the corporation income tax for small corporations*

Corporation income class [1]	Effective rate of tax [2]
	Percent
Under $25,000	20.4
$25,000 to 50,000	27.5
$50,000 to 100,000	36.6
$100,000 to 250,000	41.7
$250,000 to $1 million	44.2
$1 million or over	44.4
All returns with income subject to tax	42.0

[1] Corporations are classified by amount of income subject to tax at normal tax and surtax rates.
[2] Total tax divided by total income. "Tax" is liability after the investment credit but before the foreign tax credit. "Income" is income subject to tax (including alternative tax) after the net operating loss and dividend deductions.

In addition to the general factors described above, there are a number of more specialized provisions of the Internal Revenue Code that were enacted to benefit small business. They are summarized in the appendix.

It is very important to remember always that businesses are owned by people, and that it is ultimately people who bear the taxes. Thus, it is relevant to inquire what kind of people in fact own small businesses. When we are talking about potential tax benefits for corporations with taxable income of $25,000, $50,000, or $100,000, we should keep in mind that those companies tend to be owned by persons who, by most of our standards, are considered wealthy. They tend to be closely held, and in many, if not most, cases the income which we are talking about is only what remains after the owner-managers have paid themselves salaries and bonuses. Take, for example, a small retail corporation managed by its owner. Assume that he pays himself salary and bonus of $60,000 and that the corporation after deducting that amount has taxable income of $25,000. That $25,000 is, in effect, an amount saved by the owner. It is presently taxed at a 22-percent rate, even though his personal marginal rate is probably (depending on his exemptions and deductions) 50 percent or above and would be substantially higher if the $25,000 were also included in his income. The right to save $25,000 a year at a 22-percent tax rate is a very major tax benefit to persons in substantial tax brackets—which is where most owners of such corporations are. Ordinary taxpayers pay higher tax rates than 22 percent when their taxable income exceeds only $12,000.

Table 6 indicates clearly, though somewhat incompletely, the degree to which small business is owned by persons in relatively high-income classes.

TABLE 6.—*Percentage distributions of income from different forms of business by adjusted gross income class of recipient, 1970*

	Proprietorships		Partnerships		Subchapter S corporations		Other corporations	
	Percent within class	Cumul. percent	Percent within class	Cumul. percent	Percent within class	Cumul. percent	Percent within class	Cumul. percent
Adjusted gross income of recipient:								
Under $5,000	3.8	3.8	−7.0	−7.0	−13.6	−13.6	7.2	7.2
$5,000 to $10,000	16.8	20.6	9.7	2.7	2.1	−11.5	14.0	21.2
$10,000 to $20,000	27.7	48.3	18.7	21.4	13.0	1.5	16.2	37.4
$20,000 to $50,000	34.8	83.1	41.5	62.9	40.1	41.6	24.3	61.7
$50,000 and over	16.9	100.0	37.1	100.0	58.4	100.0	38.3	100.0
Amount of income from business form	$30.6 billion		$10.5 billion		$1.8 billion		$16.0 billion	

We have no tax data with respect to the incomes of owners of small corporations generally, but we can tell a great deal about that subject by looking at data with respect to Subchapter S corporations. Typically, those are relatively prosperous small corporations in the sense that they have significant earnings that remain after the payment of salaries and bonuses. The table shows that the great preponderance of income from such corporations goes to persons in income classes of $20,000 and above, and nearly 60 percent of that goes to persons with adjusted gross incomes of $50,000 or more. It is notable that stockholders of Subchapter S corporations are distinctly more affluent than stockholders of "giant" publicly held corporations, reflected in the columns labeled "other corporations." Partnerships are functionally very much like Subchapter S corporations and similar patterns of income distribution may be observed there. A great deal of the dividends of major corporations go to low- and middle-income persons indirectly through pension funds and life insurance. Those flows cannot be traced to individuals or adjusted gross income classifications, and are therefore not reflected in the columns entitled "other corporations." If they were reflected, a significantly larger percentage of the total distributions would go to lower income persons than is indicated. Yet notwithstanding this major omission, a larger percentage of the income flows from these corporations to persons with adjusted gross incomes below $10,000 than in the case of the income flows of any of the small business categories shown on the table.

Is small business declining?

It is often contended that small business is weak, unprofitable, and lacking access to capital funds. However, the evidence suggests that small business is doing relatively well.

Two measures of how well business is doing are the number of business incorporations and the failure rate. In 1973, there were 330,000 new incorporations, an increase of 4 percent over the previous year and 75 percent over the number of new incorporations in 1963. (See appendix.)

The Small Business Administration has estimated that the annual failure rate for 1974 will reach 40 per 10,000 firms. It is true that the failure rate for businesses generally rises during periods of economic downturn, and we can expect the rate for 1974 to be higher than the 36.4 per 10,000 firms in 1973, the lowest level in the last 20 years. Even a rate of 40 per 10,000 firms will be lower than the rate for 15 of the last 20 years, and it is considerably lower than the high of 64.4 reached in 1961, a recession year.

An important measure of the profitability of small corporations is the rate of return on stockholders' equity. The FTC compiles data on rates of return from manufacturing corporations. (See appendix.) From 1955 to 1964, the rate of return, whether before or after taxes, was lower for manufacturing corporations with assets under $1 million than for all manufacturing corporations. The relationship reversed from 1965 through 1969. The rate of return earned by all manufacturing corporations was below that earned by manufacturing corporations with assets under $1 million. In 1970 and 1971, the rate of return for small corporations fell below that of all manufacturing corporations, but for 1972 through 1974 the rate of return for small corporations was again higher than the overall return.

Credit is available to small business and at reasonable cost. In recent years the debt-equity ratio of manufacturing corporations has increased significantly. However, in all years, the ratio for small manufacturing corporations was much higher than that of all manufacturing corporations. In 1973, small manufacturing corporations had a debt-equity ratio of 93.6 percent while the debt-equity ratio of all corporations was only 62.1 percent. The composition of debt, however, differs considerably between small and all manufacturing corporations. Small manufacturing corporations have greater reliance on nonbank sources and on short-term debt.

Debt ratios for manufacturing corporations, fourth quarter 1973

Type of debt	Small corporations [1]	All corporations
Short-term debt:	*Percent*	*Percent*
Bank	15.4	9.3
Other	40.4	20.0
Total	55.8	29.3
Long-term debt:		
Bank	14.6	8.3
Other	23.2	24.5
Total	37.8	32.8
Combined long- and short-term debt:		
Bank	30.0	17.6
Other	63.6	44.5
Total	93.6	62.1

[1] Assets under $1 million.

Availability of credit implies little about its cost. It is often said that the cost of credit is very high for small business. Though it is generally true that the bank rate on business loans varies inversely with the size of the loan, this differential has tended to narrow over the years. In 1967 the average bank rate on short-term business loans of $1 million or more was 5.8 percent, and the rate on short-term loans of $1,000 to $10,000 was 6.6 percent, or 14 percent higher than the rate on loans of $1 million or more. By 1974, the differential between small and large business short-term loans has been almost eliminated. In the case of long-term loans, the differential was between 5.8 percent and 6.4 percent in 1967, a 10-percent differential. In 1974 the differential has decreased to 6 percent, i.e., 10.7 percent compared with 10.1 percent.

Bank rates on business loans, 1967 and 1974

	1967	1974
	Percent	*Percent*
All short-term loans	6.0	9.9
Loans of:		
$1,000 to $10,000	6.6	9.9
$10,000 to $100,000	6.5	10.1
$100,000 to $500,000	6.2	10.3
$500,000 to $1 million	6.0	10.1
$1 million and over	5.8	9.8
All long-term loans	5.9	10.2
Loans of:		
$1,000 to $10,000	6.4	10.7
$10,000 to $100,000	6.5	10.4
$100,000 to $500,000	6.2	10.5
$500,000 to $1 million	6.1	10.2
$1 million and over	5.8	10.1

Proposals for tax change

This committee has heard a number of proposals for tax changes aimed at helping small business. Today I have no administration proposals to present to you. I would, however, like to discuss some of the proposals that have been made to this committee.

Increase in the surtax exemption.—A number of proposals have been made to increase the corporate surtax exemption from $25,000 to $50,000 or $100,000. The tax bill finished yesterday by the House Ways and Means Committee would increase the surtax exemption to $50,000. It is estimated that this change will reduce revenues by $1.2 billion a year. Of the total business tax relief approved by the committee yesterday, the increase in the surtax exemption represents one-third. The increase in the surtax will provide no relief to small corporations with no taxable income or with taxable income of less than $25,000. Only 10.5 percent of all corporations will receive any tax reduction. These corporations represent only 1.3 percent of all business entities. And only a very small portion of these will get major benefits from increasing the surtax exemption. The major beneficiaries are the owners of those corporations that have taxable incomes in range from $25,000 to about $200,000. Below that income level there is no benefit, and above that level the percentage reduction in the effective tax rate is attractive but not munificent. Thus, assuming a corporation with no credits:

Taxable income	Present tax	Tax with $50,000 surtax exemption	Percentage reduction
$25,000	$5,500	$5,500	0
$50,000	17,500	11,000	37.1
$75,000	29,500	23,000	22.0
$100,000	41,500	35,000	15.7
$150,000	65,500	59,000	9.9
$200,000	S9,500	83,000	7.3

Increase in investment credit.—The Ways and Means Committee bill increases the investment tax credit to 10 percent. It has been pointed out that most of the dollar benefits from that increase will go to larger businesses, and some of your witnesses have recommended that the credit for small businesses be set at a higher rate than 10 percent, perhaps 20 percent. In general, if small businesses—however defined—get, say, 20 percent of the benefit from the increase in the tax credit, it is because they make only 20 percent of the investment. If we are to give an incentive for investment in new machinery and we wish to make it as effective as possible, we should give it where the investments are in fact made. There is no reason to favor additional investment made by small business over that made by large businesses. There is one feature of the present investment tax credit, the net income limitation, which does tend to penalize small businesses. The administration recommended last October that this net income limitation be liberalized as part of a general restructuring of the investment tax credit. We still support this change, and we hope that the tax-writing committees will be able to turn to this proposal later this year.

Investment credit for used property.—The Ways and Means increases this investment tax credit for used property from $50,000 to $75,000 per year. This change is generally considered a small business measure because used property is purchased more by small business than by large. This change will cost $80 million per year. We opposed the change before the Ways and Means Committee because it is an inefficient way to aid small business or to stimulate investment. Actually, used property already benefits from the tax credit for new property. If a new machine costs less because the investment credit provides a 10-percent discount, the price of used machines will be correspondingly reduced. In short, the credit is capitalized in the value of used machinery. Providing a credit for both new and used property only encourages the churning of property so that additional tax credits can be "earned."

Accumulated earnings.—Another proposal which your committee has considered is increasing the accumulated earnings credit from $100.000 to $150,000. Those supporting this change seem to suggest that it is necessary if small businesses are to reinvest their earnings. That is not correct. The accumulated earnings tax is imposed only on corporations whose accumulations exceed the reasonable needs of their business, including reasonably anticipated future needs. Thus, this tax does not now hamper reinvestment. Moreover, as a practical matter, revenue agents do not ordinarily assert the tax unless they observe amounts of liquid assets that are very large in relation to the size of the business. As we all know, this is not the situation with most small businesses, certainly not with those which merit the concern of this committee.

Net operating losses.—As you are aware, the House Ways and Means Committee recently considered and rejected certain proposals to alter the period to which net operating losses may be carried. These proposals were limited to the losses of corporations and thus would have been of no benefit to that vast majority of small businesses which are unincorporated. The Treasury opposed those proposals on the ground that they would primarily have advanced the special interest of a few large corporations. If there are to be changes in the carryover period, we agree that large corporations should not be treated more favorably than small businesses. Moreover, we think that increasing the carryforward period, especially in the case of fledgling business, bears careful study.

Conclusion

I appreciate the opportunity to appear before your committee and to discuss with you this very important subject. I hope that my comments will be helpful in your analysis of the problem, and look forward to working with you.

APPENDIX

Provisions conferring special benefits on small businesses

(1) *Surtax exemption.* Corporations pay tax at a rate of 22 percent on the first $25,000 of taxable income, 48 percent on taxable income in excess of $25,000. This results in an estimated tax expenditure of $3.6 billion for fiscal 1975. Section 11(d).

(2) *Additional first-year depreciation.* A taxpayer can deduct, in addition to normal depreciation, 20 percent of the cost of up to $10,000 worth of depreciable property ($20,000 in the case of a husband and wife filing a joint return) in the first year in which such property may be depreciated. Section 179.

(3) *Redemptions to pay death taxes.* If a decedent's stock in a corporation has a value greater than either 35 percent of his gross estate or 50 percent of his taxable estate, the corporation can redeem enough stock to pay all State and Federal estate taxes and to pay funeral and administration expenses. This redemption will be treated as a sale (usually producing little gain because the basis of the stock is the value at the decedent's death) rather than as a dividend. Section 303.

(4) *Gains and losses on small business investment company stock.* Any gain on the disposition of small business investment company stock is taxed at capital gain rates, while loss on such stock is treated much more favorably than loss on the sale of other capital assets: (a) 100 percent of the amount of such a loss (as opposed to 50 percent for a long-term capital loss) is deductible against ordinary income; and (b) such a loss may be deducted without regard to any limit (limit of $1,000 for a long-term capital loss). Sections 1242–1243.

(5) *Gains and losses on small business stock.* There is similar capital gain/ordinary loss treatment up to $25,000 of loss annually ($50,000 in the case of a husband and wife filing a joint return) for the stock of small domestic corporations. Section 1244.

(6) *Subchapter S—small business corporations.* A corporation with 10 or fewer shareholders (a husband and wife owning stock jointly count as a single shareholder) may elect to be exempt from the corporate tax; instead, profits and losses flow through to the shareholders. Sections 1371–1377.

(7) *Extension of time for paying estate taxes.* If either 35 percent of the value of the gross estate or 50 percent of the value of the taxable estate consists of an interest in a closely held business, the time for paying the estate tax may be extended. Section 6166.

Business incorporations and failures

Year	New incorporations	Failure annual rate (number per 10,000 concerns)
1954	117,411	42.0
1955	139,915	41.6
1956	141,163	48.0
1957	137,112	51.7
1958	150,781	55.9
1959	193,067	51.8
1960	182,713	57.0
1961	181,535	64.4
1962	182,057	60.8
1963	186,404	56.3
1964	197,724	53.2
1965	203,897	53.3
1966	200,010	51.6
1967	206,569	49.0
1968	233,635	38.6
1969	274,267	37.3
1970	266,086	43.8
1971	287,547	41.7
1972	316,601	38.3
1973	329,562	36.4

Source: Survey of Current Business; compiled by Dun & Bradstreet.

Annual rates of profit on stockholders' equity for manufacturing corporations, by asset size [1] (percent)

Year	All manufacturing corporations		Manufacturing corporations with assets under $1 million	
	Before Federal income tax	After Federal income tax	Before Federal income tax	After Federal income tax
1955	23.8	12.5	10.7	5.5
1956	22.6	12.3	19.9	11.8
1957	20.0	11.0	14.7	7.8
1958	15.4	8.6	8.0	4.5
1959	18.9	10.4	15.7	8.3
1960	16.7	9.2	12.2	5.6
1961	15.9	8.8	12.1	5.6
1962	17.6	9.8	15.3	8.4
1963	18.4	10.3	15.3	8.2
1964	19.8	11.6	18.7	11.6
1965	21.9	13.0	22.4	14.3
1966	22.5	13.5	26.9	17.5
1967	19.3	11.7	22.1	13.7
1968	20.8	12.1	21.8	13.2
1969	20.1	11.5	22.0	12.7
1970	15.7	9.3	14.8	7.6
1971	16.5	9.7	15.0	7.4
1972	18.4	10.6	22.7	14.1
1973	21.8	13.1	26.7	16.8
1974 [2]	24.6	15.5	33.2	21.8

[1] Simple average of the four quarters.
[2] Simple average of first three quarters.

Source: FTC-SEC, "Quarterly Financial Report for Manufacturing Corporations."

Exhibit 31.—Statement of Secretary Simon, March 3, 1975, before the House Ways and Means Committee, concerning the administration's energy tax program

I am pleased to be with you this morning to consider the President's energy proposals.

When I was here on January 22, I presented a comprehensive and detailed statement dealing with the President's energy proposals as well as the need for stimulating the economy and controlling inflation. On the assumption that the earlier statement can be included in the record, I will confine my remarks this morning to some summary observations.

What sacrifices are we willing to make?

There appears to be near-universal agreement on the need to conserve energy and, in particular, to reduce our imports of petroleum. As a Nation we have become addicted to cheap oil and to a level of oil consumption unknown elsewhere in the world. As a consequence we are at the mercy of a small cartel, which has the power to bring about international political and economic spasms of the kind we have recently experienced. We must extricate ourselves from this situation.

In the process of facing up to the problem, there has been a growing awareness that there will be some withdrawal pains. One result has been the emergence of a "mañana" cult that says, "Yes, we must solve the problem, but 'mañana'—not today." That is, in my view, a dangerous philosophy. The present level of petroleum imports is a direct threat to our national security. I say that for these reasons:

1. Petroleum is a unique commodity, entering into almost every facet of our economy, either as the fuel for transportation of goods and people or as the raw material for a myriad of products like fertilizer and petrochemicals. It is hardly an exaggeration to say that petroleum has become the lifeblood of our economy.
2. Because our demands for energy have been outstripping the growth in domestic production, we have become increasingly reliant upon foreign sources of oil. We are now importing about 40 percent of our total petro-

leum consumption; by 1985, if present trends continue, we would be dependent on foreign nations for more than half of the oil we consume.

3. Only a small portion of these imports can be deemed to be secure from interruption in the event of a political or military crisis, and recent history strongly indicates that such a crisis is by no means a remote possibility in an area where two-thirds of the world's known petroleum reserves are located.
4. Most of the countries which export the oil that we import are organized into a cartel which has managed to raise international oil prices to a level four times above that which prevailed prior to the 1973–74 embargo.
5. The outflow of U.S. funds to those oil-rich countries greatly enhances their economic and political power and weakens our own and that of our allies. In 1970, our total bill for foreign oil was $2.7 bilion. In 1974, that figure shot up to approximately $24 billion, and unless we act to restrict imports, the bill will rise within a short time to over $30 billion a year.

I believe the American public understands this threat to our security and the need to act decisively. We are often assured by public spokesmen that the American people are willing to "sacrifice" and are only waiting for leadership. I believe that too.

We are the wealthiest nation the world has ever known. Our citizens are the most affluent. In the last 15 years, our per capita income has risen by 50 percent. We pay less for oil and oil products than almost any other major industrial nation. Around the world, gasoline sells for two to three times as much as here. If this country can't face up to the problem, which can?

The President has proposed a program which will, by the end of the first year, reduce our consumption of oil by about 5 percent. That will be accomplished principally by price increases of roughly 10 cents a gallon. That is about the same price increase for oil that we had last year. Oil was only one of many increases last year, and we lived through them all. The difference this time is that we plan to give it all back.

We simply must keep a sense of perspective. We are talking about 10 cents a gallon, and most people will get it all back. For the majority, it will not even be an inconvenience, let alone a sacrifice. For a great many, particularly in lower income classes, there will be a net benefit.

It will be a tragedy if for fear of public reaction to 10 cents a gallon—which will be given back—we fail to take these critical measures. And it will be equally tragic if we insist on building into the solution a series of bureaucratic changes which are wholly disproportionate to the size of the problem and which will permanently disable the efficient operation of our economic system.

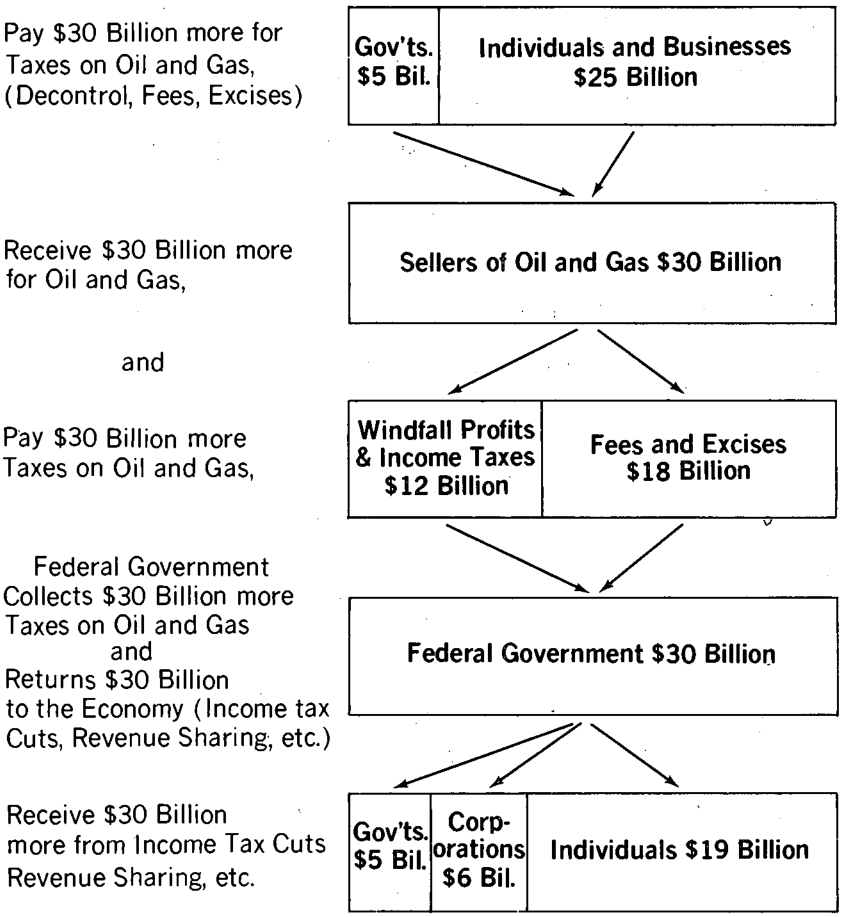
The proposals

The basic proposal is to raise the price of oil *relative* to other commodities. That would be accomplished by an import fee on imported oil and by the decontrol of that portion of our domestic production which is artificially held to a price less than half the price paid by other nations. Together those actions will raise the average price of oil by about $4 a barrel, which translates into 10 cents a gallon. Geographical discriminations will be eliminated, as we will no longer have regions with differing mixes of artificially cheap oil. Concurrently, we would deal with natural gas. An excise tax would be levied on all natural gas, to keep its price in line with the increased price of oil and end the careless use of this fuel by those for whom it is cheap at present prices. And new natural gas would be deregulated, to begin to undo the artificial and job destructive shortage we have created with more than 20 years of regulation.

At the same time these price increases are occurring, the Government will collect additional taxes in equal aggregate amount and return them to consumers through the tax system. Approximately $30 billion in extra prices will be paid. And approximately $30 billion will be returned to consumers—$25 billion to private purchasers, $2 billion to State and local governments, and $3 billion to the Federal Government.

The following chart shows how these additional prices are returned to consumers.

President's Energy and Tax Package



There is not much sacrifice in such a program. Some individuals won't get back quite as much as they paid. But, in general, lower income persons will get more back than the extra they spend. Most will come out ahead. It is not possible for everyone to come out ahead, but the only ones who will not come out at least even are those who are exceptionally high energy consumers or who are in higher income brackets.

The proposals would eliminate discomfort for the great majority and keep the pain at the lowest possible level for the remainder.

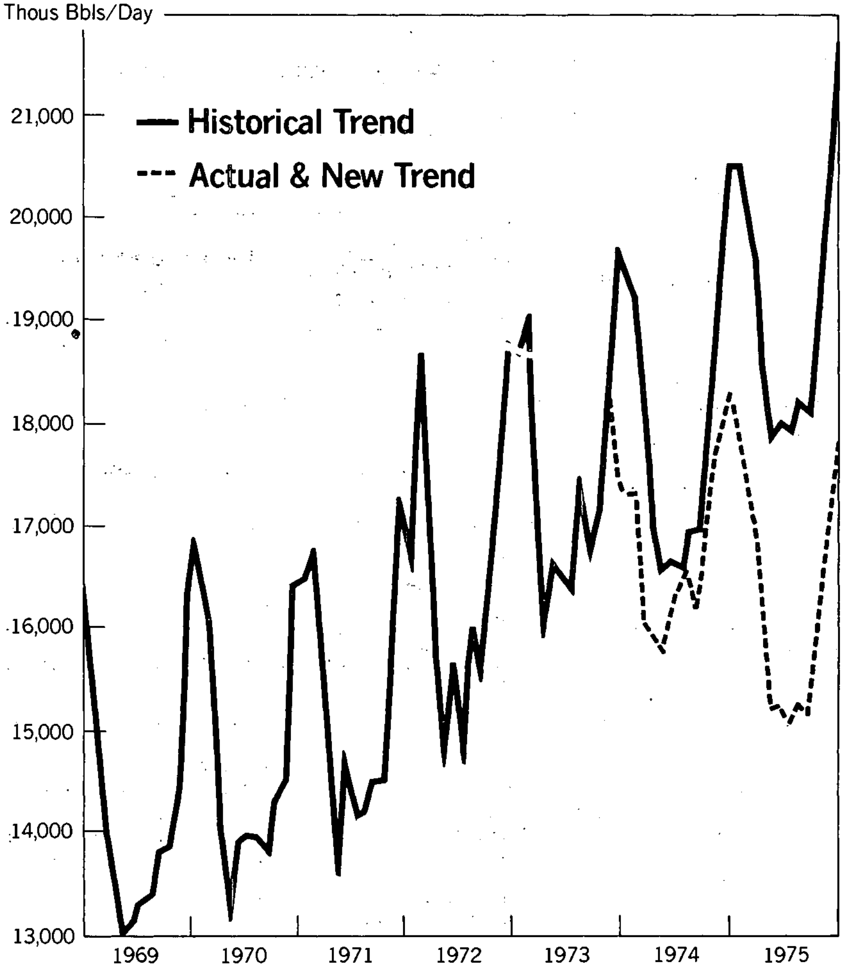
Will it work?

It is a fact, long known to economists, that "a rise in the price reduces the use"; that is, if prices of a product are increased *relative* to other commodities, the consumption of that product will be less than it otherwise would be. And that is true even if the incomes of the consumers rise at the same time. Some laymen are puzzled by the proposition that a price increase can cause consumption to fall if consumers are concurrently returned an amount of money equal roughly to the price increases they paid.

But think about it this way. Suppose you were spending $50 a year on apples and the price of apples were to double, while at the same time your take-home pay were increased an additional $50 a year. Would you still buy the same amount of apples? Or would you perhaps, at least to some extent, substitute pears and bananas for the apples you previously bought?

The evidence is incontrovertible that a *relative* change in price will cause a *relative* change in consumption. The degree to which that happens is referred to by economists as the "elasticity" of demand, and the experience of the last 18 months provides dramatic proof that price greatly affects demand for oil and oil products. You can see that from the chart which follows:

Comparisons of Total Product Demand



The chart shows that the consumption of petroleum has great seasonal variation, but has increased steadily for some years. However, the major price increases which occurred last year helped arrest that upward climb and caused consumption to be substantially less than it would otherwise have been. There was some absolute drop in consumption, and a very substantial *relative* drop from what consumption would otherwise have been.

In the longer run, the reduction in energy use from the price rises which have already occurred will be still greater, as there are many adaptations which taxpayers can and will make over time. Buying better mileage cars, insulating homes, and switching factories from oil to coal are just a few examples. Similar results have occured in other countries. Thus, the Wall Street Journal for January 29 reports:

> Britain, West Germany and a majority of countries depend upon rising prices to encourage cuts in energy use. The Petroleum Economist, an oil weekly published in London, estimates that in the first half of last year, fuel consumption dropped from a year earlier by 14% in West Germany, by 9% in Britain, by 6% in France. . . .

Several econometric studies have been made, inside the Government and out, to measure the elasticities of demand for energy products. The experience of the last year provided a unique laboratory to test the reliability of these measures of elasticity, and as a result we have confidence in our estimates—keeping in mind that they are still only estimates.

Do we know exactly how much 10 cents a gallon will reduce consumption? The answer is no. Do we *need* to know exactly how much consumption will be reduced? The answer again is no. The important thing is that we move in the right direction and that our estimates be roughly correct over a period of several years. If it turns out that we are too high or too low, adjustments can be made in the import fees and excises.

Are we reasonably sure that we are in the ballpark? The answer to that is yes. We believe that the econometric data, updated by the experience of last year, provides a reasonably reliable basis for estimates.

Quotas as an alternative

There has been considerable discussion about using a series of gradually more restrictive quotas rather than price changes to achieve import reductions. Proponents of quotas seem to assume that it is critical to know precisely how much imports would be reduced and argue that quotas would provide that answer.

But most of the arguments for quotas I have seen leave off in midair, and do not consider what happens after the quantity-reducing quota is imposed. One of two things is possible: Prices of oil will rise just as in the case of an import fee, or, alternatively, shortages and/or rationing will occur.

Quota without further controls.—If a quota is imposed to restrict imports, the price of oil will rise unless further action is taken to prevent that rise. If we knew for sure that a 10-cent-a-gallon price increase would reduce consumption by 1 million barrels, we could be equally sure that an import quota that reduced consumption by 1 million barrels would increase U.S. prices by the same 10 cents. We are dealing with the same supplies and the same demand and they will balance out at the same place. Thus, an import fee and a quota have identical price implications.

A quota system, however, has two disadvantages. First, a quota leaves the additional price increase in the hands of importers and producers rather than in the hands of the government, unless an elaborate quota auctioning scheme is developed.

Second, a series of quotas would be more disruptive of economic activity because the expectation of quota reductions would create business uncertainties as to how prices would react. It is much better to have certainty about prices (and be less certain about the size of import reductions), because it is price data that businessmen need in order to make intelligent decisions about running their businesses and making their capital investments. For a company assessing the risks of going into the oil-shale business, for example, the critical data are oil prices.

Quota with controls.—Some proponents of quotas would prohibit the price increases that would normally follow from a quota. That could be accomplished by a system of price controls, and would, in turn, create shortages. At artificially low prices the quantities demanded will exceed the supply. The shortages could then be distributed across the population by a system of allocation or rationing. We would be embarked on an era of chronic shortage and maladjustment, without the efficient incentives provided by the price system for producers to develop additional sources of supplies and for consumers to accept substitutes. I do not think the public would stick with such a system.

An allocation program is sometimes cited as a solution—primarily, I think, on the mistaken notion that it would avoid rationing. But allocation is itself a system of partial rationing which occurs at the business level rather than at the consumer level. An allocation program would deny businesses some of the supplies they need to continue functioning, and would lead to business dislocations and the loss of jobs. The same kind of thing would happen that we have seen this winter when plants have closed because they could not get a sufficient allocation of natural gas. We estimate that several hundred thousand jobs would be lost. At the retail level, quantities would be rationed by queuing, as was gasoline last winter. Nor would all of this necessarily prevent consumer prices from rising. To fully ensure that prices will not rise due to restrictive supplies of oil, the ultimate requirement is rationing of gasoline, fuel oil, fertilizer, and petrochemicals.

In sum, if prices were not permitted to rise, a major bureaucracy would have to be created and permanently maintained to decide how the resulting shortages would be allocated. I cannot imagine that many citizens who lived through the rationing experiences of World War II would willingly elect the massive interference with their freedom of choice which rationing entails—certainly not in preference to a price increase of 10 cents a gallon which they get back. Those who are too young to remember the rationing experience of World War II would be quickly disenchanted.

Effect on the economy

The effect of the program on the economy will in broad outline be neutral. Thirty billion dollars is taken out of the private economy and $30 billion is put back in. The mere enactment of a clear energy policy should have a beneficial effect, regardless of details, for it will remove many uncertainties that presently inhibit economic and business planning. In a few industries, substantial readjustments will be required. That is inevitable if we are to cut back consumption, and is a process which must get underway. However, most businesses will pass most of the increases through to consumers. (The projected 2-percent increase in prices assumes that all such increases are passed through.)

Much debate has focused on whether price levels will increase. We have estimated that there will be a 2-percent increase in the CPI. But even that is a statistical mirage, for most consumers will get the money back through tax reduction. The average citizen will have the same wherewithal to buy the same amount of petroleum products as before—if he chooses to—without reducing his other purchases.

The CPI is important, even if it has many inadequacies in conveying the true state of affairs, because people's thinking and actions are often shaped by it. But, it should be emphasized that whatever effect the program has on the CPI or on price levels generally, it will be a one-time effect. Once digested, petroleum price increases will not increase the ongoing, future rates of inflation.

Would a gasoline tax be better?

We have proposed a tax on crude oil because we believe it will do the job most efficiently, create the fewest major dislocations, and spread the burden of modest adjustments across everyone, rather than impose major adjustments on a few.

A tax on gasoline alone does just part of the job. Gasoline accounts for less than half of each barrel of crude. We need to conserve the other half equally as much.

The fact is that gasoline is not the most price responsive element in the barrel of oil—particularly in the longer run. There has been a tendency for most of us to think that gasoline is the easiest thing for somebody else to give up or to find a substitute for. But the surest way to identify the things that the public can give up most easily is to look at the response to changes in price. Things which people find most difficult to give up are the least responsive to price changes, because people continue to buy almost the same amount even when the price rises sharply. Things which people value the least are the most responsive to price changes. When people are willing to do without them or can easily find acceptable substitutes, even a small increase in price can produce a large falloff in demand.

Thus, the price system provides a kind of automatic "polling system" which tells us the public's relative preferences. There are a variety of products that come from a barrel of crude—including gasoline, residual fuel oil, jet fuel, kerosene, ordinary residential heating oil, and petrochemical feedstocks. The evidence on hand is that it is no easier for people to give up gasoline than other products in the short run, and harder to do so in the longer run. It seems to me hard to argue against the proposition that the public should be permitted to decide for themselves which particular petroleum products they are willing to cut down on.

It would take a gasoline tax of 45 cents to 50 cents per gallon to achieve the same ultimate reduction in consumption as the roughly 10-cent-per-gallon tax which the President's proposals would put on all petroleum products. If the present proposals raised the CPI by 2 percent, then by the same reckoning, substitution of a 45-cent-a-gallon increase in the price of gasoline for a 10-cent-a-gallon increase in the price of crude would cause the CPI to go up by about 3 percent.

Tax reductions for individuals

The Treasury will collect about $30 billion in taxes under the proposal, which is roughly equal to the aggregate price increase that will result from the proposal. The private sector will bear an estimated $25 billion of that in the form of higher costs of energy-related items they buy, and Federal, State, and local governments will bear the remainder.

For individuals, the proposals include an income tax reduction of $16½ billion:

- By increasing the low-income allowance from its present level of $1,300, to $2,600 for a couple and $2,000 for single taxpayers, which will provide benefits of $5 billion, and
- By cutting in half, from 14 percent to 7 percent, the tax rate for the first taxable income bracket and making substantial, but smaller, reductions in tax rates in the next four brackets,[1] which will provide additional benefits of $11½ billion.

The effect of these proposed reductions is very progressive, as they are proportionately greater, both in dollars and percentages for lower income taxpayers. The following table shows the degree to which that is true.

Effect of proposed income tax reductions

[1975 levels]

Adjusted gross income class	Percentage reduction in income tax	Reduction as a percent of present after-tax income
0–$3,000	−83.3	[1] 8.9
$3,000–$5,000	−66.7	[1] 4.6
$5,000–$7,000	−49.0	4.2
$7,000–$10,000	−38.0	3.9
$10,000–$15,000	−21.6	2.6
$15,000–$20,000	−11.8	1.7
$20,000–$50,000	−4.8	.9
$50,000–$100,000	−.8	.3
$100,000 and over	−.2	.1
Total	−12.6	2.0

[1]Includes energy tax equalization payments to low-income adults.

The last column is especially significant in assessing the extent to which the tax reductions more than offset any price increases resulting from the energy proposals. We estimate that consumer price levels will increase 2 percent if all energy costs are fully passed through to consumers. Individuals whose after-tax incomes go up more than 2 percent while their living costs go up only 2 percent are obviously ahead of the game.

The next table tells a similar story in terms of individual families.

[1] Illustrates rates changes for married persons filing jointly. Comparable changes are made in other rate schedules.

Illustrations of permanent tax relief and increased energy costs at various levels of household income

Household income	Total increased energy costs [1]	Permanent tax relief plus $80 special payments for adjusted gross incomes equal to household incomes shown	
		Single person	Family of four persons
$2,000	$85	−$80	−$160
3,000	110	−120	−160
5,000	150	−250	−178
8,000	188	−297	−337
10,000	228	−254	−349
12,000	253	−190	−316
15,000	296	−190	−221
18,000	318	−190	−210
25,000	393	−190	−192
30,000	420	−148	−151

[1] Assumes that all energy price increases are fully reflected in prices of final products.

It is true, of course, that an average statistic does not fit everyone. Some people have greater than average energy costs just as some people have less than average costs. But in an overall, rough way the tax reductions are more than compensations for lower income persons. It is not the purpose to compensate everyone exactly and there will surely be persons for whom the program creates significant additional expense and others to whom it gives windfalls. There is no way to prevent such individual windfall gains and windfall losses under this or any other program of energy reduction with teeth in it.

To those individuals whose incomes are so low that they do not benefit sufficiently from income tax reductions to offset greater additional energy costs, the proposal would distribute an additional $2 billion in the form of an $80-per-adult credit as explained in my prior testimony. Finally, to bring the benefits for individuals up to a total of $19 billion, a special tax credit would be allowed for expenditures on thermal-efficiency improvements for homes, such as storm windows and doors, insulation, and weather stripping. Three-fourths of the total revenue is thus dedicated to individual and unincorporated business tax reductions.

State and local governments

Since State and local governments are important consumers of energy, they too would get $2 billion of benefits through the revenue sharing system. While distributions under the existing formulas would no doubt be easiest to implement, there has been some feeling that it would not adequately provide for schools, which are major energy users. We believe flexibility in this respect is desirable and would be happy to work with you in working out satisfactory adjustments to the distribution formula, if you believe that to be appropriate.

Corporate tax rate adjustment

The balance of the $25 billion to be returned to the private sector would go to corporations in the form of a reduction in the corporate tax rate.

In my prior testimony, I explained in some detail our concern over the deterioration of business profits, which is further exacerbated by the current recession. The increase in energy costs will provide still further burdens to the extent not passed on in prices. Thus, we believe it essential that corporations, as well as individuals, be accorded substantial tax reductions. Tax reductions for corporations are seldom politically popular, but declining business profits mean declining productivity and increasing unemployment, which are even less popular. Fairness and commonsense require that businesses share in the distribution of these revenues.

The reasons for recommending reduction in corporate taxes by means of a rate reduction instead of by some other means are as follows:

Rate reduction is the most neutral way of reducing corporate taxes. Neutrality means that all corporations now paying at a 48-percent rate will share in the tax reduction, will have maximum flexibility in making business and investment decisions, and can therefore operate most efficiently without regard to tax consequences.

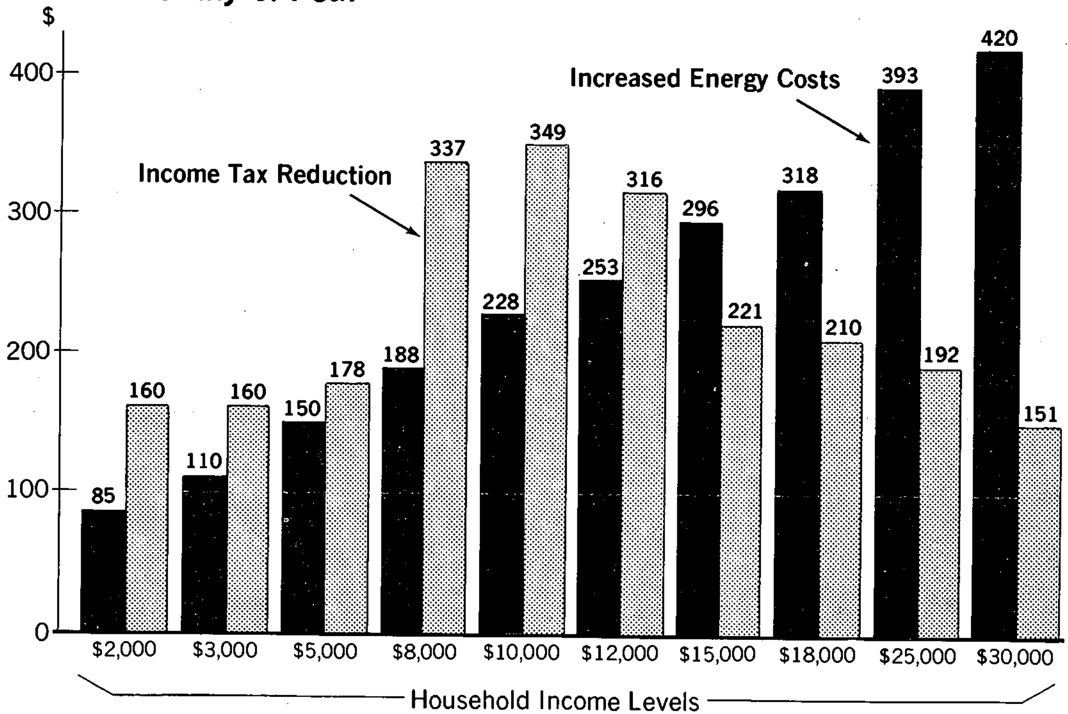
Reduction of the presently high corporate tax rate will be the most meaningful and symbolic signal to business, to investors, and to the market of a serious intent to assist business.

Rate reduction has a character of permanence. We have proposed to make the permanent tax reduction for individuals in large part by rate reduction. We should do the same for corporations.

Conclusion

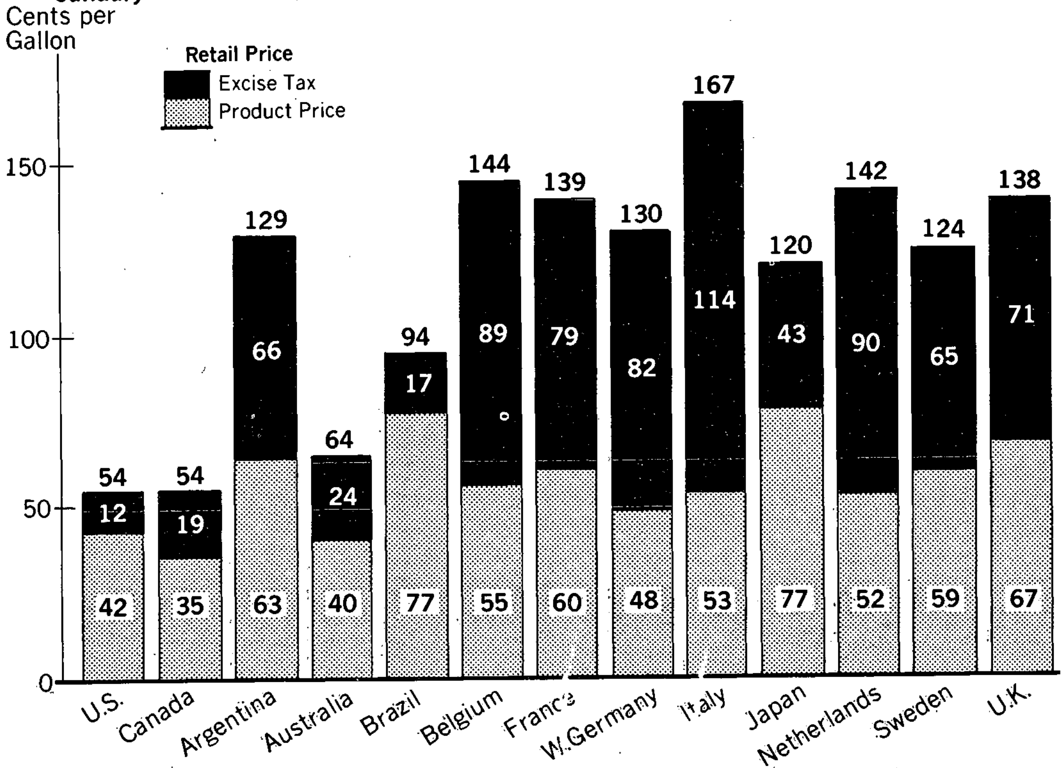
The program which we have proposed will be effective in reducing energy consumption and oil imports. While there are complexities to be pondered by those who design and those who enact it, it will be simplicity itself in operation. The ordinary citizen will be entirely unaware of anything except the change in relative prices, for which he will have more money to spend. He will continue to have complete freedom of choice. No new bureaucracy will be spawned. And the total tax burden on our least affluent citizens will have been significantly reduced.

Average Increases in Energy Costs for Households at Specific Levels Compared to Proposed Income Tax Reductions for a Family of Four [1]



[1] Includes energy tax equalization payments to low income adults.

Gasoline Prices and Excise Taxes Around the World
January 1975



Source: Richardson Associates, New York

Trade and Raw Materials Policy

Exhibit 32.—Executive order, March 27, 1975, on administration of the trade agreements program

By virtue of the authority vested in me by the Trade Act of 1974, hereinafter referred to as the Act (Public Law 93-618, 88 Stat. 1978), the Trade Expansion Act of 1962, as amended (19 U.S.C. 1801), Section 350 of the Tariff Act of 1930, as amended (19 U.S.C. 1351), and Section 301 of Title 3 of the United States Code, and as President of the United States, it is hereby ordered as follows:

Section 1. *The Trade Agreements Program.* The "trade agreements program" includes all activities consisting of, or related to, the negotiation or administration of international agreements which primarily concern trade and which are concluded pursuant to the authority vested in the President by the Constitution, Section 350 of the Tariff Act of 1930, as amended, the Trade Expansion Act of 1962, as amended, or the Act.

Sec. 2. *The Special Representative for Trade Negotiations.*

(a) The Special Representative for Trade Negotiations, hereinafter referred to as the Special Representative, in addition to the functions conferred upon him by the Act, including Section 141 thereof, and in addition to the functions and responsibilities set forth in this Order, shall be responsible for such other functions as the President may direct.

(b) The Special Representative, except where otherwise expressly provided by statute, Executive order, or instructions of the President, shall be the chief representative of the United States for each negotiation under the trade agreements program and shall participate in other negotiations which may have a direct and significant impact on trade.

(c) The Special Representative shall prepare, for the President's transmission to Congress, the annual report on the trade agreements program required by Section 163(a) of the Act. At the request of the Special Representative, other agencies shall assist in the preparation of that report.

(d) The Special Representative, except where expressly otherwise provided or prohibited by statute, Executive order, or instructions of the President, shall be responsible for the proper administration of the trade agreements program, and may, as he deems necessary, assign to the head of any Executive agency or body the performance of his duties which are incidental to the administration of the trade agreements program.

(e) The Special Representative shall consult with the Trade Policy Committee in connection with the performance of his functions, including those established or delegated by this Order, and shall, as appropriate, consult with other Federal agencies or bodies. With respect to the performance of his functions under Title IV of the Act, including those established or delegated by this Order, the Special Representative shall also consult with the East-West Foreign Trade Board.

(f) The Special Representative shall be responsible for the preparation and submission of any Proclamation which relates wholly or primarily to the trade agreements program. Any such Proclamation shall be subject to all the provisions of Executive Order No. 11030, as amended, except that such Proclamation need not be submitted to the Director of the Office of Management and Budget.

(g) The Secretary of State shall advise the Special Representative, and the Committee, on the foreign policy implications of any action under the trade agreements program. The Special Representative shall invite appropriate departments to participate in trade negotiations of particular interest to such departments, and the Department of State shall participate in trade negotiations which have a direct and significant impact on foreign policy.

Sec. 3. *The Trade Policy Committee.*

(a) As provided by Section 242 of the Trade Expansion Act of 1962 (19 U.S.C. 1872), as amended by Section 602(b) of the Act, there is established the Trade Policy Committee, hereinafter referred to as the Committee. The Committee shall be composed of:

(1) The Special Representative, who shall be Chairman.
(2) The Secretary of State.

(3) The Secretary of the Treasury.
(4) The Secretary of Defense.
(5) The Attorney General.
(6) The Secretary of the Interior.
(7) The Secretary of Agriculture.
(8) The Secretary of Commerce.
(9) The Secretary of Labor.
(10) The Assistant to the President for Economic Affairs.
(11) The Executive Director of the Council on International Economic Policy.

Each member of the Committee may designate an officer of his agency, whose status is not below that of an Assistant Secretary, to serve in his stead, when he is unable to attend any meetings of the Committee. The Chairman, as he deems appropriate, may invite representatives from other agencies to attend the meetings of the Committee.

(b) The Committee shall have the functions conferred by the Trade Expansion Act of 1962, as amended, upon the inter-agency organization referred to in Section 242 thereof, as amended, the functions delegated to it by the provisions of this Order, and such other functions as the President may from time to time direct. Recommendations and advice of the Committee shall be submitted to the President by the Chairman.

(c) The Recommendations made by the Committee under Section 242(b) (1) of the Trade Expansion Act of 1962, as amended, with respect to basic policy issues arising in the administration of the trade agreements program, as approved or modified by the President, shall guide the administration of the trade agreements program. The Special Representative or any other officer who is chief representative of the United States in a negotiation in connection with the trade agreements program shall keep the Committee informed with respect to the status and conduct of negotiations and shall consult with the Committee regarding the basic policy issues arising in the course of negotiations.

(d) Before making recommendations to the President under Section 242(b) (2) of the Trade Expansion Act of 1962, as amended, the Committee shall, through the Special Representative, request the advice of the Adjustment Assistance Coordinating Committee, established by Section 281 of the Act.

(e) The Committee shall advise the President as to what action, if any, he should take under Section 337(g) of the Tariff Act of 1930, as amended by Section 341 of the Act, relating to unfair practices in import trade.

(f) The Trade Expansion Act Advisory Committee established by Section 4 of Executive Order No. 11075 of January 15, 1963, is abolished and all of its records are transferred to the Trade Policy Committee.

Sec. 4. *Trade Negotiations Under Title I of the Act.*

(a) The functions of the President under Section 102 of the Act concerning notice to, and consultation with, Congress, in connection with agreements on nontariff barriers to, and other distortions of, trade, are hereby delegated to the Special Representative.

(b) The Special Representative, after consultation with the Committee, shall prepare, for the President's transmission to Congress, all proposed legislation and other documents necessary or appropriate for the implementation of, or otherwise required in connection with, trade agreements; provided, however, that where implementation of an agreement on nontariff barriers to, and other distortions of, trade requires a change in a domestic law, the department or agency having the primary interest in the administration of such domestic law shall prepare and transmit to the Special Representative the proposed legislation necessary or appropriate for such implementation.

(c) The functions of the President under Section 131(c) of the Act with respect to advice of the International Trade Commission and under Section 132 of the Act with respect to advice of the departments of the Federal Government and other sources, are delegated to the Special Representative. The functions of the President under Section 133 of the Act with respect to public hearings in connection with certain trade negotiations are delegated to the Special Representative, who shall designate an interagency committee to hold and conduct any such hearings.

(d) The functions of the President under Section 135 of the Act with respect to advisory committees and, notwithstanding the provisions of any other

Executive order, the functions of the President under the Federal Advisory Committee Act (86 Stat. 770, 5 U.S.C. App. I), except that of reporting annually to Congress, which are applicable to advisory committees under the Act are delegated to the Special Representative. In establishing and organizing general policy advisory committees or sector advisory committees under Section 135(c) of the Act, the Special Representative shall act through the Secretaries of Commerce, Labor and Agriculture, as appropriate.

(e) The functions of the President with respect to determining ad valorem amounts and equivalents pursuant to Sections 601 (3) and (4) of the Act are hereby delegated to the Special Representative. The International Trade Commission is requested to advise the Special Representative with respect to determining such ad valorem amounts and equivalents. The Special Representative shall seek the advice of the Commission and consult with the Committee with respect to the determination of such ad valorem amounts and equivalents.

(f) Advice of the International Trade Commission under Section 131 of the Act, and other advice or reports by the International Trade Commission to the President or the Special Representative, the release or disclosure of which is not specifically authorized or required by law, shall not be released or disclosed in any manner or to any extent not specifically authorized by the President or by the Special Representative.

Sec. 5. *Import Relief and Market Disruption.*

(a) The Special Representative is authorized to request from the International Trade Commission the information specified in Sections 202(d) and 203(i) (1) and (2) of the Act.

(b) The Secretary of the Treasury, in consultation with the Secretary of Commerce or the Secretary of Agriculture, as appropriate, is authorized to issue, under Section 203(g) of the Act, regulations governing the administration of any quantitative restrictions proclaimed in order to provide import relief and is authorized to issue, under Section 203(g) of the Act or 352(b) of the Trade Expansion Act of 1962, regulations governing the entry, or withdrawal from warehouses for consumption, of articles pursuant to any orderly marketing agreement.

(c) The Secretary of Commerce shall exercise primary responsibility for monitoring imports under any orderly marketing agreement.

Sec. 6. *Unfair Trade Practices.*

(a) The Special Representative, acting through an interagency committee which he shall designate for such purpose, shall provide the opportunity for the presentation of views, under Sections 301(d)(1) and 301(e)(1) of the Act, with respect to unfair or unreasonable foreign trade practices and with respect to the United States response thereto.

(b) The Special Representative shall provide for appropriate public hearings under Section 301(e)(2) of the Act; and, shall issue regulations concerning the filing of requests for, and the conduct of, such hearings.

(c) The Special Representative is authorized to request, pursuant to Section 301(e)(3) of the Act, from the International Trade Commission, its views as to the probable impact on the economy of the United States of any action under Section 301(a) of the Act.

Sec. 7. *East-West Foreign Trade Board.*

(a) In accordance with Section 411 of the Act, there is hereby established the East-West Foreign Trade Board, hereinafter referred to as the Board. The Board shall be composed of the following members and such additional members of the Executive branch as the President may designate:

(1) The Secretary of State.
(2) The Secretary of the Treasury.
(3) The Secretary of Agriculture.
(4) The Secretary of Commerce.
(5) The Special Representative for Trade Negotiations.
(6) The Director of the Office of Management and Budget.
(7) The Executive Director of the Council on International Economic Policy.
(8) The President of the Export-Import Bank of the United States.
(9) The Assistant to the President for Economic Affairs.

The President shall designate the Chairman and the Deputy Chairman of the Board. The President may designate an Executive Secretary, who shall be Chairman of a working group which will include membership from the agencies represented on the Board.

(b) The Board shall perform such functions as are required by Section 411 of the Act and such other functions as the President may direct.

(c) The Board is authorized to promulgate such rules and regulations as are necessary or appropriate to carry out its responsibilities under the Act and this Order.

(d) The Secretary of State shall advise the President with respect to determinations required to be made in connection with Sections 402 and 409 of the Act (dealing with freedom of emigration) and Section 403 (dealing with United States personnel missing in action in Southeast Asia), and shall prepare, for the President's transmission to Congress, the reports and other documents required by Sections 402 and 409 of the Act.

(e) The President's Committee on East-West Trade Policy, established by Executive Order No. 11789 of June 25, 1974, as amended by Section 6(d of Executive Order No. 11808 of September 30, 1974, is abolished and all of it records are transferred to the Board.

Sec. 8. *Generalized System of Preferences.*

(a) The Special Representative, in consultation with the Secretary of State, shall be responsible for the administration of the generalized system of preferences under Title V of the Act.

(b) The Committee, through the Special Representative, shall advise the President as to which countries should be designated as beneficiary developing countries, and as to which articles should be designated as eligible articles for the purposes of the system of generalized preferences.

Sec. 9. *Prior Executive Orders.*

(a) Executive Order No. 11789 of June 25, 1974, and Section 6(d) of Executive Order No. 11808 of September 30, 1974, relating to the President's Committee on East-West Trade Policy are hereby revoked.

(b) (1) Sections 5(b), 7, and 8 of Executive Order No. 11075 of January 15, 1963, are hereby revoked effective April 3, 1975; (2) the remainder of Executive Order No. 11075, and Executive Order No. 11106 of April 18, 1963 and Executive Order No. 11113 of June 13, 1963, are hereby revoked.

GERALD R. FORD.

THE WHITE HOUSE, *March 27, 1975.*

Exhibit 33.—Statement by Secretary Simon, April 10, 1975, at the Fifth Session of the U.S.-U.S.S.R. Commercial Commission, Moscow [not a verbatim transcript]

On behalf of the American delegation, I want to thank you for your warm and generous welcome to the Soviet Union for the fifth annual meeting of our Joint Commercial Commission.

I also want to express my personal pleasure at the opportunity to return to your country. This is my second trip to the Soviet Union, and on this occasion my colleagues and I will have a chance to visit parts of your land that many of us have never seen before. We deeply appreciate your gracious hospitality in inviting us not only to Moscow but to Sochi and Tashkent as well.

The United States continues to regard these meetings and the trade which they encourage as a vital building block in the bridge that we are constructing between our two nations. The American commitment to that process remains firm, just as the bridge itself has become strong and durable.

In the year that has passed since we met in Washington, much has happened in the world that might affect these discussions today. There has been a change of leadership in America. Our American economy, along with the economies of many other nations in Europe and the rest of the world, has experienced certain difficulties. And internal differences have developed within the United States over the 1972 Trade Agreement between our two countries.

While these events are significant, they should not be misinterpreted nor should they be allowed to interfere with the progress we can make here.

The transition of leadership in our country, though unique, passed smoothly and, in fact, helped to strengthen the unity of our people. We are confident that the United States will be well on the road to economic recovery during the second half of this year. Indeed, there is mounting evidence that our economy will recover much more rapidly than many observers thought possible only a few weeks ago. Under these circumstances, we must exercise extreme care to avoid overheating our economy and unleashing the distortions caused by high rates of inflation.

We do not need additional exports to assure the recovery of our economy. We have ample needs and ample means to create domestically the appropriate level of demand upon our economy. But we do need to participate fully in the opportunities offered by open international trade if we—and others—are to derive through trade the maximum benefits from the great potential productivity of our economies.

It is for this reason—as well as further to strengthen the bonds of peace between our nations—that we believe so passionately in the principles embodied in the Trade Agreement of 1972. The administration strongly opposed the actions by our Congress which interrupted the normalization of our trade relations with the Soviet Union. The President has committed himself to work for removal of current restrictions at the earliest opportunity. We must proceed carefully to insure that when the President next puts forward a specific proposal it will be on the basis of a consensus between the administration and the responsible leaders of the Congress.

In preparing a legislative proposal, we shall have in mind both the importance of removing arbitrary ceilings on Eximbank credits for U.S. exports and the importance of eliminating the unacceptable aspects of the Jackson amendment to the recent trade bill.

Achieving the necessary consensus with the Congress in the fields of finance and trade will be greatly facilitated by visible forward movement in other areas of détente, for example, by the achievement of reasonable progress in the SALT talks.

I hope that the clear cooperative spirit which I am sure will be demonstrated in our talks today and tomorrow will permit us to present specific new proposals to the Congress by midyear.

In this context, I would note that since the last meeting of this Commission, there has, in fact, been notable progress in a number of areas relating to trade between us. Signing of the long-term agreement to facilitate economic, industrial, and technical cooperation was an important step forward. We are especially pleased that despite a reduction in agricultural sales, our bilateral trade reached approximately one billion dollars last year—four times what it was in 1970. American exports to the U.S.S.R. of machinery and transportation equipment have increased steadily and may increase still further in 1975. Soviet exports to the United States, particularly of mineral fuels and manufactured goods, have likewise registered significant gains. Our countries are well on their way toward surpassing the trade goals announced at the Summit Conference in June of 1973.

Another recent development of some interest here has been the establishment by President Ford of the East-West Foreign Trade Board, which I will chair and which will include in its membership the Secretaries of State, Agriculture, and Commerce. The membership of the Board ensures that our economic relations with the Soviet Union will continue to receive attention at the highest levels of our Government.

Among its duties, the Board will report to the Congress on activities of joint commissions such as this one. It will also submit recommendations to the Congress for the promotion of East-West trade, thus providing a regular channel by which such proposals can be made which will advance trade and cooperation between our countries.

Turning now to the agenda before us today, I would like first of all to introduce the other members of the American delegation. [Names followed]

The agenda that you have suggested for these meetings, Mr. Minister, is quite satisfactory to us. It promises to be a demanding program, but we feel certain that with good will and hard work, much can be achieved.

To expedite the work of the Commission, I agree with your suggestion, Mr. Minister, that we assign certain members of our delegations to informal working groups which will discuss specialized areas of interest in preparation for our next plenary session. On our side, I have asked Mr. Bennett and Mr. Downey together with other members of our delegation to meet with members of the Soviet delegation designated by you for these discussions.

As to the first item on the agenda today, I suggest that it would be useful to have a more complete review by both sides of development in the field of U.S.-U.S.S.R. economic relations since the last meeting of the Commission. Mr. Tabor is prepared to make such a presentation for the United States at a time that you may designate.

In conclusion, Mr. Minister, let me reemphasize that we share with you the belief that the development of long-term economic cooperation will contribute to the overall stability of our relationship. There is no reasonable alternative to conducting our mutual relations on the basis of peaceful coexistence. Commercial and economic ties are an essential part of this process. We recognize that for commerce to flourish, our relationship must be mutually beneficial. Let me assure you that we will seek to promote the growth of trade in both directions.

Looking about the room today, I recognize many familiar faces among the Soviet delegation—men with whom we have had the pleasure of working on other occasions. My colleagues and I are looking forward to these discussions with you and are fully confident that, with your help, they will be fruitful.

Thank you.

Exhibit 34.—Press release at conclusion of Fifth Session of the U.S.-U.S.S.R. Commercial Commission, April 10–11, 1975

The joint U.S.-U.S.S.R. Commercial Commission, meeting in Moscow for its fifth annual session, has completed a wide-ranging review of trade issues and has renewed the determination of both governments to remove the barriers which prevent full development of trade between them.

During the 2 days in which the Commission was meeting, the leader of the U.S. delegation, Treasury Secretary William E. Simon, and Acting Commerce Secretary John K. Tabor were received by Leonid Brezhnev, General Secretary of the Communist Party of the U.S.S.R. The leader of the Soviet delegation, Minister N. S. Patolichev, took part in the meeting.

Both parties in the Commission meetings expressed their regret that it has not yet been possible to bring into force the 1972 Trade Agreement, complicating efforts to strengthen their trade and economic relationships. The Soviet Section, under the chairmanship of Mr. N. S. Patolichev, Minister of Foreign Trade of the USSR, stressed that maximum development of trade would depend upon the normalization of trade and financial relations. The U.S. section affirmed the determination of the U.S. administration to work with the American Congress in obtaining enactment of legislation to hasten the normalization of trade and financial relationships between the United States and the U.S.S.R.

At the same time, both delegations expressed satisfaction that, despite the difficulties of the past year, bilateral trade continues at a high level. While Soviet agricultural imports declined in 1974, the overall volume of trade last year was approximately $1 billion—four times what it was in 1970. The general expectation of the Commission was that bilateral trade would reach at least $1 billion in 1975 and might well exceed that figure. Both sides agreed that in the near future they would start work on the preparation of targets for the next 3- to 5-year period.

Another advance noted in the discussion was the progress made under the Long-Term Economic Agreement of June 29, 1974. The purpose of that Agreement is to assist appropriate organizations, enterprises, and firms of both countries in identifying the fields of cooperation most likely to provide a basis for mutually beneficial contracts. An experts working group established under that Agreement has already met once in Moscow (February 12–14) and exchanged information and forecasts of the basic economic, industrial, and commercial trends in the two countries. Because the results of that meeting proved to be highly fruitful, the Commission was agreed to schedule a second meeting in Washington during the first 6 months of 1976. In addition there was agreement on the need to exchange information on economic, industrial, and foreign trade trends in the two countries during the first half of 1975, and also to organize in 1975 seminars and joint specialized meetings to exchange information on the organizational and legal aspects of trade between the Soviet Union and the United States.

In addition, during the 2-day session, the Commission—

Heard reports and exchanged views on the status of discussions between Soviet foreign trade organizations and U.S. companies on a number of cooperation projects, including those such as exploration for oil and gas, expansion of the pulp and paper industry, machine building, and the manufacture of energy-consuming products;

Heard a report from the U.S.-U.S.S.R. Trade and Economic Council on its efforts in assisting business circles in both countries in identifying possibilities for expanded trade and economic cooperation;

Reaffirmed its intention to facilitate, as appropriate, the issuance of visas including multiple entry visas, to representatives of organizations, enterprises, and firms and their travel for business purposes; and

Agreed to promote trade and cooperation between the civil aviation industries of the two countries by favoring acceleration of arrangements for negotiations on a bilateral airworthiness agreement.

In general, the sessions were marked by a belief that bonds between the two countries were gathering strength and by a mutual determination to overcome the remaining impediments to the normalization of trade. Both delegations also agreed that despite occasional strains during the past year, the meeting in Moscow has helped to generate a new sense of forward momentum in trade relations between their countries.

The Commission expressed satisfaction with the results of the fifth session, considering that discussion that took place would help to normalize and develop long-term and mutually beneficial trade and economic relations.

An understanding was reached to conduct the next (Sixth) Session of the Commission in 1976 in Washington.

The U.S. delegation expressed sincere gratitude for the warm hospitality extended to it by the Soviet side during its stay in the U.S.S.R.

Exhibit 35.—Letter from Secretary Simon to the Chairman of the Subcommittee on Foreign Trade of the House Ways and Means Committee, May 8, 1975, on the U.S.-Romania Trade Agreement

DEAR MR. CHAIRMAN: I am pleased to submit my views for the record on the trade agreement with Romania.

I have no hesitation in recommending to the Congress that it approve this agreement permitting the extension of nondiscriminatory treatment for imports from Romania. Trade between the United States and Romania amounted to over $400 million last year, eighteen times as much as in 1968. This rapid growth cannot be expected to continue, however, unless we eliminate our discriminatory treatment of Romanian products. Our exports to Romania have far exceeded our imports for many years. There is good reason to believe that, with nondiscriminatory tariff treatment, we shall achieve a level of two-way trade mounting to a billion dollars by 1980, and that the trade balance will continue to be in our favor.

The proposed agreement includes a number of provisions to insure compliance with the requirements of Section 405 of the Trade Act of 1974 concerning the content of trade agreements with nonmarket economy countries. For example, we have established ground rules to facilitate the activities of American businessmen in Romania; both countries have included commitments to maintain a balance of concessions over the lifetime of the agreement; and we have negotiated comprehensive safeguards against market disruption.

Section 411 of the Trade Act required the President to establish an East-West Foreign Trade Board to monitor trade between the United States and nonmarket economy countries "to insure that such trade will be in the national interest of the United States." As Chairman of the Board and of its predecessor, the President's East-West Trade Policy Committee, I am happy to endorse the statements given to the Subcommittee May 7 by Ambassador Dent, Under Secretary of Commerce Tabor, and Assistant Secretary of State Hartman.

This agreement with Romania is the result of good interdepartmental teamwork. In negotiating the agreement, Ambassador Barnes was assisted in Bucharest by representatives from the Departments of State, Treasury, and Commerce, the Office of the Special Representative for Trade Negotiations and the Council on International Economic Policy. The outcome of this carefully coordinated effort, in the course of which Congressional views were fully taken into account, is an agreement which should promote east-west trade in a manner fully consistent with the national interest of the United States.

Sincerely yours,

(Signed) WILLIAM E. SIMON.

The Honorable
WILLIAM J. GREEN
Chairman, Subcommittee on Foreign Trade, Committee on Ways and Means, House of Representatives, Washington, D.C. 20515

Exhibit 36.—Speech by Assistant Secretary Parsky, June 20, 1975, before the Los Angeles World Affairs Council, Los Angeles, Calif., on "The Challenge of an Interdependent World: Isolation, Confrontation, or Cooperation"

It is a privilege for me to be able to address such a distinguished group. We gather here today at a time when the world is undergoing considerable change. Capitalism, the free enterprise system, and many other values which have been basic to the development of our country are now being questioned. While some fear the change that is taking place and the challenges that result, I believe it presents a real opportunity to us as individuals, and to the United States as a Nation. The world is looking for those who can recognize that changing times can provide the environment for the development of long-lasting solutions to our problems.

Winston Churchill once said to the American people, "The destiny of mankind is not decided by material computation. When great causes are on the move * * * we learn that something is going on in space and time, and beyond space and time which, whether we like it or not, spells duty."

The United States now has an opportunity, and therefore a duty, which comes rarely to a nation, to help shape a strong economic and peaceful political future for the world. In so doing, however, we must not let the emotions and concerns of the political arena overwhelm and distort the economic realities of the marketplace. It's often easy to cast economic issues in terms of extremes and to politicize economics. It may sound politically attractive to say that the free market causes inflation and thus call for "national economic planning," or more intensive regulation of the airline industry, or for allocation of resources, but the inevitable result of such policies is to alter a market-oriented economy that has been history's most prosperous, and as important, to place basic freedoms in jeopardy. Now, more than ever, we have a responsibility to relate both domestic and international policy to the maintenance of human freedom. Some have the view of economics that the doing of business must not be left to the people but must be planned by the State. The worker is forced to give up his freedom in the name of security, but the inevitable result is to stifle innovation and subvert productivity. We must not let this happen. In the name of "price stability," we must not take part in the creation of new barriers to trade and investment, special bilateral deals, or reciprocal restrictions which threaten the world's economic system and which can work to limit the freedom of every American.

To ensure that this will not happen, however, we need leadership, not only at the national level but throughout our society. How many times in recent months have you heard the statement, "What we need is leadership"? In many respects this feeling of a lack of leadership is a symptom of a more basic problem. In survey after survey, Americans register their loss of confidence in our leading institutions and in those who lead them. It is not just "Watergate," since this feeling preceded that series of events and has continued beyond it. It is not confined to the institutions of the Federal Government—although these are certainly getting low ratings. These feelings go virtually across the board to include business, labor, education, religion, and the media.

Is this because we have run out of able people to give us leadership? I do not believe so. As a matter of fact, I think just the opposite is true. There are plenty of people of high quality, strong character, and genuine dedication, both in the government and out. What's needed, however, is for more of these people to stand up and seek to be heard, and when they do, for more people to listen. Recall some of the voices of America's past: "Fourscore and seven years ago"; "We hold these truths to be self-evident that all men are created equal"; "Ask not what your country can do for you, but what you can do for your country"; "We have met the enemy and they are ours"; "One small step for man, one giant step for mankind"; "I have a dream."

The problems we face today need not be accompanied by a permanent sense of uncertainty and unease. Instead, they can serve as an impetus to creativity, but people must not just sit back and complain about our problems. We spend too much time talking about what we're going to do and I'm afraid too little time acting. We must seek to learn what our fathers never seemed to know—that is, that different views and different ways of life need not be impediments to understanding or barriers to harmony in the world.

Each of the major problems we face today—controlling inflation and stimulating growth; providing food to the hungry and assisting the poor; ensuring adequate supplies of natural resources—demonstrates the interdependence of the world. Whatever our ideological beliefs or social mores, we are now part of a single global system on which all of our national objectives depend. And the United States has a critical responsibility. As President Ford has said, "At no time in our peacetime history has the state of the Nation depended more heavily on the state of the world. And seldom, if ever, has the state of the world depended more heavily on the state of our Nation."

Let us not forget that by any measure, we have given more in the last 30 years than any other nation in history. We have successfully resisted serious threats to world order from those who wished to change it in ways that would have been detrimental to democratic governments. We have provided more economic assistance to others than any other country. We have contributed more food, educated more people from other countries, and welcomed more foreigners. We have done so because the American people, after more than a century of isolation, learned that cooperation with others is not so much a gift for short-term political gain but rather a service in the interest of long-term economic harmony.

The next few years will determine whether interdependence will result in common progress or common failure. The choices we face are basic: They include isolation, confrontation, or cooperation. At a time when there are questions about the nature of our commitments in the world, some are arguing that we should turn inward and concern ourselves only with the state of our country, thus isolating ourselves from other parts of the world. Others have grown fearful of our showing weakness and would have us confront certain countries in order to demonstrate strength to the world. To me, neither of these approaches will adequately meet the challenge of interdependence. Instead, I believe we must respond by building a worldwide framework of cooperation. It's time to recognize that we cannot exist apart from the world around us. A world linked by instantaneous communications and imperiled by nuclear weapons forbids it. We must seek political and economic relations which will strengthen the ability of free people to work toward a common goal together.

The issues facing us today cannot be perceived in terms of confrontation between the haves and the have nots, for the world is composed not of two sets of interests but of many: developing nations which are energy producers and developed nations which are energy consumers; market economies and nonmarket economies; capital-rich countries and capital-poor countries. Such a world imposes on us the recognition of our interdependence and in turn the necessity of our cooperation.

Cooperation and the response to the "new economic order"

Cooperation, however, does not mean an abdication of our principles. We as individuals, and the United States as a country, must not be afraid to stand up for what we believe is right. We must not be afraid to defend a free enterprise system that has made us strong and, equally as important, has helped the rest of the world.

The need to strike the proper balance between a desire for cooperation and the responsibility for leadership can be seen as we seek a response to the call by the developing countries for a "new economic order," a proposal which involves a basic redistribution of wealth from the industrialized nations to the poorer countries. Inherent in such a policy is the belief that the less fortunate countries cannot develop unless the industrial nations are disadvantaged. This is simply not the case; and while we want to avoid confrontation, we clearly cannot acquiesce in such an approach, for such an economic order outside the United

States would require us either to adopt such a system here or isolate ourselves economically from the system around us.

I am not suggesting that we seek to maintain the status quo. We must support the legitimate aspirations of the developing countries, and we are prepared to discuss with them ways in which they can participate more fully in the world economy. However, in this process, we must not sacrifice our economic system which is based on competitive, free markets. We must keep in mind that this system has greatly benefited the developing countries. Through a combination of greater liberalization of world trade as well as an extensive program of bilateral and multilateral assistance, many developing countries have been able to grow at rapid rates—in fact, more rapidly than most developed countries.

From 1960 to 1970, the manufactured exports of less developed countries increased from $3.8 billion to $12.7 billion, increasing less developed countries' share of world manufactured exports from 6.5 percent to 6.9 percent. Industrial production in less developed countries (LDC) increased by 8.3 percent per year, considerably larger than the 5.9-percent rate registered by developed countries, and the real GNP of developing countries increased at an annual rate of 5.6 percent as compared with 4.8 percent for OECD countries.

The main determinant of a country's economic growth rate has been the skill with which it utilizes its own resources, not its status as an industrial nation or LDC. While we frequently tend to think of Japan and Germany as the outstanding examples of countries with high growth rates, there have also been many exceptional performances registered by less developed countries. Over the past decade real GNP grew by over 8 percent in Taiwan, South Korea, Thailand, and Kenya, while the exports of Taiwan and South Korea increased by more than 20 percent per year.

In light of such progress, we should not be afraid to stand behind the economic principles which have been central to our system. As we do so, it is important to recognize that the market is often hard on producers in that it forces them to undergo the rigors of competition—but isn't that in everyone's interest?

Our response to the call for a new economic order should be a willingness to discuss and negotiate problem areas in a spirit of cooperation while upholding our commitment to the basic principles of private ownership and free competitive markets.

Inherent in such an approach is the belief that the longrun salvation for the poorest countries lies in their own efforts. The aid we give, the reforms we agree to, will not help these people unless they themselves create the conditions for self-sustained economic growth.

The general outlines of this approch have recently been set forth by Secretary Kissinger and Secretary Simon. As Secretary Kissinger said: "We are prepared to consider realistic proposals * * * but we are convinced that the present economic system has generally served the world well * * *[and] that the poor nations benefit most from an expanding world economy."

In order to appreciate fully this approach, I think it would be useful to examine several critical problem areas and see how each calls for a cooperative response. Let us examine the problems of energy, of commodities, and of trade and investment. As we examine each, we must bear in mind that we will be seeking an international policy that is complementary to our domestic policy. President Ford has pursued a domestic economic policy that is based on greater utilization of the free market. His proposals in energy which call for deregulation of prices of oil and gas, his concern for escalating levels of Federal spending, his veto of the farm bill and his opposition to credit allocation all illustrate the orientation of our domestic policy. In each of the areas I will discuss with you, we will be striving to transform such a national approach into an international policy that is based not on pure ideology but rather on reality.

Energy

No subject illustrates world interdependence more emphatically than the field of energy. The economies of all nations are affected by prices they pay for oil. The problem, however, is that price is not determined by market forces. Because the source of supply is presently concentrated in a small group of countries, the price can be determined by unilateral decisions. Due to both action and inaction, we and the other consuming countries have allowed ourselves to become overly dependent. The result is that we now have lost the ability to ensure that the market can set the price for oil.

Where does the answer lie? It lies with us and with the other consuming countries and with our ability to achieve harmony with the producing countries. In order for this to happen, there must be greater understanding by both consumers and producers of each others' needs:

> Consumers must understand the desires of the producers for diversification of their economies and for higher standards of living for their population.
>
> Producers must understand that the rapid rise in oil prices has placed a great economic burden on all consumers, developed and developing alike.

We in the United States must help this process of understanding and we must assume a leaderhip role in developing policies that will bring about an expanding supply of energy at market prices. Our efforts must include national and international programs aimed at reducing demand for oil as well as accelerating the development of alternative energy resources. Substantial progress has been made internationally. Through the establishment of the International Energy Agency, we and other consuming countries have been able to address the steps that are required in the energy area. Conservation objectives have been agreed to, and an international foundation has been laid for developing alternative energy resources.

However, by seeking international cooperation in the energy area we must be cautious not to move to a Government controlled and operated energy industry, domestically or internationally. The cooperative response to interdependence in energy must not move us farther down the road to State-managed economic development. We must instead attempt to establish the conditions for the maximum return to the private market for an industry which in recent years has experienced further and further incursions by the government sector. A world energy industry consisting of government-owned operations, government-set prices, and government-to-government supply arrangements must be avoided, for history has shown us that no individual or group of individuals can allocate resources more effectively or more efficiently than the marketplace.

Our efforts with other consuming countries should not be viewed as a desire to confront the oil-producing countries. I view energy conservation and the development of alternative energy resources as in the interest of the oil producers as well as the oil consumers. The oil producers are almost totally dependent on a depletable asset, namely, oil, for their future. To the extent that oil is not needed, they can preserve their natural resources and will have more time to diversify their economies.

Recently, there have been indications that there will be a rise in the price of oil soon and that such an increase would be justified since the prices of other commodities have risen. In addressing such a possibility, I think it is again important to separate the politics from the economics. There is no question that the oil-producing countries could raise the price if they wish to. Further, given the fact that substantial increases in supply cannot take place quickly, control over the price can be maintained by OPEC for at least the next 2 years. Despite the fact that a price rise could happen, I do not believe that it is economically justified. It is true that oil producers have lost purchasing power in 1974—they have cited a 35-percent reduction, while others says it is 24 percent. The important fact, however, is that a significant amount of that loss can be traced back to earlier increases in oil prices. Further, although prices of other commodities have gone up, many have also declined because market forces have been allowed to function, and changes in price were in response to supply and demand.

Despite such an economic situation, there is a possibility that a political decision could be made. I feel that the producing countries recognize the impact that a price rise could have on the economies of the world—economies that they want to remain viable and strong. A responsible answer, however, will not evolve if the issue is cast into the political arena. Only by analyzing and discussing the underlying economic facts can producers and consumers act in the best interest of each. With this in mind, we have put forward proposals to renew a dialogue between producers and consumers. Further, we are pushing forward with our bilateral economic efforts with the producers. Such a cooperative approach is the only way progress can be made.

Don't misunderstand what I am saying—cooperation does not mean abandoning our principles. The United States must not be afraid to take positions we believe are right. We object to the current economics of oil pricing, and we believe that an increase in oil prices could be extremely detrimental to both consumers and producers. Therefore, we have the right—in fact the obligation—to express our views. However, this need not be done in a spirit of confrontation or with the objective of winning a short-term political victory. Our long-term economic interests are too vital for that. Instead, we must seek an open dialog with the producers aimed at serving the interests of all people.

Commodities

Just as in the energy area, the subject of commodities provides insight into the interdependence of today's world, and the principles which apply to energy apply as well as the problems of commodities. To some raw material producers, it may be tempting to think of establishing cartels through which they could negotiate higher prices for their products. Such an approach, however, would be detrimental for all countries. Large price increases combined with production restrictions will lead to disaster—worldwide inflation followed by worldwide recession from which no nation could escape.

Before we accept a complete overhaul of the present system, we should ask ourselves how bad the existing system really is.

Let us look at what has happened to the world market for commodities. World market prices of most nonenergy commodities have in fact risen over the past quarter century. This is true both in terms of their nominal prices and in terms of the industrial products which developing countries need. The Economist index of all commodities (excluding energy) rose over two times from its high in 1951 to its new peak in the first quarter of 1974. The index for metals went up some four times over the same period. On the other hand, the U.N.'s index of industrial goods did not quite double over the same period. Thus, the actual purchasing power of earnings from these commodity exports went up.

Prices of commodities did break downward last year from their record highs. The Economist index has dropped about 40 percent from the record high reached in the first quarter of 1974. At the same time prices for industrial goods—fueled in part at least by ever soaring energy costs—have continued to increase.

There's no question that many of the developing countries, especially those who depend on exports of a few commodities to earn the bulk of their foreign exchange, have seen their terms of trade turn against them.

Their concern is natural. We understand and sympathize with it, but although there may be a possibility of growing scarcity of resources in the years ahead, we should not base our policy on the expectation of such a trend. The situation in the commodity markets during the 1972–1974 period has caused fears of continued shortage and volatility. However, there was an unusual amount of speculation during this period, and we need to carefully asssess whether this occurrence was unusual before we make major changes in our policies. To this end we are currently engaged in an intensive interagency review of our international commodity policy. This review has already developed some tentative conclusions, which were embodied in the proposals which Secretary Kissinger recently made before the Organization for Economic Cooperation and Development:

- We believe that both developed and developing countries should negotiate new rules and procedures for access to both markets and supplies of commodities in the multilateral trade negotiations currently taking place in Geneva;
- We believe that instead of exclusive producer organizations, consumers and producers should jointly discuss their problems in the commodity area;
- We believe that the World Bank should consider increasing its financing of resource investments and explore ways of combining its financing with private management, skills, technology, and capital; and
- We believe there should be a review of the existing mechanisms aimed at helping to stabilize the earnings of developing countries against excessive fluctuation in their export incomes.

Underlying these proposals is a recognition of several basic principles:

First, there must be increased investment in the resource area.

Second, excessive price fluctuations are costly to both producers and consumers. However, price fluctuations per se are not evil—in fact, they are part of the realities of the marketplace, and we should not attempt to distort the functioning of the market in the interest of shortrun price stability.

Third, the solution to commodity problems does not lie in establishing high-fixed prices and attempting to maintain their value through indexing. Although it is often overlooked, the rich countries produce more raw materials than the poor. Of total world exports of nonfood, nonfuel raw materials, the industrial countries supply about 70 percent. Any indexing scheme would probably benefit the rich countries more than the poor.

Fourth, any generalized system of commodity agreements aimed at fixing prices would be counterproductive. Instead, we should look at proposals only on a case-by-case basis. As we do so, we should bear in mind that commodity agreements, where they have been tried, have not been very successful. The coffee agreement broke down when countries exported more than their quotas. The wheat agreement is not operative, and the sugar agreement has been replaced by special arrangements. One basic reason for this is that producers have seen such arrangements as a means of raising prices, not achieving greater stability. Nonetheless, we are willing to look at possibilities for new arrangements. We are now participating in the renegotiation of the International Tin Agreement, we have put forward a new proposal for a coffee agreement, and we are assessing problems in other commodities such as copper.

Inherent in this approach is a desire to improve the present system. We do not want to maintain things as they are if sound improvements can be made. For example, the United States will participate constructively in the review of the International Monetary Fund's compensatory financing facility which the Ministers of the IMF's Interim Committee called for during their meetings in Paris last week. This facility provides loans to developing countries facing balance of payments difficulties arising from temporary shortfalls in their export earnings.

We will soon follow up with further proposals to international financial institutions on ways to mobilize investments to give both producers and consumers of commodities the output they will need in years to come.

Further, we feel that increased exchange of information among producers, consumers, and investors would help strengthen the market, and we will explore ways this can be done. We are also studying the question of economic emergency stockpiles which would not involve interference with the functioning of the market, but would make supplies available only in times of extreme shortage. We hope to have recommendations on this possibility shortly.

The United States is thus providing leadership toward improving the workings of international commodities markets. This will take time. There is no magic wand that we can wave to solve all problems.

We need to build and to improve on the system which we now have to provide a solid basis for balanced growth in real earnings by commodity producers and for ample supplies for consumers. We stand ready to cooperate for our mutual benefit with all countries, both producers and consumers, to strengthen and improve the system under which we produce, process, and trade commodities.

Trade and investment

A third area that calls for cooperation is trade and investment. Both developed and developing countries must renew their commitment to an open trading system and a positive climate for the free flow of resources.

Multilateral trade negotiations.—The United States is now fully engaged in the Tokyo Round of multilateral trade negotiations in Geneva involving some 85 developed and developing countries in a sweeping effort to liberalize and improve the rules of the world trading system. These trade negotiations were conceived nearly 4 years ago as a major companion effort to reform of the international monetary system. As with those monetary negotiations, the trade talks are not focused on short-term solutions and spectacular initiatives; they rather aim at creating a better longrun structure for efficient trade and more harmonious trade relations. A cardinal principle of this effort will be increased cooperation among governments in creating a framework for national policies which reinforce rather than conflict with each other.

The international mandate for this work came from ministers meeting in Tokyo in September 1973. Our own domestic mandate is found in the overwhelming congressional endorsement of last year's Trade Act of 1974. What we can make of this mandate in the next few years again will be a question of the leadership the United States can provide in the Tokyo Round. This leadership is needed not just for the traditional work of reducing tariffs and other barriers to trade. It will also be essential if we are to create more effective international disciplines for all members of the trading community who find themselves under pressure to fall back on restrictive or narrowly conceived policies which would result in economic burdens for their trading partners. Since these pressures are especially acute in many countries this year, our vigorous and imaginative pursuit of the Tokyo Round takes on a special importance. The most relevant issues of the day, including the problems of commodities and access to supplies as well as demands for temporary import restrictions, are on the table in Geneva. Fortunately, the atmosphere is businesslike, tempers are low, and progress there is not impeded by rhetoric. We hope to see the first results early next year.

Trade with Socialist countries.—Elsewhere, we must continue to expand our relationships throughout the world. With the Socialist countries, we embarked on a policy in the 1970's which will move us away from confrontation. The decision to expand our trading relations with Eastern Europe, the Soviet Union, and the People's Republic of China does not reflect weakness on our part. Rather, it is a further recognition that world prosperity comes through acceptance of a global economy.

We have made great progress in the expansion of our commercial relations with the Socialist countries in the last 3 years. In 1971, our total exports to all of these countries combined amounted to less than $400 million. In 1974 exports were $2.3 billion. This was a fivefold increase in 3 years. By contrast, 1971 U.S. imports were $230 million while in 1974 our imports were $1 billion. Thus, our trade surplus with these countries grew eight times—to about $1.3 billion in 1974.

The potential for future U.S. exports of goods and services remains high. However, the linkage in the 1974 Trade Act of emigration conditions to negotiation of commercial agreements and the extension of official credits—no matter how well intended—has put our firms at a disadvantage in their competition with other Europeans and Japanese firms for this market. Here is another example of how politicization of an economic issue can be detrimental to our long-term interests.

Trade with Middle East.—As in our trade with the Socialist nations, our relations with the countries of the Middle East must be founded on increased economic cooperation. We have been pursuing the economic potential there not only because we feel it will benefit the United States economically, but also because we feel it can assist us in achieving peace in that part of the world.

At a time when the potential for hostility is high and the political atmosphere uncertain, one response would be to do nothing on the economic side until the political situation improved. This, to me, would be a shortsighted view. Instead, I feel that we must work for increased economic cooperation at the same time we are seeking the political answer and in so doing not let political expediency dictate what basic economics tells us should be done. As such, we must continue to pursue ways in which we can support the oil-producing countries' legitimate desires to accelerate their own economic development, establish their industrial and agricultural bases, and improve the living standards of their people.

Investment.—As we attempt to increase our trading relations with the countries of the world and participate in their development, we must also maintain an attractive market for their investment in this country. As most of you are aware, the transfer of wealth to the oil-producing nations has precipitated a worldwide reappraisal of national policies with respect to foreign investment. In the United States, there have been persistent demands that we reject our traditional policy of not interfering with the free movement of international capital.

We in the administration recently conducted a review of our policy and concluded that no additional limitations were warranted. The bases for such a conclusion were:

First, that there is no threat to the world or the U.S. economy presented by the increased investment capabilities of the oil producing nations. Neither our experience so far, nor our estimates of future OPEC accumulations justify fears of domination of our industries.

Second, existing laws provide us with adequate authority to protect our national security and other essential national interests.

Third, the investment policies being pursued by the oil-producing countries do not warrant a change in our policy. They have no desire to control our companies.

They realize that the investment decisions they make now are their insurance for the future. Therefore, they will be seeking safe, long-term investments.

Fourth, on the whole, the benefits that result from foreign investment in terms of increased jobs, additional tax revenues and more competitively priced goods and services far outweigh any potential danger.

At the same time, we have taken a number of administrative measures to supplement existing laws and procedures. This initiative involves the establishment of a high-level, inter-agency Committee on Foreign Investment and a new Office on Foreign Investment. In addition, we have indicated to foreign governments that it is in our mutual interest for us to consult on major prospective governmental investments in this country.

This should not be construed as a retreat from our traditional policy. Indeed, these measures are designed to provide a healthy climate for foreign investment, consistent with our belief that such investment will further increase our ties with other parts of the world. It will be another means of accepting a world of interdependence and building on it.

Once again, it's important not to let economic realities be distorted by political rhetoric. Instead, we must avail ourselves of the rare opportunity to maintain a policy which is at once principled and profitable—leading through example by not interfering with investment in this country and by continuing our efforts in international forums to break down all barriers to investment and capital flows.

We must frankly acknowledge our different perspectives and then try to build on what can unite us.

We must strive for a new level of political wisdom that will permit, in fact require, that economic principles be supported for the good of all.

We must transfer the concept of a world community from a slogan into a belief.

In this spirit, we can become masters of our common fate, and history will record that this was the year that man at last began to conquer its noblest and most human challenge—the challenge of an interdependent world.

Energy Policy

Exhibit 37.—Remarks of Secretary Simon, September 23, 1974, before the 1974 World Energy Conference Special Event, Detroit, Mich.

It is an honor and indeed a great personal pleasure for me to welcome delegates and distinguished guests participating in this vital session of the World Energy Conference.

All of us are here today, not merely as representatives of our respective countries, but as representatives of the world community. We share a single purpose: The task of developing policies that will enable man to satisfy his vital energy needs. In reflecting on what the environmental, the economic, and indeed the human cost of energy will be, we can no longer limit ourselves to the boundaries of our individual countries.

There is, indeed, a ripple effect in fulfilling the world's energy needs. Decisions made in one country affect the very fabric of life throughout the rest of the world. Such decisions demand a continuing spirit of cooperation among the countries of the world. By building an international framework of cooperation among nations, I am convinced that we can overcome the problems that face all of us in the energy area today, and establish a permanent and equitable structure for worldwide economic development.

As we discuss various phases of energy policy today, I think it is important to recognize that the root of our current problems lies within ourselves—within our past failures to acknowledge and act in accordance with our mutual interdependence. There are several specific areas in which we have so failed. On an individual basis, we here in the United States and decisionmakers in other industrialized nations have abused our energy resources. Shortsightedness has lulled us into believing that our abundant and cheap energy supplies could continue indefinitely, and so we have failed to come to grips with the rate of growth of our people's energy demands. We have failed to develop our own domestic energy resources adequately, and have leaned instead upon those of other nations. As a group, all of us have failed to coordinate national energy policies. Incredible as it seems, we have not even adequately discussed their interrelations at high political levels. In fact, in the energy area, we are only now beginning to collect adequate information and data on world demand and supply, oil supply arrangements between consumer and producer nations, and future prospective resources, so that we can adopt realistic energy policies.

Because of all these failures, we now find ourselves at a crossroads. We are faced with hard choices that will influence all future generations of the modern world we live in. As a great statesman of our nation once pointed out, "those who ignore the lessons of the past are doomed to relive them." Let us, instead, learn from the past, and forge together a new atmosphere for orderly world economic growth. We must commit ourselves to work against unconstrained bilateral arrangements which will, in the long run, defeat the very goals we agree on. We must, henceforth, work always within the umbrella of international cooperation.

At this conference we will be sharing in a unique perspective on the components that make up the energy challenge. I think it is essential that we focus on a number of interrelated issues:

The proper balance between our respective needs for adequate supplies of energy and our common environmental goals;

The availability of oil and natural gas resources, and the role these energy sources should play in our world energy outlook;

The promise offered by the world's massive coal resources that hold forth to us all a whole system of alternative energy sources;

Nuclear power, and the role it will play now and in the future; and

As I have already indicated, the international aspects of our common energy future—the inescapable fact that we can no longer think of developing only "domestic" energy policies. We must evolve a world approach.

Throughout our discussions, I think it is important to focus on how we can match the international dimensions of the energy challenge with international opportunities, not just for the industralized nations, but for the entire world community. Our energy problems will demand more of us all: more of our technology, of our science, of our economics, of our natural resources, and of our human spirit.

One important thing to emphasize is that last winter's embargo only highlighted a problem that has been developing for a generation—and gone practically unheeded in the United States—by our Government, by our private sector, and by our people. This is despite the fact that for two decades we have had a succession of warnings: hearings before our Congress, alarm from our industry, and analyses by the world scientific community that we were moving on a collision course with future realities.

We were fortunate in the United States that the embargo occurred at a point in time when we were not yet irretrievably reliant on foreign supply. The United States is still 85 percent self-sufficient in energy. Our domestic situation was grave, but not impossible.

I am concerned, however, that many of us may forget too quickly. It's always easy to get action during a crisis. It's not so easy to get response when crisis is behind you. We simply cannot afford to forget that the problem is still with us. And so, the thrust of our efforts in the United States is towards energy self-sufficiency.

As you all know, we have called this effort "Project Independence." It is designed to ensure expansion of our domestic energy production, so that we will no longer be so helpless in times of economic disruption, or the threat of such disruption, from a sudden curtailment of vital energy supplies.

We are doing this in several ways. First, we are proceeding to reduce waste through energy conservation programs. Our growth in energy demand must be at least halved over the next 20 years, from a 4- to 5-percent annual rate, to a 2- or 3-percent rate. It will not be easy, but we believe this can be done without disrupting orderly economic growth. Second, we must stimulate the development of domestic energy resources. We must accelerate the development of oil and natural gas, boost coal production, and bring online coal liquefaction and gasification capacity. We must develop the promise of our vast oil shale reserves, and expand our use of nuclear and geothermal power.

We must develop a coordinated, realistic program to accomplish all of this—not only because it will increase our self-sufficiency, but because the oil-producing nations are watching. It will indeed be noticed that we are willing to make the necessary decisions to achieve a more balanced international bargaining relationship.

As a first step, we must begin an all-out effort to remove the Government-imposed restraints which have curtailed our domestic industry's efforts in recent years. Despite the best intentions of the draftsmen of the Government's past policies, we continue to pose the major obstacles to the short and medium-term efficient market allocation of energy. We regulate the price and distribution of natural gas; we manipulate the pricing and distribution of oil; we have "created a Frankenstein" of administrative delay in the obtaining of licenses and rate changes. In our enthusiasm to make good after generations of neglect, we have imposed severe environmental restraints upon both the production and combustion of fossile fuels, before knowing as much as we should about not only their need, but their ultimate effects.

All of these efforts must be reexamined. In addition, as we develop our long-range energy policies, we must set some short-term goals. These must be clearly understood, and explained at each step not only to the American people, but to the entire world. I believe this framework should involve several major areas of action, including a comprehensive legislative package, changes in existing regulatory procedures, and conservation efforts.

First, we must make an all-out attempt to produce additional supplies of oil. This production could be developed through a variety of measures: We could open Elk Hills and Naval Petroleum Reserve #4 to higher levels of production, reopen the Santa Barbara Channel to production under strict environmental controls, reevaluate upward the maximum effective rate for certain oilfields, and increase secondary and tertiary recovery efforts from existing fields.

Second, we must each renew our individual commitments as citizens to conserve energy and reduce our overall consumption.

Third, we must move towards removal of restrictive price controls from oil and natural gas, and phase out price and allocation programs which have so disrupted marketing patterns. We could begin by reducing the amount of our domestic crude production subject to such controls, but this would be just an interim measure. Ultimately, these controls must go if we are to have a domestic production market with maximum incentives to increase our daily output.

Fourth, we need to greatly accelerate Federal leasing programs for both oil and coal.

Finally, and related to all of these, we must develop energy legislation and work closely with the Congress to ensure that it's enacted. I believe the time has clearly come, for instance, for a statement of National Energy Policy, in an act patterned after both the National Environmental Policy Act of 1969 and the Mining and Mineral Development Act of 1970. We can no longer afford to treat energy considerations on an ad hoc basis, and put out brush fires only after they have begun to affect vital national interests. Energy considerations should be geared into all our Federal efforts, and I will propose this to the President for inclusion in a legislative package.

At the same time that we develop this short-range program, we must look towards increased coal production, and work to make gasification and liquefaction of our coal and oil shale reserves on a commercial scale a reality.

With one trillion 500 billion tons of identifiable coal reserves, we possess half of the free world's known reserves—one-third of which is economically recoverable today.

By the same token, we have an estimated one trillion 800 billion barrels of oil locked in the shale of our Western States. That is enough to meet our total needs for decades to come.

It is up to the Federal Government and private industry to bring the promise of these reserves into the marketplace.

Nuclear power today provides about the same amount of the Nation's energy as firewood. It's time to accelerate the development and use of this important source.

It's only through a concentrated effort on all these fronts that we can achieve the ability for self-sufficiency. You will note that I said the "ability" for self-sufficiency. That does not mean that the United States will not continue to import. In fact, our program is based on the assumption that we will import. However, our reliance will not be such that we will have to depend on one set of suppliers.

Seen in this way, I do not view Project Independence as a move toward autarchy but rather as part of a worldwide effort to bring greater balance to world energy supply and demand. We all live in an energy interdependent world, and we in the United States see Project Independence as a means to reduce our own call on oil available to the international market.

As we begin our panel discussion, I would stress that we are facing a dramatically changed energy scene in the world of the future. The present condition is unstable, and the short-term gains of wealth and power which some are experiencing are already proving undesirable in the longer scheme of affairs. The world is reacting to current prices by cutting consumption, and expanding productive capacity of energy. For instance, outside of the OPEC countries, there are renewed efforts for oil and natural gas:

The North Sea, in spite of the hazardous drilling conditions, yields new additions to proven reserves each month, and promise of even greater finds.

Southeast Asia, while it is still in the first generation of exploration, has great promise of new supplies.

Recent discoveries in West Africa have demonstrated great supply potential.

And within our own hemisphere, Mexico has made dramatic finds that will literally revitalize their oil industry, and could lead to surpassing the production level of the late 1920's.

Thus, the shortrun actions of some oil exporters have, in fact, insured that the value of oil in the ground will fall over the next decade. We may be able to do a lot by governmental regulations and cooperation, but we cannot repeal the law of supply and demand.

Today, however, we must recognize that the present price levels present grave potential economic problems not only for consuming nations, but even more so for the producing nations. No benefits derive for price levels which result in unemployment and inflation throughout Europe and Japan, and damage the world economy as a whole. The international investments of all nations are in jeopardy, and the old fable of the goose that laid the golden egg can be seen developing in today's headlines and international cable traffic. Consumers now suffer from the effects of the sharp and sudden upswing in prices. Producers are likely to suffer at some later time from the downswing in prices caused by the market's strong reactions to present high prices. It is clearly in the best interests of the oil producers that the world economy maintain sound growth.

Prices lower than those being charged at present would be in the economic interest of both producers and consumers. High cost alternative sources would not then be encouraged to so great an extent, while the producers can expect not merely short-term, dangerous and distortive national incomes, but the more meaningful and truly valuable growth represented by expanding economies which develop the capacity to absorb increasing imports of capital and technology.

Ideally, what is needed is a diversity of consumers and producers operating in a cooperative international framework.

Together, we can prevent unemployment. Together, we can prevent a worldwide monetary crisis. Together, we can maintain economic progress.

I believe there are grounds for optimism. The world has the capacity and resources to meet our energy needs, and the United States stands ready and willing to help build a structure of international cooperation with producers and consumers alike.

Thank you.

Exhibit 38.—Address by Secretary Simon, November 18, 1974, before the 61st National Foreign Trade Convention, sponsored by the National Foreign Trade Council, Inc., New York, N.Y., on the establishment of a supplementary loan facility

We meet today in serious times—times that demand plain speaking—and I intend to speak plainly and bluntly.

As all of you know, the policies of the oil cartel now pose a fundamental challenge to the economic and political structure which has served the international community for a quarter of a century. Some believe the world confronts the greatest economic crisis since the early postwar years. Yet, as President Eisenhower once observed, a crisis need not stampede men into headlong panic. "A crisis," he said, "is also the sharpest goad to the creative energies of men, particularly when they recognize it as a challenge to their every resource, and move to meet it in faith, in thought, and in courage."

That was a lesson the leaders of the early postwar years had already learned, and they applied it well. Their vision and their work laid the foundations for a period of unprecedented growth and progress, not only among the industrialized nations but among the newly developing nations as well.

Today, the vision and creative energies—and indeed, the principles—of those earlier years are needed once again. With consumers, we must seek a new unity of purpose and strength of common effort. With producers, we must seek to resolve our differences through mutual understanding and cooperation. And with developing nations, we must continue to provide help and assistance so that they may fulfill their dreams of advancement. This is the basis upon which the United States is moving forward today in both its trade and energy policies.

Need for swift action on the trade bill

With trade deficits mounting in almost every nation outside the oil producing and exporting countries bloc, governments in many countries are increasingly tempted to restrict trade in the name of shortage, surplus, inflation, or unemployment. As we have learned once before in this century, however, beggar-thy-neighbor policies by one party are ultimately destructive for all. This is not a time for unconstrained bilateralism, for monopolistic restriction on supply or for other administrative arrangements which distort normal patterns of trade and investment. The solutions to the problems of an interdependent world lie in more interdependence, not less. An expanding world economy with reasonably stable prices is essential to the political, social, and economic interests of all nations. This can only be achieved if conditions are established which permit foreign trade and investment to play their historical role as engines of economic progress.

Negotiations on trade and trade relations were never more appropriate or timely. In this regard, we place great importance upon enactment of the trade reform bill before the end of this year. A clean act, unencumbered by extraneous amendments, is a matter of urgent priority to the President. Only with this legislative mandate can our negotiators be effective in seeking an open and flexible world trading system, and only with the full participation of the United States can we solve common economic problems.

Previous international trade negotiations have focused on the problem of opening national markets to the exports of other countries. It is essential that the multilateral trade negotiations in Tokyo now turn to the other side of the question, finding means to ensure international access to food and raw material supplies.

The challenge of the OPEC bloc

This problem of gaining access to supplies has been pointedly raised, of course, by actions of the oil-exporting nations belonging to the OPEC bloc—first by the embargo last fall, then by a quadrupling of prices, and finally by their production cutbacks designed to maintain prices.

Before the price increase in October of last year, the average payment to producing countries for a barrel of oil—using Saudi Arabian light crude as a benchmark—was less than \$2; today it is approximately \$10. Payments to OPEC nations for oil, amounting to \$22 billion in 1973, are expected to exceed \$85 billion this year and as of this fall are running at an annual rate of about \$100 billion. This year alone the OPEC nations will have \$60 billion in earnings which they do not spend on imports of goods and services. A receipt for the OPEC group is obviously a payment for the oil importers, and a surplus for OPEC is a deficit for the rest of the world. Only by piling up debt to the OPEC nations can the importers, as a group, pay for the oil.

The costs imposed on the world economy by exorbitant oil prices are both severe and extensive. They make our battle against inflation more difficult and the inflation itself more virulent. As the world shifts resources to adapt to a new energy balance, there will also be serious frictions and unavoidable costs of structural adjustment. Reluctance to borrow year after year to finance oil purchases will cause nations to maintain lower levels of economic activity and there will be slower economic growth. There is a clear danger that some countries might take inappropriate or disruptive actions, with the risk of retaliation and resort to competitive restrictions. At some time, furthermore, real resources will have to be transferred to OPEC countries to pay for accumulated debt. The direct impact will not be equal for all countries—but directly or indirectly, all countries will find their hopes for prosperity dimmed. I can think of no single change that would more improve the outlook for the world economy than a substantial decrease in the price of oil. And I can conceive of no development more essential to the preservation of our international trading system.

Why oil prices must eventually fall

The producing nations are aware that oil is not immune to the forces of supply and demand. The sharp jump in prices has already resulted in reduced oil consumption around the world—and as the passage of time permits further adjustments, such reductions will be far greater. In the oil-importing countries of the non-Communist world, consumption is projected to decline from the 1973 level of 48 million barrels per day to about 46½ million barrels per day this year. When it became evident that consumption was declining, a number of OPEC countries cut their output, not their price. Prior to the embargo last year, OPEC spare capacity was on the order of 1½ million barrels per day. Now they have unutilized capacity of nearly 8 million barrels a day. Even during their oil embargo, excess capacity did not reach this level. Inevitably, if that excess capacity grows, there will be increasing pressures for lower prices.

In the face of high prices, consumers are also accelerating development of their own sources of energy which, in time, will cost them significantly less than the current price of OPEC oil. If the OPEC nations persist in cutting back output in order to maintain price, they will find that both their market and their income have been drastically eroded. To me, the question is not *whether* oil prices will fall but *when* they will fall.

I know there are energy doomsayers in the world who believe that the world is about to run out of oil. Those people are dead wrong. First of all, many experts believe that in the Middle East itself, proven reserves of nearly 400 billion barrels of oil are matched by additional reserves at least equal in amount. Nor are the world's energy consumers locked in an OPEC vise. The world's oil and energy resources outside the OPEC nations are even larger than inside. Here in the United States, our oil production potential is enormous from new sources off our shores and in the Arctic and from older sources through improved and more intensive methods of recovery. And other traditional energy sources—natural gas, coal, and nuclear power—will become increasingly important as market incentives move our potential into production. Waiting in the wings, new sources of energy will be brought forth by technological progress and economic incentives—the same process by which our energy resources have always been developed.

Realistically, some potential sources of energy will require passage of time before they result in substantial production. But the oil market itself is already in the process of being transformed. In the past year alone, 26 significant, new oil discoveries have been reported. At least 30 billion barrels of oil have been added to proven reserves outside the OPEC countries—an increase of 25 percent. Proven North Sea reserves have doubled since last fall; Mexico has discovered enormous new fields; even China has announced finds that allow it to become a significant oil exporter. Oil has also been found in commercial quantities in Guatemala, the Peru-Amazon Basin, the Tierra Del Fuego region of Chile and Argentina, Gabon, Zaire, Cabinda, Angola, Tunisia, India, Bangladesh, Burma, Malaysia, Brunei, Thailand, South Vietnam, Taiwan, and Egypt. And all these discoveries have taken place in just 1 year.

Altogether these finds outside OPEC have an estimated production potential of 13 million barrels per day by 1980—all of which reduce OPEC's potential market. And this doesn't even include the oil which will be flowing from Alaska and our Outer Continental Shelf.

We do have an energy crisis but it's clearly solvable. The OPEC nations, by stringently limiting the rate at which their oil is flowing, are inevitably creating the conditions under which floods of energy from other sources will be forthcoming—and forthcoming at prices well below current levels.

There is no justification today for the present price of oil. It bears no relationship to the costs of production. The contention by some OPEC members that the increase was required in order to keep pace with the rise in price of other commodities is just not true. A barrel of oil today buys in imports some five times what it did two decades ago and four times what it bought as recently as last September.

Let us also be clear that we are not faced with a case of producing companies rigging the markets. Profits of the oil companies have increased, but this is largely a shortrun phenomenon resulting from revaluation of inventories, profits in collateral activities such as chemicals and transportation, and other factors. Certainly the oil companies would not conspire to escalate the revenues of the OPEC countries so that the host countries would then take over their industry. Oil is now overpriced for one reason and one reason only: because a small group of countries have joined together to manipulate the price.

Securing cooperation among consumer nations

It has been our hope that these nations would recognize that their policies are in neither their own interests nor in the interests of the world. Their hopes as well as ours lie in the resumption of international trade on reasonable terms. Until now, however, our arguments have fallen on seemingly deaf ears. The United States has long recognized that logic and moderation might not prevail, and for that reason, over the past year and a half we have been quietly but firmly laying the groundwork for a more effective response to this challenge by the major consumer nations.

A central thrust of our policy has been to achieve greater cooperation among consumer nations. In pursuit of that goal, literally hundreds of hours have been devoted to private and public diplomacy by the highest ranking officials of our Government. Our record is clear:

In April of 1973, President Nixon warned that energy was becoming a major problem and that close cooperation was needed between the United States, Western Europe, and Japan.

In February of 1974, at our invitation, a dozen major consuming nations gathered here for the Washington Energy Conference. I submitted a detailed paper at that time on the financial and economic aspects of international oil prices and on the need for conservation and expanded production. At that conference, the international Energy Coordinating Group was established, providing essential machinery for consultation and negotiations among consuming nations.

After extended discussions by members of that coordinating group, an agreement was reached in Brussels this September for an unprecedented plan to share energy resources among consumer nations during times of emergency. The Brussels agreement represents a major breakthrough, for it will provide mutual protection in time of need and it was reached after previous attempts had failed. The Brussels meeting also produced guidelines for cooperative longrun efforts in energy conservation, production, and research and development, and led to the formation of a new organization associated with the OECD to carry out this program, the International Energy Agency. The Governing Board of this new agency is holding its first meeting today. These are all solid achievements, but now we must go further.

The new proposals by the United States

In many meetings with senior officials of other nations over the course of the past 10 months, Secretary Kissinger and I and our senior deputies have discussed our views of the current world economic situation and listened to theirs. We have continually stressed that energy, economic, and financial problems cannot be separated and that new initiatives in one area must be linked to new initiatives in the other areas. In the past several weeks, we have presented a comprehensive set of proposals in private talks with a limited number of major industrial countries, and the discussions that followed have been very intensive and constructive. Recently, feeling that the agreements reached in Brussels gave us solid foundations upon which to build, President Ford directed that the United States should finally make a public presentation of its proposals. That was the basis of Dr. Kissinger's speech in Chicago last Thursday night when he outlined the global aspects of our position, and my talk here today in which I will present the financial aspects of our proposals in greater detail.

The essence of the U.S. position can be succinctly described:

The price of oil itself, not its financial repercussions, is the real source of trouble in the world economy.

To help bring about lower oil prices, and to reduce the economic burden of oil imports, major consuming nations should work together to achieve significant reductions in their imports of OPEC oil.

They should also coordinate policies and pool their technical resources to increase energy production within their own nations.

IMF resources should be more fully mobilized for all its member nations.

A major new financial mechanism should be set up in association with the OECD to provide standby financial support in case any of the participating countries find themselves in economic trouble after having made reasonable efforts on their own part.

Consideration should also be given to setting up a special trust fund managed by the IMF to help developing nations that are suffering the most and require financing on concessional terms.

Finally, serious preparations should be made for an eventual dialog between a united consumer group and the producer nations.

Our ideas call for a forthright, earnest effort by the world's major industrial countries to resolve the international energy crisis. To implement such a far-reaching initiative will require further weeks of diplomacy with our allies and friends. We will need the cooperation of the Congress. And we will need your support and the support of all other Americans.

Reducing oil imports

Let us look more closely now at these proposals. All major oil-consuming countries have adopted national programs of energy conservation to reduce oil imports. President Ford has announced a U.S. program to reduce oil imports by 1 million barrels a day below what they otherwise would have been by the end of 1975. The President has made it clear that we will meet this target and that whatever steps are necessary will be taken. The French Government announced some weeks ago that it would take actions to limit 1975 oil imports in France to a quantity costing no more than imports in 1974. Just last week, the British Government announced new taxes on gasoline in order to reduce oil imports. Other governments have adopted targets, goals, and policies differing according to national circumstances, but all directed towards reducing oil imports.

These first steps toward conservation could be strengthened if the major industrial nations as a group were to place on the table their proposed conservation programs and their proposed programs for expanding energy production so that both could be internationally reviewed and discussed to determine their overall adequacy and the equity with which the effort is being shared among nations.

We believe that effective national programs of conservation could achieve a reduction in imports of the major industrial countries of the world by the end of 1975 of at least 3 million barrels a day—without unduly dampening economic activity and performance. Such a reduction in imports, were it to be agreed upon and implemented, would result in import savings at an annual rate of some $11 billion at present price levels, and would provide strong marketplace pressures to bring down the price of oil. The impact of the efforts of each of us can be multiplied many times by the efforts of all of us. I would be less than candid if I were to leave the impression that achieving this goal will be easy. But I would be less than honest if I were to pretend that what is easy will be effective.

Immediate efforts to reduce oil imports are essential. But equally essential are the efforts needed to promote energy conservation and production in the longer run. Fortunately, we now have, in the new International Energy Agency, a forum for developing and coordinating new national and international policies to achieve these ends. It is no secret that administrative and policy barriers to conservation and to increased production still exist in almost all countries—including the United States. It is also no secret that international efforts to achieve these same objectives face many difficulties. But it is essential that we push ahead.

A basic requirement is to develop in the IEA a common longer term target for reducing the rate of growth of energy consumption and oil imports. Such a longer run objective will be helpful to governments as national policy decisions are made, and will also serve to demonstrate to OPEC nations where their present course is leading.

We should also establish a review process within the International Energy Agency of the policies of the participating countries for developing new energy sources. Out of this process should evolve not only useful, guiding principles for energy development, but an increased awareness among all members of the requirements of successful policies in this field.

Another complex problem with which we must come to grips in the IEA is the so-called "downside risk" problem. Which energy resources will be developed in the future and at what rates will depend on investor estimates of the prospective price of oil. Prospective investors in energy projects can be expected to be cautious in a situation in which the price of oil could plunge as easily as it has soared. Thus, we must begin to consider methods of international cooperation to provide investors an appropriate degree of protection against such risks.

Finally, there remain unexploited opportunities for cooperation in energy R&D—in nuclear fusion, coal technology, the use of hydrogen, and enriched uranium—and the new International Energy Agency can usefuly serve to expedite and facilitate such cooperation in these and other areas.

In all of these areas, a collective determination to move forward quickly and effectively will not only serve to reduce our dependence on oil from OPEC nations, but also to accelerate the process by which the price of OPEC oil is brought down to acceptable levels.

Providing financial security

At the same time, countries which agree to act together in energy need to be confident that if a financial emergency arises, credit will be available to them on reasonable terms. They could be given such confidence through a new supplementary financial mechanism which the major industrial nations could themselves establish. Among them they will receive the capital represented by the OPEC surpluses. The OPEC countries do not have to be offered special guarantees, above-market rates of return, or value-indexing schemes. They can place their money where they choose. All that is needed are adequate arrangements—private and public—to insure that funds are distributed among the individual oil-importing states so as to avoid unnecessarily stringent economic difficulties in particular countries.

Existing private and public facilities have been doing this job of redistribution in the past, and there is no evidence that they cannot continue to do the job. The problems of financing higher oil bills can be managed until oil prices come down—not easily, not without strains, and not without effort, but they can be managed. Substantial volumes of OPEC funds, probably $45 billion in the first 10 months of this year, have been invested in a variety of ways. Nearly one-quarter of these funds have been invested directly in the U.S. market and nearly another quarter in the domestic assets of other industrial countries. The OPEC countries have also lent directly to other governments and transferred additional amounts to international institutions—for example, the International Monetary Fund's special oil facility. In addition, substantial amounts have been placed in Eurocurrency markets—but the total, less than 40 percent, is not as large as many have assumed. For borrowers, all these investments represent potential sources of funds and provide a wide range of alternative financing channels.

While the international financial system has worked well, we must recognize, however, that individual countries could find themselves in economic trouble with needed credit too scarce or too expensive to permit them to maintain open economies at appropriate levels of activity. A supplementary loan facility, established by the major industrial countries associated with the OECD, would provide the backstopping that is needed to supplement existing channels of financing. This is the financial safety net that the United States is recommending.

Certain principles would be fundamental to such a mechanism:

1. Participation should be linked with a commitment to cooperate in reducing dependence on oil imports.
2. Participants would also undertake to follow responsible adjustment policies and avoid resorting to the use of trade restrictive measures or other beggar-thy-neighbor policies.
3. Like any insurance policy, the facility should be large enough to do the job. It must be clear that the potential for borrowing is adequate to meet the need. We recommend a facility with total commitments by all members of $25 billion in 1975. Additional financial resources would be provided in subsequent years in case of need.
4. The facility should supplement private market channels and other channels, including the IMF and other official institutions. It should not replace them. For this reason it should do its lending on market-related terms.
5. Decisions on the provision of financial support should be made by a weighted vote of participants and should be based on the overall economic

position of the borrower, not on any single criterion such as oil import bills.
6. Whenever support is provided by the facility, all members should share the credit risk on the basis of their share of participation.

Beyond these general principles there are many details to be worked out and on which we are openminded. One question that must be answered is the manner in which the facility would obtain the funds with which to lend. An individual government could lend directly to the new facility or could permit the facility to go into the capital markets of the world and borrow funds on the basis of its guarantee.

There would appear to be a number of advantages in having funds provided to the facility through direct lending by member governments rather than guarantees. Traditionally, the loan route is more efficient and it is cheaper. Nevertheless, it may be desirable in establishing the facility to provide some flexibility on this score simply because national practices and legislative requirements vary widely. Whatever means is chosen, the United States will need to obtain additional authority from the Congress in order to proceed.

For the United States, participation might best be accomplished through the Exchange Stabilization Fund. This Fund has the authority to engage in international lending operations for the purpose of stabilizing the value of the dollar and this would be a basic purpose of our participation in the proposed facility.

Arrangements for administration of the facility will also have to be negotiated. Our initial feeling is that it should be associated with the OECD in a manner similar to that of the new International Energy Agency, and administered by its own governing board, whose members might be drawn from among the senior finance officials of the member countries.

The question of shares will be an important issue in setting up a facility of this nature. Various factors have been mentioned that might be taken into account, such as the size of the oil import bills of the member states, the relative value of gross national product, share in international trade, or some combination of these factors. The various possibilities will have to be carefully weighed.

It may also be important to state that in our current thinking, borrowing from the facility should not be related specifically to imports of oil. "Oil deficits" become increasingly indistinguishable from "nonoil" deficits. And even the concept of balance of payments deficits is of limited utility in the world we face today. In our view, access to this facility should be based on an overall judgment of a country's needs taken in conjunction with its resources, its basic economic policies, and the actions it is taking to reduce dependence on OPEC oil.

We have been discussing the broad outlines of how such a facility might work with a number of other governments for several months. Both my personal conversations with other Finance Ministers and our official-level contacts give me confidence that there will be support for this general line of thinking. We now intend to urge consideration of this idea more formally in official-level discussions in Paris this week. I should note that the Secretary-General of the OECD has independently developed suggestions for a supplementary funding mechanism similar in many respects to the one I have just described. His ideas, which are very welcome, will also be on the table at the meetings this week in Paris of the OECD Working Party 3 and of the Group of Ten deputies.

We will be prepared to devote many hours and many days of hard work over the next few weeks to translate these broad outlines into an operating program. We will need to work very closely with the authorities of the IMF and the newly established Interim Committee of that body. Intensive consultations with our Congress will also be undertaken, and I am sure that our partners in this venture will be consulting intensively with their legislatures.

What we are suggesting is in no way intended to replace the International Monetary Fund as the permanent institution providing the basic financial support for a well-functioning world economy. The IMF is in a position to provide substantial additional support to any of its members. It has over $10 billion of currencies which are effectively available and usable, quite apart from its holdings of gold. We are prepared, in the current review of IMF quotas, to support a substantial increase in that figure. Furthermore, we are prepared to support early measures to insure effective mobilization of the resources that the IMF now has.

At the same time, we are suggesting an initiative outside the IMF, in part because of the magnitude of the possible transfer requirements among the major industrial countries and in part because the terms and conditions of IMF financial operations are not appropriate to the exceptional circumstances we now face. Moreover, it would be inappropriate—even if possible—to introduce into the IMF the full range of policy issues which must be taken into account when decisions and judgments are made with respect to financial support among major industrial countries.

Meeting the needs of the developing nations

Of equal importance is our concern for the developing countries and the smaller industrial countries. Of course, it is true that for the developing countries it is essential that the major industrial countries maintain healthy, growing economies in the face of the oil crisis. The developing countries depend on the industrial nations to take a growing volume of their exports and to continue essential concessional aid levels. If we establish a facility which will help assure the maintenance of economic activity in the industrial countries, we are assisting the developing countries as well. Many of the developing countries have come to depend on continued large capital flows to support their rapid economic growth. By helping to assure orderly access to the major capital markets and thereby reducing the danger of undue competition for the surplus investment funds of the oil exporters, the establishment of a new financial mechanism for industrial countries would enhance the ability of many developing countries to attract the large amounts of capital they need and can productively employ. These countries will also be able to make appropriate use of the resources of the IMF.

One group of developing countries—those with the lowest per capita incomes and those seriously affected by natural disasters and other problems—will, however, still require concessional assistance. We and other developed countries have been redirecting our concessional assistance toward these countries and urging the international financial institutions to do the same. We also look to the oil exporters to provide a major part of the additional concessional funds needed by these countries because of the increase in oil prices. The additional amounts needed by these poorest countries—perhaps $1.5 billion in 1975—is small in comparison with the oil exporters' surpluses. But although relatively modest in global terms, the sums involved bulk very large for the countries concerned because needs are this desperate.

We shall be addressing the problems of these countries on an urgent basis in the new Development Committee where we shall keep the availabilities of funds under continual review as well as the efforts of developing countries to make maximum efforts to use available resources effectively. One way to help these countries would be to establish a trust fund managed by the IMF and receiving contributions from OPEC states and from other sources. Perhaps the IMF itself could contribute to such a fund profits derived by the sale in the private market of some portion of its gold holdings. A trust fund of this nature which would offer credit at relatively low cost—perhaps 2 to 4 percent and on moderately long maturities—would provide funds to those most seriously affected on terms which are not appropriate for other borrowers. We hope this suggestion will receive the urgent attention of ministers in the IMF Interim Committee and IMF/IBRD Development Committee.

Cooperation with the OPEC nations

U.S. proposals for greater solidarity among major industrial countries in no sense stem from any desire for confrontation with the OPEC nations. We recognize and support the legitimate aspirations of these nations to accelerate their own development, establish their industrial and agricultural bases, and to improve the living standards of their peoples today and in the years to come.

We have established joint cooperation commissions with the key oil producers in the Middle East to help them achieve these objectives. We have undertaken a major effort within our Government to provide them the expertise we have achieved in developing the economy of our own country and to help make it adaptable to their development programs. I personally visited a number of countries in the Middle East last July to launch this effort and intend to return soon to ensure its momentum. My visit last summer was followed by meetings both here and in the Middle East of other U.S. officials, technicians, and experts, with their counterparts, which have put flesh on the Commission structures that have been established. We are prepared to continue to do what we can to accelerate the economic development of OPEC nations and to encourage the private sector of our country and other industrial countries to take an active role in this process. In the meantime, we will continue to permit these countries to invest in our markets and I am confident they will be allowed to invest in the markets of other nations as well.

For their part the OPEC countries must recognize that their position in the world economy has already changed dramatically. These countries will continue to have greater influence in the world even with a substantial fall in oil prices. These countries are now the major surplus countries of the world, with a surplus of a magnitude unprecedented in history. It is vital to the maintenance of a sound and equitable world economy that they accept, without delay, the responsibilities which have historically fallen upon major creditor countries.

I have spoken already of their responsibilities for assisting the needy of the world. They must also understand that their foreign investments can be treated no differently from the investments of others. They cannot realistically expect the rest of the world to devise a special system of guarantees for them alone. It is also encumbent upon them to shed the outmoded habits acquired when they were developing countries with limited resources. The resources of this group of countries are adequate to finance their legitimate development aspirations, even though the situation of individual OPEC countries may differ. Their excess revenues this year alone approximate six times the flow of development assistance to all developing countries last year. This new reality must be reflected in the policies of our international financial institutions.

In my conversations with officials of OPEC nations, and on my travels to the Middle East, I have found that there is widespread understanding in OPEC countries of the responsibilities inherent in their new international role. Certainly leaders of OPEC nations are well aware of the important stake they have in a healthy world economic system. I remain confident that a basis can be found for the industrial nations of the world to continue to work constructively with OPEC nations.

Of course, they must recognize that we continue to be strongly opposed to the actions they have taken to compel a massive temporary transfer of resources—real and financial—to them from the rest of the world. We believe they can achieve their development objectives on a more secure basis at a substantially lower level of oil prices.

They must recognize, too, that each passing day takes us a step further a from an optimal utilization of the world's resources, as other nations revi.. their policies toward reliance on oil imports. Certainly, there is even now no possibility that oil-consuming countries can return to the energy practices of 2 years ago. But the full scope of consuming country reaction is not yet defined, and the hope remains that reasonable men can find rational solutions.

We remain persuaded that extreme policies will, in time, prove very harmful to the basic economic and social aspirations of these nations, and that there is a solid foundation for reaching agreement on a constructive resolution of this issue. Greater cooperation among the world's industrial countries along the lines that Secretary Kissinger and I have set forth last week and today will help establish the basis for such agreement.

Conclusion

In their own interest, and in the interest of the world as a whole, the time has now come when the major industrial nations must grasp the nettle. The evidence before us—of rapid inflation and economic stagnation—offers bleak encouragement for the future unless we now take decisive collective action to break the present train of events. We must act together to limit our dependence on imported oil and to promote our mutual economic and financial solidarity. Such action will inevitably be carried out through decisions and actions often appearing to be technical in nature and limited in scope. But underlying all of what we do must be a solid foundation of commitment—a political consensus that we will act together to determine our own destiny—and a mutual faith that we can do so. We must maintain our commitment to expanding trade and foreign investment. We are too far down the road to interdependence to look back. We have it in our power to choose whether we are prisoners of a history yet to be written or the architects of a future yet to be seen. I have no doubt what our choice will be. We know what the required international response must be.

Exhibit 39.—Letter from Secretary Simon to Senator Mike Gravel, May 23, 1975, updating testimony given to the Subcommittee on Energy in 1974

DEAR MIKE: I am happy to have the opportunity to update the testimony which I presented to the Subcommittee on Energy last year.

Conditions have changed—some for the better and some less encouraging. Worldwide productive capacity has increased from about 60 million barrels per day to 65 million barrels per day. New reserves have been fouud, many of which are substantial in size. For example, the increase in potential reserves in the North Sea is estimated to be on the order of 10 billion barrels. The new finds in Mexico are similarly estimated to add 10 to 12 billion barrels to the world's assets. Total new discoveries in the last year have added about 25 to 30 billion barrels to proved and probable reserves in non-OPEC nations.

Also, there are signs of weakness in foreign crude oil prices. Abu Dhabi has recently reduced prices in order to maintain its volume of production and revenues. Libya, too, is concerned about falling production and a reduction in revenues. As a result, Libya is pressuring Occidental Petroleum to increase liftings. Reports indicating extensions of payment terms are not unusual. All of these indicators offer mild encouragement for more reaonable foreign prices.

By contrast, oil production in the United States has continued its declining trend, now about 7% less than it was a year ago. We are withdrawing more oil than we are finding. The latest figures show that in 1974 we produced 3.8 billion bbls. of crude oil and natural gas liquids but only added 2.6 billion bbls. to our recoverable reserves. Natural gas reserves in the U.S. fared no better. During 1974, the reserves of natural gas dropped 5.2%, leaving only 11.1 years supply at current rates of consumption.

However, some encouraging domestic developments have occurred. Industry has responded to the call for energy development and to higher prices. Drilling activity throughout 1974, which is the precursor of new reserves, was up by 18 to 20 percent for most of the year. Of course, finding new oil is more difficult than it was in the past. Success, as measured in barrels found, requires more drilling effort, a greater number and deeper wells. So we have to run faster simply to stay even. Let me mention the cost of these efforts. Drilling costs have risen significantly due to inflation and the limited availability of materials and manpower. For example, the Oil and Gas Journal reports that the total costs of drilling and equipping a typical offshore tract, exclusive of lease costs, has jumped 41% in the last eighteen months. So the total costs for new oil discovered are compounded.

There were five major aspects to the energy problems which I discussed in last year's testimony. I will review the points we discussed last year in order to emphasize the interrelationship between economic policy and energy policy.

First, I still believe there is a need for a central Cabinet level energy agency such as the Department of Energy and National Resources. While the Federal Energy Administration has responded in an effective manner, there is still a long term need for a Cabinet level department to provide centralized policy for all natural resources.

Secondly, I recommended that the nation establish a conservation ethic—I believe we have been reasonably successful in this. From the highest government circles in Washington and extending to the remotest part of the nation, there is an increased awareness that we can no longer afford our former wasteful practices, that the availability of present forms of energy is limited and that, henceforth, the energy we use will cost more. As one example of our national determination which affects almost everyone, we have reduced highway speed limits. Before the Congress at this time are numerous bills penalizing excessive use of energy and rewarding reduced consumption.

Third, I pointed out the need to develop our domestic energy resources without delay. In this area I have been disappointed in the progress which has been made. Time is short and delay invites further vulnerability to unfriendly foreign acts. Specifically, the proposed Energy Independence Act of 1975 lists steps which need to be taken—

- We need to explore and develop our offshore oil and gas prospects.
- We need to accelerate exploration and development of petroleum resources in the Naval Petroleum Reserves.
- We need to develop and use our abundant resources of coal.
- We need to accelerate efforts to reduce the administrative delays in bringing nuclear power on line.

- We need a vigorous application of known technology in those areas where it is economically feasible to develop synthetic gas and fuels.
- And lastly, we need our most competent scientists to develop new techniques and new methods of providing low-cost replenishable energy systems.

Previously I spoke of the relationship betwen industry and government. Certainly it will be beneficial to both parties to act in concert, not as adversaries. The U.S. oil industry, both independents and major oil companies, have the organizations, expertise and access to funds to develop our domestic oil and gas resources, provided there is adequate economic incentive. Our policies should encourage development of these resources. If we are considering legislation which may not encourage commercial development, such as further taxation on production or an extension of price controls, it should be studied carefully and, more importantly, any alternative to development by the private sector must be considered with great care.

With the collection of input data from the industry, the FEA has been able to obtain far more reliable and timely information on consumption, demand, and production. I think that we are now in a position where we have confidence in our figures and, as a result, better visibility of the national energy status.

My fifth point was the necessity to develop cooperation between producing and consuming nations. The International Energy Agency has been a successful vehicle in organizing the majority of the largest of the Free World consuming nations. The charter of the group provides for mutual assistance in times of emergencies, in meeting common goals of conservation and planning for long-term cooperation through the sharing of technology. As you know, the recent preparatory conference between producers, consumers and developing countries did not achieve the goals we had hoped for, but it did accomplish a serious recognition of the widely diverse national views of the world's economic direction. We are not altogether discouraged and will continue with our efforts to seek a mutual ground with the producers for further discussions.

The unexpected severity of our current domestic economic difficulties created a condition which had to be considered along with the energy program. Following the exhaustive studies which went into the Project Independence Report and a detailed assessment of the nation's economic problems, the Administration developed a combined energy and economic program, which the President presented to the nation on January 15. I am sure you are thoroughly familiar with the President's program and the subsequent views which have been expressed, but I might add that the President's program is a uniquely balanced and integrated program designed to alleviate our current economic conditions and to reduce our dependence on foreign oil.

Since the enactment of the Tax Reduction Act of 1975, it has been necessary for the Administration to reassess certain provisions in the President's program which we originally supported.

The current trend of legislative proposals includes provisions which I find particularly disturbing. Some provisions generally would transfer the decision making process from industry and individuals to the government. It means more controls, not less. Not only is such a trend contrary to our accepted principles of economic freedom, but in practice, I believe inefficiencies will be introduced which will result ultimately in higher costs to the consumer.

I will list some of these provisions and shortcomings which I believe will result in damage to the nation.

1. An oil procurement system in which the government acts as the buying and selling agent for imports of crude oil and products.
2. Failure to provide for sufficient differential in import duties between crude oil and products, which is needed to make the construction and operation of domestic refineries more favorable than buying foreign refined products.
3. Failure to promptly decontrol prices of old oil and new natural gas.
4. Failure to allow free market forces to replace the current system of allocation.
5. Failure to provide sufficient financial incentives to raise the enormous sums of capital needed to increase our supplies of oil, gas, coal and nuclear power.

I have previously testified on all of these subjects at great length, and my recent testimony of May 7 before the Senate Finance Committee discusses future capital investment requirements in energy in detail. I find particularly disturbing the trend for increased government regulation and control not only for prices, but for the conduct of everyday business. I find even more distressing the assumption that a government agency can replace the private sector with equal or more efficient operations.

The U.S. oil industry has a combination of qualities in areas of decision making, technology and access to financing which cannot be equaled in the Federal government for years, if ever. To limit or restrict the only group which can provide the knowledge and stimulus to help the nation through this critical period is to perform a disservice to the country. I am seriously concerned with such trends and appreciate this occasion to make my views known.

As you requested, I am attaching current data on imports and exports which I furnished in last year's testimony.[1]

With best regards,

Sincerely yours,

Bill
WILLIAM E. SIMON.

The Honorable
MIKE GRAVEL,
Chairman, Subcommittee on Energy, Committee on Finance, United States Senate, Washington, D.C.

Exhibit 40.—Other Treasury testimony in hearings before congressional committees

Secretary Simon

Statement, February 17, 1975, before the House Interstate and Foreign Commerce Subcommittee on Energy and Power.

Assistant Secretary Parsky

Statement, March 11, 1975, before the Committee on Interior and Insular Affairs and the Subcommittee on National Stockpile and Naval Petroleum Reserves of the Committee on Armed Services of the U.S. Senate.

Financial Resources Policy Coordination

Exhibit 41.—Remarks by Assistant Secretary Parsky, January 14, 1975, before the Investment Association of New York, New York, N.Y., on recycling of oil revenues and the role of U.S. capital markets

I am delighted to have the opportunity to be here today to discuss aspects of "recycling," and in particular, the role of private investors and private financial institutions with respect to the funds which the oil-producing countries will have available for placement outside their own economies. Any such discussion must also consider the potential effect such funds may have on our capital markets. In doing so, it is important to realize that at the heart of all of these issues lies the price level of oil. As all of you know, since October 1973, we have experienced a sudden rise in world oil prices—in fact a fivefold increase from less than $2 per barrel to over $10 per barrel, the consequences of which are far reaching. Some have said that the world now faces unavoidable financial disaster. I don't agree. I do believe we are confronted with a major challenge. We have been used to an abundance of cheap energy, and the easy availability lulled us into letting our dependence on foreign supplies increase to a point where a group of oil-producing countries can control the price.

That is really the crux of our problem: We have lost the ability to allow the market for oil to operate freely. Now, we must face the fact that cheap energy is no longer available. $10 or $11 oil is with us, and I believe if you consider just the economics of the situation, there is no way that the forces of supply and demand will be able to force the price to decline for at least 3 years.

I say this principally because sufficient non-OPEC supply will not be available before then. Further, if we do not take the necessary actions now to insure

[1] Not included in this exhibit.

that supplies of energy will be developed in this country, the price will not have to be reduced after 3 years—and might go higher. The immediate costs imposed on the economies of the world by this situation are severe; but I am confident that our financial system will respond, and the response will come from a combination of official facilities and private markets. Recently, there has been much publicity given to the official side—to an expanded IMF oil facility, to our "safety net" proposal for OECD countries and to various other mechanisms. We must recognize, however, that any of the facilities are really supplemental to our private capital markets. Further, we must not lose sight of the interrelationship between our approach on the financial side and the price of oil. As such, we must not adopt a financing arrangement that perpetuates higher oil prices.

Summary of capital flows to OPEC

Before discussing how we should seek to balance the official mechanisms and our private capital markets in the recycling process, I think it's important to review the current magnitudes of the capital flows themselves. We estimate that the 13 oil-exporting nations that are members of OPEC will receive about $90 billion in 1974 from their exports of oil—about four times the amount they received the year before—and about $5 billion from other exports. They appear to have spent about one-third of this income, or $30 billion, on imports. Funds they did not spend on goods and services they invested abroad or donated as grant aid. Since actual flows of grant aid by the OPEC nations in 1974 seems to have been quite small, we estimate that these countries will have had about $60 billion of funds available for investment in the rest of the world during the year.

It is impossible to be very precise in tracing these investments flows. However, our preliminary estimates covering 1974 based on data from a number of sources trace about $11 billion directly to the United States, about $8 billion to England in sterling assets, about $5 billion in direct official or quasi-official borrowing by other industrial countries, over $2 billion to the developing countries, and about $3½ billion to international financing institutions. Probably at least $21 billion was deposited with banks in the Eurocurrency market. Additional funds, not included in these figures, have been directed to investment management accounts in Europe, private sector loans, and purchases of real estate and corporate securities in Europe and Japan.

It should be recognized these data are estimates of where the oil producers have placed these funds. Banks and other financial institutions, of course, subsequently relend these funds nationally and internationally; and the continued identity of a dollar as a "petrodollar" becomes impossible—and also meaningless.

Of the estimated $11 billion that was directly invested in the United States last year, about one-half was placed in marketable government and agency securities. We estimate less than a billion was placed in U.S. real estate and private securities; the rest is in bank deposits and short-term money market instruments. Thus, we are receiving significantly less than a fifth of total OPEC investments, and we have no evidence that this percentage is increasing. In fact, in recent months our share has declined.

While we received about $11 billion from the oil producers last year, we have paid, during that same period, an extra $18 billion for crude oil and refined products due to the increased prices. And of the total amount of funds that came in during 1974, our banking system lent a good portion of it back to other oil-consuming countries. Thus it appears that an excessive portion of the producers' funds has not flowed to the United States and remained here.

Recycling

With this background in mind, let's turn to the process of recycling itself. First of all, it's important to understand what we mean by recycling. When I use the term, I mean the overall response to the fact that a substantial portion of the wealth of the oil-consuming nations of the world is flowing to the oil-producing states to pay for oil. Recycling really involves two functions: (1) providing that the consuming nations as a group get much of this wealth back through grants, loans, and other forms of investment and payments for goods and services; and (2) distributing the "recycled" wealth among the consuming nations, including avoiding potential "bankruptcies" among nations unable directly to attract such flows. Thus, in one sense recycling refers simply to the process by which the oil producers' investible funds are moved into final investments either directly or through the intermediary of banks and institutions often located in a different country from the final destination of the investments. In the other narrower sense, it refers to a process by which governments of stronger industrialized countries might intervene to ensure that the funds are lent to selected countries on terms less onerous than those on which the funds would otherwise be available, if at all, to those borrowing countries.

In this latter sense recycling could be undertaken by the U.S. Government either—

(a) Directly, by borrowing oil funds either on the market or directly from an oil producer and then relending the funds on favorable terms to another country, or

(b) Indirectly, by placing some form of U.S. repayment guarantee on borrowings by a foreign country of oil funds lent either directly or through an intermediary such as the International Monetary Fund.

In developing the proper balance among these approaches, we recognize that countries differ as to the amounts of debt they are comfortable with and how much of their oil imports they are able or willing to pay for in current exports of goods and services. There is a danger that increasing reluctance to borrow, or decreasing creditworthiness, or both, will lead some countries to seek lower levels of economic activity in order to preserve their financial positions—and the world will lose heavily in foregone production. There is also the danger that some countries will feel compelled to take self-protective actions that are disruptive to others and to the world economy, and the risk of possible retaliation and general resort to competitive restrictions cannot be ignored.

Bearing this in mind, we have proposed a comprehensive approach to multilateral financing which would supplement the private capital markets' role in recycling. It consists of several parts: Use of the IMF, a special trust fund managed by the IMF, and a fund for industrialized countries.

The IMF would be the first line of official multilateral financing for the full range of its membership. The developed nations and the middle range of the developing nations that have demonstrated creditworthiness will participate in this expanded use of IMF resources, as well as borrowing in the world's capital markets. However, the poorest developing countries cannot afford to assume a greater debt burden except on very liberal terms. We have, therefore, suggested the creation of a trust fund, managed by the IMF, which would channel funds to the most seriously affected nations on concessional terms not appropriate for other borrowers. We would hope that the OPEC countries would provide a substantial part of the concessional contributions to the trust fund.

Our proposals for a financial solidarity fund among the industrialized countries is the third component of our multilateral financing proposals. This fund would be a financial safety net, consisting of standby arrangements among the major industrialized countries to provide financial support in case any participating country finds itself in economic trouble after having made reasonable efforts on its own part to resolve its difficulties. I stress the insurance aspect of this safety net. Our belief is that the existence of the safety net will help assure the continued openness of the national and international capital markets, and so, minimize the amount of official recycling that will actually be carried out.

Inherent in these proposals for official recycling is the belief that the private capital markets will still be central and the key to stimulating productive investments—investments that are needed to facilitate the future transfer of goods and services implied in the current buildup of OPEC financial assets. Official recycling must not be a substitute for private investment, for in the final analysis, this is really what recycling is all about.

During the past year, the international banking system was the focus of receiving and lending surplus oil revenues. For example, the net size of the Eurocurrency market (that is, after deducting deposits of one bank in another) grew by about $35 billion between the end of 1973 and July 1974. This is an extraordinary growth, even for the Eurocurrency market. During the first half of 1974, total deposits in the top five U.S. banks increased by about 20 percent, and the bulk of this growth occurred in the second quarter.

Direct loans by the OPEC countries to consumer governments and purchases of government securities also played an important role in recycling last year, and I expect they will play a more important role this year. With respect to the

United States, as I noted earlier, about half of the direct placement of OPEC funds in our country was in marketable government and agency securities. Such transactions surely have implications for our private capital markets for they reduce the amount of funds the government must raise from domestic sources.

While the international banking system will continue to handle a good deal of the recycling requirements in 1975 as they did last year, direct loans to governments and purchases of government securities will become increasingly attractive alternatives to the producers; and other sectors of our private capital markets will also play a more important role in the direct placement of producer funds. Real estate investments have been made in the United States and to a greater extent in Europe and this will continue to be an important vehicle. Further, equity investments, both direct and portfolio, will play an increasing role as the OPEC countries develop their investment portfolio and management capabilities. In determining the extent to which there will be a move into the equity area, we must distinguish among the OPEC countries.

A number of the producers regard their investment horizons as long term. That is, a portion, and probably a growing portion of their investments are thought of as long-term commitments and will not be turned over quickly. This will be particularly true for Kuwait, the Gulf States, and Saudi Arabia which have low absorptive capacities and substantial oil reserves. They can foresee a future of accumulating far more in revenues than they can hope to put to use domestically. For a country like Kuwait, oil in the ground at some point will become but one part of a much larger asset portfolio. The Kuwaitis are very sophisticated and understand investment very well. They want to invest in the most productive vehicles and, in making their decisions, they can be expected to seek to acquire assets that are at least no less valuable, in their view, than oil in the ground. This should lead to a greater emphasis on equity investments.

Iran, while able to employ all of its revenues domestically in the relatively near future if it so wishes, has also evidenced a desire for equity investments in the industrialized countries. It sees important possibilities for investments in companies that are in position to help Iran expand its domestic industrial base. Similar considerations are likely to enter into future investments by Saudi Arabia.

Such diversification of OPEC capital will add an important ingredient to the recycling process. Further, it should make an important contribution towards our meeting the capital requirements of American businesses in the coming years, and to the need to increase capital formation. Some have argued that the initial placement of OPEC funds will have no significant effect on the ultimate level of capital formation in the corporate sector.

Whether or not there is an increase in savings and capital formation on a worldwide basis, there still can be important shifts in which sectors capital formation occurs. An inflow of OPEC funds into the equity market would not mean that supply of funds to that market will increase by the full amount. However, the investments by oil producers could induce additional domestic purchases by improving the business climate and, in particular, providing an uplift to the depressed equity markets.

In summary, I think that increased oil producer investments in our private sector would facilitate needed capital formation in that sector despite the offsetting market adjustments that surely would occur. These potential investments should not be regarded as the major solution to our domestic capital market problems, for our major solution must be to get inflation under control and to make needed reforms in the structure and regulation of these markets. But these investments can make a contribution to our capital formation as well as facilitate a desirable lengthening in the maturity of the producers' asset portfolios.

For all these reasons, I believe it is very important that we maintain a policy towards foreign investments which maximizes the freedom of our capital markets and minimizes restrictions which are deemed necessary for reasons of national security or other critical national interests. International investments directed by the competitive forces of the private markets have yielded major benefits to the U.S. and world economies. In this period of unprecedented inflation and the particular problems posed by the high oil prices, it is extremely important that we make the most efficient and productive use of our capital resources.

As such, we must recognize that today we are living in an interdependent world. Policies made in one country, whether they be in the energy area or in the financial area, affect many other countries. The whole recycling process serves as a reflection of this interdependence. In developing government policies in this area, we should not reject interdependence but utilize it to build a framework of international cooperation.

With consumers, we must seek greater financial solidarity and a common effort to reduce our dependence on others for our energy resources. With producers, we must resolve our differences through mutual understanding and cooperation. As such, we must recognize and support the legitimate aspirations of the producing countries to accelerate their own development, establish their industrial and agricultural bases, and to improve the living standards of their people. The producers in turn must realize the important stake they have in a healthy world economic system. I believe they will. In my recent conversations with officials in the Middle East, I found a widespread understanding of the responsibilities inherent in their new international role, and I am confident that a basis can be found for the industrial nations of the world to work constructively with the OPEC nations. Maybe I'm too much of an optimist, but we really have no other choice. We are too far down the road to interdependence to turn back. Either we will succeed by expanding trade and investment among all nations or we will fail by sinking into a world of small isolated fragments. I have no doubt what our response must be.

Estimated current account balances of OPEC countries, 1974

	$ billions
Exports:	
Oil	90
Other	5
Total	95
Imports:	
Goods and services	—35
Surplus	60

NOTE.—Some estimates of oil receipts are slightly higher and estimates of imports slightly lower.

Preliminary estimate of percent distribution of cumulative OPEC investments, January through December 1974

	Percent of total
In the United States	18½
In Eurobanking market	35
Sterling assets in United Kingdom	13½
All other	33
Total	100

Exhibit 42.—Statement by Assistant Secretary Parsky, March 18, 1975, before the Subcommittee on Multinational Corporations of the Senate Foreign Relations Committee, on foreign investment in the United States

I am pleased to respond to the Chairman's request for my views on the question of equity investment by OPEC countries in the United States. In recent months I have spent a great deal of time both here and abroad with financial officials of OPEC governments and have devoted considerable attention to the issues now before this committee.

At the outset, let me express my agreement with the subcommittee's deliberate approach to the investment question. As you may recall, when Congress considered the foreign investment issue last session, there were dire predictions of surpluses approaching $1 trillion and of massive takeovers of U.S. industry. Recent estimates indicate that the surpluses will be much smaller. Further, the takeovers have not materialized, and there is nothing to suggest that they will in the future. Last session, Congress directed the Treasury and Commerce Departments to conduct a study of foreign investment flows. That study, along with the administration's new program, which I shall describe later, and deliberations such as those of this subcommittee, will enable the Government to get the facts on foreign investment. Results of all of these efforts will put us in a better position to decide whether the need exists to deviate from our open policies on foreign investment which have helped make our capital markets the greatest in the world.

My testimony today will be in three parts. First, I shall describe how foreign investment—including OPEC investment—helps our economy. Next, I shall highlight the broad array of safeguards which existing law provides against possible undesirable effects of foreign investment. And finally, I shall review the administration's program for implementing these safeguards in a coordinated and effective way.

The importance of foreign investment

Maintenance of an open policy on foreign investment is important for three reasons. *First*, foreign investment helps us to meet our large and rapidly growing capital needs. A recent New York Stock Exchange study estimates that our overall capital requirements will be $4.5 trillion between now and 1985. Moreover, at a time when unprecedented budget deficits will place extraordinary demands on our capital markets, we ought to be very reluctant to close off those markets to willing investors from abroad.

In the past, we have been willing to look to foreign investors to satisfy some of these needs. In the 18th and 19th centuries, foreign investors played a very important role in the economic development of our country, including, in particular, building the network of railroads that linked the various sectors together. In the 20th century, capital formation from domestic sources has far exceeded foreign investments, but the foreign investors still play an important role.

Many people are not aware of the fact that some of our best known companies are partially or totally owned by foreign investors. Companies such as Shell, Level Brothers, and Nestle Co. yield the U.S. economy the same benefits as their domestically owned counterparts—that is, employment opportunities, tax revenues, and competitively priced goods and services. And foreign investors have brought unique technology to this country. The pharmaceutical industry provides a good example of this. Others have played a major role in the development of a particular State or region. As shown by such companies as Paul Masson, Sony, and Toyota, foreign investment can mean more jobs and can offer other important benefits to a State's economy.

More importantly, the behavior of these companies does not differ from domestically owned companies: The ownership of these companies has not altered the way in which they function—they still must abide by our laws, and they still must compete in our marketplace.

Second, as this subcommittee is particularly aware, we are by far the largest foreign investor in the world. The book value of our direct investments alone is well over $100 billion: some six times greater than direct investments in this country. As we invested around the world, we have negotiated numerous treaties of friendship, commerce, and navigation under which investors from other nations are promised equal treatment with American citizens with respect to investments within the United States. As we consider changes in our policies we must be cautious not to endanger these important commercial treaties.

Finally, a *third*, more subtle, reason for caution is the leadership role we play in the world economic picture. We need only recall the experience of the 1930's, when the willingness of the United States to adopt restrictive trade practices resulted in retailatory conduct by other nations and helped turn a recession to a full-fledged world depression. If the United States, with our historical support of free capital movements, were to adopt investment restrictions, other nations could be expected to take similar measures. At a time when the need for worldwide cooperation is at a peak, the nations of the world, led by the United States, would be retreating into isolated economic shells.

OPEC investment policies

Despite such benefits, however, if we actually felt that there was a substantial risk that OPEC investments would be detrimental to our economy, we would be willing to alter this basic policy of welcoming foreign investment. After extensive discussions with the leaders of the OPEC countries, I do not believe there is a threat that the oil producers will use their investments to dominate or disrupt sectors of the U.S. economy.

First of all, the overall flows are not likely to approach some of the early projections. Of the $60 billion in surplus revenues accumulated by all OPEC members in 1974, $11 billion—or only 18 percent—was invested in the United

States. And of that amount, well under $1 billion was placed in permanent investments—stocks, long-term corporate bonds, or real estate. We anticipate that the total amount of OPEC surplus funds in 1975 will be slightly less than the 1974 figure of $60 billion. Although we can expect a larger proportion of funds to be placed in long-term instruments, I do not see a disproportionate amount flowing to the United States. I would be surprised if as much as $5 billion of OPEC funds were invested in long-term instruments in the private sector in 1975. This figure, which includes investments in a broad variety of assets, is less than 3 percent of the 1973 transaction volume on the New York Stock Exchange alone and well under one percent of the total value of all common stock. Moreover, it would represent barely 25 percent of foreign purchases of U.S. securities which were nearly $13 billion in 1973. Beyond 1975, I believe that accumulations of oil surpluses will effectively disappear before the end of the decade, and that new investments will begin to decline before they reach a cumulative total of $200–$250 billion.

Second, although approaches to investment differ among the OPEC countries, each emphasizes return on investment, not domination. Kuwait, the Gulf States, and Saudi Arabia, which foresee a future of accumulating far more in revenues than they can hope to put to use domestically, regard their investment horizons as long term. The Kuwaitis are the most sophisticated and have some of the most knowledgeable people I've met in the field of foreign investment. They are exploring the entire spectrum of profitable long-term investment opportunities: from common stock to real estate. They will be seeking to acquire assets that are at least no less valuable, in their view, than oil in the ground.

Saudi Arabia's foreign investment experience is not so extensive as Kuwait's, but it too recognizes the need to participate on a diversified basis in the consuming nations' economies. With our assistance, and that of U.S. financial institutions, it has developed an investment strategy which emphasizes *stability*—as reflected in its requiring a steady pattern of dividend payments—*growth*—as reflected in its requiring a steady pattern of earnings growth—and *diversification*. Based on my experiences, I would be surprised if Saudi Arabia invested more than 10 percent in a particular industry and more than 5 percent in a particular company.

Iran's investment policies are significantly influenced by its internal development program. Iran will emphasize investments in companies which are in a position to help it expand its domestic industrial base by providing it with access to foreign products, increased technology, manpower skills, and resources. I do not believe that Iran will be interested in investing in real estate or highly speculative ventures. For example, the judgment it must make in determining whether to invest in Pan Am—and to my knowledge that transaction is not a fait accompli—will involve several factors: whether the investment is sound in a financial sense; whether the relationship with Pan Am can benefit Iran's domestic economy; and whether it can enhance the economic relationship between our two countries.

On my recent trips to the Middle East and in the course of commission meetings with Iran and Saudi Arabia, I have discussed with government leaders the oft-expressed fears of OPEC capital controlling key industries in the West. As reflected in my statement today, these countries neither have the desire to control companies, nor do they have the facilities to manage such companies. They view themselves like any institutional investor, seeking a diverse portfolio of investments which will yield the best long-term return. They recognize that an investment decision today is really an investment in their future. They are looking beyond their day of oil primacy, toward a future when they can have a diversified economy, and the only way this will happen is if they make sound investments now.

Existing restraints and safeguards

As confident as I am that OPEC governments will invest their funds in a nondisruptive way, we as policymakers would be remiss if we did not satisfy ourselves that our laws provide adequate protection against the undesirable effects of foreign investment. We recently reviewed the restraints and safeguards in Federal law specifically applicable to foreign investors or to the types of harm foreign investors are more likely to cause. I would like to outline briefly some of these safeguards which may be of particular interest to the subcommittee.

First, there is a relatively short list of laws which prohibit or limit foreign investments in certain sectors for reasons of national security or to protect an essential national interest. These sectors include atomic energy, domestic airlines, shipping, federally owned land, communications and media, and fishing.

Second, there are many laws which prevent abuses in specific sectors, for example, the defense area. The Defense Department may deny security clearances required to do classified work for the Government to any firm under "foreign ownership, control or influence." Foreign ownership of producers of defense materials is not expressly prohibited, but it is effectively deterred by the prospect that such an acquisition would very likely cause the firm to lose its classified Government business. Also, exports of arms and of classified technology related to defense manufacture are effectively controlled.

Finally, every foreign investment is subject to the same laws and regulatory constraints which control U.S. business. These laws provide broad protection against the possibility that any owner, including a foreign investor, could use his position to inflict economic injury. Consider the protection the following laws provide:

(1) Our antitrust laws apply fully to foreign investors and prevent a foreign investor from monopolizing a specific sector, or engaging in various anticompetitive practices. They also prevent a foreign investor from making a purchase of, or engaging in a merger or joint venture with, a U.S. firm if the result would be to substantially lessen competition or tend to create a monopoly. These laws would also prevent such actions by a group of foreign investors acting in concert.

(2) Our export control authority provides protection against the export of any product or resource if national security is threatened, if there is an excessive drain of scarce materials and a serious inflationary impact from foreign demand, or if controls are needed to further U.S. foreign policy. Special, more detailed rules apply to exports of armaments and energy materials.

(3) The securities laws require disclosures of significant foreign ownership and prevent harmful activities with respect to tender offers, stock price manipulation, and preservation of an orderly market.

(4) Our labor laws require all firms operating in the United States to refrain from unfair labor practices and to assure all workers safe and healthful working conditions.

(5) The Government has broad emergency powers, including the Trading with the Enemy Act, which gives the President the power during a war or national emergency to control completely any property in the United States in which any foreign country or national thereof has any interest; the condemnation power over any property within our jurisdiction; and priority performance powers which authorize the President to order the priority performance of defense-related contracts, to allocate materials and facilities necessary for national defense, and to place priority orders for a particular product and take possession of the facility if they are not fulfilled.

Available information about foreign investment

Of course, any safeguard is meaningless unless the Government is aware of the foreign ownership interest. In the course of the administration review, we evaluated our sources of data on foreign investment. Partially in connection with that review, the Council on International Economic Policy and the Office of Management and Budget prepared a comprehensive compilation and analysis of our data sources of foreign investment. Again, I would like only to highlight aspects of the available information and submit for the record the CIEP/OMB study.

The Treasury and Commerce Departments are jointly charged with gathering, on an ongoing basis, statistical information on foreign investment. Treasury requires all banks and stockbrokers to report monthly on all securities transactions by foreigners. The Commerce Department requires data on so-called direct investment; that is, investments where the ownership position is 10 percent or more and where the value of the investment exceeds $2 million.

In addition, under the Foreign Investment Study Act of 1974, Treasury and Commerce are conducting an even more comprehensive one-time survey of all foreign investment as of yearend 1974. Preliminary results of that survey will be available this fall.

A third noteworthy source of data on foreign investment is the SEC. Section 13(d) of Securities Exchange Act of 1934 requires any person owning 5 percent of the stock of most public companies to notify the company and the SEC. Any person owning 10 percent (or less in some cases) must report periodically on any transactions in the company's stock.

Policy regarding foreign investment

We evaluated our existing safeguards as well as the data-gathering mechanisms, and concluded that there is at this time no need for any new legislation, which would restrict foreign investment. We do believe that there may be need for legislation now being studied by the SEC to enforce more effectively existing requirements, on both domestic and foreign investors, to reveal the beneficial owners standing behind investments held in nominee names. Further, we did find that present arrangements should be supplemented by administrative action. Accordingly, the administration is taking the following steps to supplement present arrangements:

We are establishing a new continuing high-level, interagency committee to serve as the focal point within the executive branch for focusing on foreign investment in the United States;

We are creating a new office to serve that committee and all other parts of our Government by producing analyses both of developing trends in various categories of investment and of the prospective impact of significant individual investment proposals;

We are using the new office to centralize and improve the gathering of information on foreign investment and its dissemination to appropriate parts of the Government; and

We are negotiating agreements with the principal foreign governmental investors for advance consultation with the U.S. Government on prospective major direct investments in the United States.

Indeed, we have already made significant progress along these lines. Using our joint economic commissions, we have begun the process of reaching understandings with Iran and Saudi Arabia. On a less formal basis, we are beginning a dialog with Kuwait. I plan to visit both Kuwait and the Emirates in April to discuss this further. We do not want to single out any one country; our policy is to arrange for consultations by governments on all major direct investments. Accordingly, by early summer we expect to have arrangements in place with the most important potential investors.

Conclusion

We believe that this approach is the most sensible—it is aimed at preserving our free market for capital investment and yet provides the necessary mechanisms for preventing any potential adverse effects of foreign investment. In light of this, I am especially concerned that the recent publicity given to the Arab League boycott will cause some to want to alter our traditional policy toward foreign investment as well as our efforts to increase economic cooperation in the Middle East. At the heart of our approach to these economic relationships is the belief that peace and economic progress are interrelated. Without peace, economic progress will be short lived. However, through economic progress, we can assist our efforts to achieve peace. I have participated actively in all of these relationships and, in particular, in our joint commissions, which I found to be a sound vehicle for dealing with the wide range of economic issues confronting us. I have appended to my written text a report on recent progress of the United States-Saudi Arabian Commission on Economic Cooperation.

The administration has consistently opposed the boycott, and we will continue to do so. I think it is important to distinguish between the Arab economic boycott of Israel on the one hand, and discriminatory activities based on religious or ethnic grounds on the other. The boycott arose as part of the continuing conflict between the Arab countries and Israel, and it will most effectively be dealt with in that context. I do not believe the boycott issue is properly addressed by altering our traditional policies of a free and open market for trade and investment. As we review our policy in the investment area, I would urge that we keep in mind that foreign investment, and the policies we adopt, have a significant impact on other matters. It will have an overall effect on the domestic economy; it will have an impact on capital formation in the United States and on our ability to satisfy the capital requirements of our businesses; it will affect U.S. firms doing business abroad; and it will have consequences with respect to our foreign policy. We should not reflect our position to the boycott by adopting restrictive laws in the investment area.

In conclusion, I would note that both the favorable and unfavorable economic events of recent years have reemphasized the close interdependence of the world's economies. In such circumstances, I believe quite strongly that we must work for an atmosphere of respect and understanding, friendship and cooperation—such an approach can help to temper the extremity of political disputes and can help resolve the critical economic problems facing us.

Appendix A

The United States-Saudi Arabian Joint Commission on Economic Cooperation was the first commission of this type set up with any of the Middle Eastern countries. In addition to Saudi Arabia, the United States presently has joint commissions for economic cooperation with a number of Middle East countries—Egypt, Iran, Israel, and Jordan—as well as India. The joint commission arrangement is first and foremost a conscious and integral part of the U.S. peacemaking efforts in the Middle East. Our belief is that through the economic development of the Middle East, political stability in the Middle East will be enhanced.

The United States-Saudi Arabian Joint Economic Cooperation Commission was formed as a result of a joint statement issued by the United States and Saudi Arabian Governments last June 8, 1974. The statement was signed in Washington by Secretary Kissinger and Prince Fahd, Second Deputy Prime Minister, and Minister of the Interior of Saudi Arabia. The joint statement specified that the Joint Economic Cooperation Commission would be cochaired by the Secretary of the Treasury for the United States, and Minister for Financial Affairs and National Economy for Saudi Arabia.

Like the other commissions, this Joint Commission provides a government-to-government relationship across a broad spectrum which can be directly responsive to Saudi Arabia's expressed socio-economic development needs. To this end, the joint statement set up four working groups: industralization, manpower and education, agriculture, and science and technology.

On the U.S. side, in addition to the Treasury Department, all the other relevant government agencies are represented: the Departments of State, Commerce, Labor, Interior, Health, Education, and Welfare, and the National Science Foundation. On the Saudi Arabian side the representatives include: the Ministries of Foreign Affairs; Financial Affairs and National Economy; Commerce and Industry; Labor; Education; and the Central Planning Organization and other government and university agencies.

The Treasury Department serves as the coordinating agency for the American side. The Ministry of Financial Affairs and National Economy serves in the same capacity for the Saudi side. I am the U.S. working group coordinator and Dr. Soliman Solaim, Deputy Minister for Commerce and Supplies, is the acting working group coordinator for Saudi Arabia.

Last July 21, Secretary Simon went to Riyadh, Saudi Arabia, to attend the opening of the first working group meetings. During 3 days of meetings the Working Group on Industrialization discussed possible areas of cooperation. It was agreed to send U.S. Government experts to Saudi Arabia to identify problems and recommend technical assistance programs in the following areas: (1) Development of statistical base, (2) improving the industrial information and documentation capabilities of the Ministry of Commerce's Industrial Studies and Development Center, (3) improvement of customs procedures, (4) development of environmental standards, (5) improvement of port management, (6) development of marine fisheries, (7) communications facilities, and (8) helping the Saudi Arabia patent and trade system reach full international standards. In February 1975, two additional U.S. Government advisors were sent to Saudi Arabia to study industrial and food standards. The reports of the first eight experts have been written and presented to the Saudis. We are still awaiting the reports of the last two advisors.

A second meeting of the Working Group on Industrialization was held September 26–28, 1974, in Washington, D.C. The Saudi side of the Working Group on Industrialization presented an overall view of industrial projects, plans, and opportunities in Saudi Arabia to approximately 200 American industrialists and businessmen. During the last 2 days of the meeting the studies and recommendations of the experts on customs, statistical base, industrial information and documentation, evironment and pollution, and port management were presented to the working group. Discussions included the possibility of an OPIC agreement, the role of the Export-Import Bank, U.S. tariff and fee policies regarding petroleum products and short supply items such as commodities, machinery, and spare parts.

The Working Group on Manpower and Education has held one meeting, July 24–25, 1974, in Riyadh. At that meeting, the Saudis placed the highest priority on the strengthening of their vocational and technical training programs and their overall educational system. As a result, a vocational and technical training team, which included two persons from the Department of Labor and one from HEW visited Saudi Arabia during August and September 1974. In their report, which was presented to the Saudi Arabian Government in January 1975, these specialists made specific recommendations which would help to improve the existing Saudi manpower and vocational training, technical training, and on-the-job and apprenticeship training.

During November 1974, four specialists from the Department of Health, Education, and Welfare spent 3 weeks in Saudi Arabia. They studied and assessed the Saudi education system from the primary grades to the university postgraduate levels. The reports of both teams discussed additional U.S. technical assistance from both the U.S. Government and the U.S. private sector and the possibility of sending large numbers of Saudis to the United States for basic and advanced training and education programs.

During the Working Group on Agriculture meeting in Riyadh, September 14–15, 1974, it was agreed that the U.S. Government would send six specialist teams to Saudi Arabia to study national water management, research and extension training, land management, animal and plant health, research administration and management, and the development of an agriculture and water data bank. These six teams have not yet been sent to Saudi Arabia because of the lack to date of a reimbursement mechanism. It is anticipated that now that a technical cooperation agreement has been signed with Saudi Arabia, a reimbursement mechanism will soon be in place to facilitate the travel and other expenses of U.S. Government experts to Saudi Arabia.

In September 1974, both the Working Group on Science and Technology and the Working Group on Agriculture held meetings in Riyadh. The Working Group on Science and Technology, meeting September 16–17, 1974, identified 18 possible areas for scientific and technological cooperation. These areas include land reclamation, water utilization, solar energy, industrial research, transportation planning, technical training and exchanges between Saudi and American universities. It has been decided that a Saudi Arabian Center for Science and Technology is to be established to serve as a coordinating body for the development of science and technology in Saudi Arabia; in particular, in the already identified 18 priority areas.

On February 13, 1975, a technical cooperation agreement was signed in Jidda, Saudi Arabia. This agreement provides the mechanism to reimburse the U.S. Government for all travel, salaries, and administrative expenses of advisors who are sent to Saudi Arabia under Joint Commission auspices. The technical cooperation agreement marks a major step toward facilitating and increasing economic cooperation between the United States and Saudi Arabia.

The first meeting of the Joint Commission was held in Washington, February 26–27, 1975, and was chaired by the Secretary of the Treasury, William E. Simon. The Saudi Arabia delegation was headed by Muhammed Ibn Ali Aba al-Khail, Minister of State for Financial Affairs and National Economy for Saudi Arabia. All the relevant agencies for both Governments were represented at this high-level meeting.

The Commission noted the signing of the technical cooperation agreement and expressed its intention to expand the Joint Commission office in Riyadh. The U.S. component of this office, to be known as the United States Representation to the Joint Economic Cooperation Commission office, will consist of six or seven people. We plan to begin operating by the middle of May 1975.

During the Commission meeting, Secretary Simon and Minister Aba al-Khail signed an OPIC investment guaranty agreement. The agreement should increase and broaden the interest of U.S. private enterprise in participating in Saudi Arabian economic development.

In the area of industrialization and trade, the Saudi delegation reaffirmed its interest in acquiring U.S. technology from U.S. firms for the development of major industrial projects in both the hydrocarbon and nonhydrocarbon areas.

The U.S. Government expressed its willingness to send out teams of experts in a number of principal statistical disciplines as a means of providing technical assistance in developing a statistical base for Saudi development.

In the area of manpower and education, it was agreed at this meeting to send an American team to evaluate the academic and administrative structure of the Saudi Arabian university system, and, as well, its relationship to high-level technical and professional education. Broadened student/faculty exchanges between the two countries, joint research projects, the establishment of junior colleges in Saudi Arabia, and the training of academic and administrative personnel in Saudi Arabia were also discussed.

In the area of agriculture, feasibility studies were discussed for major agricultural projects, the Saudi Central Research Laboratory, an agricultural training center, and establishment of a desalination center. The U.S. Government agreed to send a four-man team to Saudi Arabia to discuss and reach an agreement for implementing feasibility studies for large agricultural areas. A team is about to leave Saudi Arabia to plan a research program and to determine organizational and management requirements of the Central Research Laboratory and Agricultural Training Center. Projects in the area of land management, water utilization, and a national data bank remain to be developed under the technical cooperation agreement.

In the area of science and technology, a team will soon be going out to lay the groundwork for a Saudi Arabian National Center for Science and Technology. Additional teams will go out soon afterwards to define programs for other agreed-upon project areas.

In order to maintain the momentum of the Joint Commission, the U.S. side has decided to establish an action group, of which I will serve as the coordinator. The Saudi side is considering forming a similar action group. On the American side, the action group will consist of representatives of Treasury, State, Agriculture, Commerce, Labor, HEW, Interior, and the National Science Foundation. The purpose of these action groups will be to monitor the progress being made on a regular basis to see that the program goals are being reached and that new proposals are agreed upon. We plan to have the action groups meet at least once before the Second Session of the Joint Commission is held in Riyadh, Saudi Arabia, in October 1975.

We have also agreed to discuss with the Saudis concrete development projects in the Department of Public Works which might be handled by the Corps of Engineers.

Exhibit 43.—Statement by Secretary Simon, June 26, 1975, before the Subcommittee on Commerce, Consumer, and Monetary Affairs of the House Committee on Government Operations, on New York City's financial crisis

A few years ago Charles de Gaulle arrived in New York and spoke affectionately about the special bonds he felt for that great city. "How often, at difficult moments, I looked to New York, I listened to New York, to find out what you were thinking and feeling here, and always I found a comforting echo." Those of us who know New York City as the financial capital of the world, the focal point of its capital markets, have similar feelings. I have been privileged to spend my professional career there, and I look upon the city as a second home.

It was with these feelings that my colleagues and I approached the very difficult problems of New York this spring. There was no prejudice against New York, only a sadness that this great city which had inspired so many had allowed its finances to become so disordered. And there were certainly no prejudgments based on the coincidence that the city's leadership happened to come from a different political party. No, we faced the problems of New York City acutely aware that fundamental questions relating to the proper roles and responsibilities of government at all levels of our system were squarely presented. And we concluded that the problems of New York were created at the local level and would have to be solved there.

For background, we must first understand the nature of the problem that was developing. Frequently, corporate entities of all types find that the timing of receipts and expenditures do not correspond. Thus, for example, a builder will borrow money from a bank to build a house, promising to repay the money out of the proceeds of its sale to the homeowner. At the corporate or governmental levels, wider options are available. Because the amounts involved are often beyond the capacity of one bank—or even a group of banks—to lend from their own funds, such borrowing may take place through the sale of debt securities in the public market.

The successful use of this system depends on one simple condition: that the amount borrowed does not exceed the anticipated income. When this condition is continually violated—when, for example, borrowing occurs not in anticipation of income, but instead to close a gap between income and expenditures—the system ultimately breaks down. And that is precisely what happened to New York City this spring.

Having borrowed to finance deficits and then lacking a surplus in later periods to pay off these loans, the only way New York could pay off past loans was by floating new ones. As the deficits persisted and grew, the borrowing pyramid mounted: Since 1969, New York's short-term debt has increased from $700 million to over $4 billion. At the end of 1974, New York accounted for nearly 40 percent of all State and local short-term debt outstanding.

The decision to halt this spiral was not made by a small group of men in a smoke-filled room. Instead, it was made in the clear light of day—visible to all—by that most omniscient of judges: the market itself. On March 13 and 20, the city, through its underwriters, offered for public sale $912 million of short-term notes at tax-exempt interest rates of up to 8 percent. Even for investors of relatively moderate means this looked, at least on the surface, like a very good deal. For such investors, the effective yield, on a tax equivalent basis, was some three times greater than that available at a savings bank. Yet weeks after the offering, despite relatively vigorous marketing, more than half of the notes remained unsold.

The market had spoken. Investors knew that buying the notes would make them just another layer in the borrowing pyramid and that their primary source of repayment would be the creation of still more layers of debt in the months ahead. In the absence of any credible indication from the city that it was taking any action to balance its budget, the necessary first step toward undoing the pyramid, investors simply shied away, choosing instead from a variety of competing investment options. Although the returns on such instruments may not have matched what New York was offering, the risks as perceived by the market were much lower. For New York, the market—at least temporarily—had closed.

It was in this atmosphere that we entered the picture. When the possibility of a financial crisis was first brought to my attention in March, I immediately asked Under Secretary for Monetary Affairs Jack F. Bennett to take personal charge of the matter. Mr. Bennett—also a New Yorker by professional background—moved quickly. Within the first week alone he convened and participated in four high-level meetings—three here in Washington and one in New York City—involving representatives from the city, from the State, and from the financial community. Indeed, at the last of this early series of meetings, he asked for and obtained the participation of experts on the municipal market from throughout the country.

Our purpose in holding the early series of meetings was twofold. First, we wanted to determine quickly whether any facile steps were available to reopen the market in time to permit the city to sell $550 million of additional notes on April 14. Accordingly, we met and talked with a variety of market experts—from New York City and elsewhere—to identify the causes of the market closure and to explore possible solutions. These were candid, realistic meetings of professionals, urgently seeking ways to sell a then unsaleable product.

A second purpose of these early sessions related more directly to the question of Federal financial assistance. Before we could identify, much less evaluate, our options in this regard, we needed facts: facts about the city's expenses and obligations, facts about its revenue sources, facts about its debt structure. An early roadblock was the absence of good records. No document existed which summarized with any clarity the income and expenses of the city. No document provided a straightforward accounting of its assets and liabilities. As we quickly became mired in the byzantine world of the city's accounts, our requests that such information be developed were met with earnest promises of prompt compliance. Although that was more than three months ago, the information has not yet arrived.

While these meetings proceeded, other parts of our staff were also at work. Our legal staff analyzed questions ranging from our legal authority to purchase municipal securities to the coverage of the Federal bankruptcy laws. Others began to explore in depth the range of Federal assistance programs. And after complaints surfaced that payments under our social and educational assistance programs were too low or too late or both, we immediately commenced an inquiry at HEW, which has responsibility for administration of the programs involved.

Let me dwell briefly on the HEW situation because it is indicative of the kind of misunderstanding which has permeated this entire matter. At the city's request, senior members of my staff and Secretary Weinberger's staff met with budget experts from the relevant departments of the city's government: the Board of Education, the Department of Social Services, and the like. Understandably, there was an element of suspicion at the start, fueled by a conviction that somehow the Federal Government was shortchanging the city in the amount and timing of its support payments. As the meeting progressed, a strange thing happened: In going through the assistance programs, item-by-item, the group determined that HEW was doing an excellent job in scheduling its assistance payments to New York. Apart from a question whether certain Medicaid payments should be changed to an advance rather than reimbursement basis—which I shall discuss later—the city officials left satisfied that we were properly carrying out our responsibilities.

But HEW's concern for New York did not stop there. After the meeting, they carefully reviewed our entire program in New York, most of which is administered through the New York State Department of Social Services. And that review resulted in the discovery of substantial underpayment of the estimated Federal welfare payments paid to the city by the State. We called the underestimates to the attention of appropriate State officials, and the matter was promptly corrected, with the city receiving an additional $90 million.

I call these matters to your attention because they so clearly belie the image of callous insensitivity that some have sought to saddle us with.

Let me now turn to the question of special federal financial assistance to the city of New York. The determination that hundreds of millions of dollars would not magically materialize from HEW programs illustrates a fundamental proposition that we established very early. Irrespective of the merits of the case for special Federal financial assistance to New York, the practical means of providing such assistance were severely limited. We identified four possible options for the Federal Government:

One: Advance revenue sharing and Medicaid payments.
Two: Guarantee or purchase New York City securities.
Three: Lend New York City all or a portion of the required funds through the Federal Reserve System.
Four: Take no action at the Federal level, recognizing that a solution must be developed and implemented at the local level.

In evaluating the options, we first looked at the legality and practicality of implementing each of them, again still not yet reaching the question which separated options 1 through 3 from option 4: that is, whether any form of Federal action was warranted on the merits.

We found that only the first option could be accomplished by executive branch administrative action. We had no authority whatsoever to make a direct loan to New York or to purchase any of its securities. As a matter of law, there were only two sources of meaningful amounts of cash.

First, there was revenue sharing. On July 7, we are scheduled to make the April–June quarter's revenue sharing payment. New York City is scheduled to receive $64 million and New York State an additional $57 million. Had we advanced the date for making this payment and had the State then agreed to turn over the city all of its share, this source could have provided $121 million.

The other potential source of cash was the change in the Medicaid payment method I referred to earlier. At present, the Federal share of Medicaid coverage for patients in private hospitals is paid to cities on a reimbursement basis; that is, upon presentation of a voucher confirming that the city has paid the hospital the amount in question. As a consequence, the city must first borrow the funds and pay the hospital before receiving the Federal share. Had we changed this procedure, agreeing to provide the funds in advance on an estimated basis, we could have provided the city with approximately $75 million from this source.

The total of $196 million available through these channels seemed small in relation to New York's enormous cash requirements. We therefore tended to dismiss this option and turned to the others.

New legislation—the second route—appeared equally unpromising. Legislation authorizing Federal purchase or guarantee of municipal securities raises a number of complex issues ranging from tax policy to management of the Federal deft to Federal/State/local relations. In view of the fact that any such legislation would—as a political necessity—have had wider application than just New York City, such complexity alone eliminated this course as a viable option. There simply was not time to resurrect and resolve these fundamental questions in a satisfactory way and still meet New York's timetable for cash.

Third, there was the possibility of a loan from the Federal Reserve. Governor Mitchell addressed this option in detail yesterday, and I need not retrace his steps. In evaluating this option from the administration's standpoint, however, these facts stand out. First, we were aware of the limitations Congress itself imposed on this approach. By requiring the approval of five members of the Board of Governors—more than a simple majority—Congress clearly intended that this authority be exercised with extreme restraint. Moreover, we knew that historically the Fed had conformed to the will of the Congress and had not exercised such authority in nearly four decades. Accordingly, we were aware from the start that this option, like the first two, was probably of dubious utility.

With these considerations in mind, we turned squarely to the merits of Federal involvement. In addressing this question, a number of criteria were relevant:

First, the assistance had to be effective: that is, it had to be part of a solution which we could confidently predict would prevent a recurrence of the crisis after this money ran out;

Second, the assistance had to be *fair* and *equitable*: we could not show undue favoritism to one city at the direct or indirect expense of others;

Finally, and this is partially a composite of the preceding critiria, the assistance had to be in the *national interest:* undue expense or adverse impact on other Federal programs or objectives could not be tolerated.

What did effectiveness mean? It meant to us that the payment must be necessary to get the city over a nonrecurring, short-term crisis, a financial accident, so to speak. A payment would not be "effective" if it appeared that the same cash flow problem—highlighted by an inability to raise funds through the sale of securities in the public market—would appear again, month after month. A payment would not be effective if it treated only the symptons, and not the cause. In other words, we were looking for a plan of responsible fiscal action, designed and implemented at the local level, to restore investor confidence and reopen the public market. Although many ideas were discussed between March and the middle of May, as of the time of our decision no city official was willing to commit the city government to an immediate and effective program of meaningful fiscal reform.

The importance of a program of fiscal reform really bridges this criterion of effectiveness and the next criterion of fairness. For if we were to use the Nation's funds to deal with the difficulties of one city, albeit a very important one, we would have to satisfy ourselves that any such payment would not be to the disadvantage of other cities.

Fairness meant two things. First, any aid we provided New York would have to be made available to other cities. Thus, nationwide application of option 1, for example, would cost the Federal taxpayer $15 million—a high price to pay for providing New York with a single $196 million payment.

Second, we looked at New York's position relative to other cities to determine whether it was demonstrating the kind of concern for its financial affairs that characterized the actions of other municipalities throughout the Nation. We immediately discovered that by comparison to other cities, New York was not a particularly hard-hit victim of the recession or the so-called urban crisis. Its real property values, its sales taxes, and its income tax revenues had held up better than most other cities. Unlike other cities, the problem was on the expenditure, not the revenue, side.

It is not the province of a Federal official to tell any city how much it should spend on social services, how much it should pay its employees or charge its students. But when that city comes to Washington seeking financial aid, it is most emphatically the duty of the Federal Government to review the balance between expenditures and revenues. And what we found in New York was a complete lack of balance—rapidly increasing expenditures that far outstripped the growth in revenues. Expenditures were increasing at a rate of 15 percent a year while revenues were growing at only 8 percent a year. This problem is not merely too much government; it is financial disaster.

With this in mind, let me turn briefly to some specific data concerning the city's finances. Looking at the payroll, Census Bureau data shows that New York employs some 49 employees per 1,000 residents. The payrolls of most other major cities range from 30–35 employees per 1,000 inhabitants. And Baltimore, New York's closest competitor at 42 employees per 1,000, this year imposed a 20-percent reduction in the municipal payroll. By comparison, New York's proposed cuts—prior to Mayor Beame's recent budget announcements—were minimal.

Turning to specific services, New York spends $151 per capita on health and hospitals. Among other cities, only Boston is over $100, at $122 per capita—most cities are at $50 or below. Yet, as measured by the vacancy rate, nearly one-quarter of the beds in New York City hospitals were empty last year.

I do not want to belabor the welfare situation; New York's problems in this regard are altogether too well known. Nevertheless, it bears noting that among cities over 1,000,000—all of which have large underprivileged populations—only New York spends more than $20 per capita on welfare and related social services. Its figure is $315 per capita.

Moreover, although the situation has improved in recent years, the welfare rolls remain laden with ineligibles. Earlier this week the State Department of Social Services reported an estimated ineligibility rate of 9 percent. Although this is down from 18 percent in 1973, the improvement still compares unfavorably with results elsewhere in the State. Over the same period, non-city welfare ineligibles fell from 15 percent to less than 1 percent. And these figures take on more meaning at over $10 million per percentage point.

Let's look at still other areas. At an annual cost of more than one-half billion dollars, New York's city-operated university—larger than virtually every state university—provides a tuition-free education to every high school graduate, regardless of the student's ability to finance his own education. Yet reasonable tuition charges would not be a hardship since both the State and Federal governments have extensive scholarship programs, insuring that no qualified student will be denied an education. The present system needlessly subsidizes, at great expense to every taxpayer, those who are able to bear the costs themselves.

The burden of New York's massive payroll is multiplied by one of the Nation's most generous employee benefits systems. Fringe benefits for many city employees equal 50 percent of base pay. In addition, employees need not contribute to their own pension plans, yet may retire early at high rates.

Police and fire, sanitation, housing—the picture is the same: New York is at or near the top in every category on a per capita basis. And on a total dollar basis, to which we ultimately must turn in determining how the bills will be paid, there is simply no comparison.

As would be expected, the bottom line reflects the component parts. New York spends in excess of three times more per capita than any city with a population of over one million. When the base is broadened to include smaller cities, only Boston and Baltimore spend more than half as much as New York—and even when compared to these cities, New York's expenses are 50 percent higher.

These figures, from 1973, provide the most current basis of comparison. When historical data are evaluated, other interesting trends come to light. Not only does New York now spend far more than any other city, but over a 10-year period, its increase in spending has far outpaced other urban centers. From 1963 through 1973 per capita municipal expenses of large U.S. cities (excluding New York) increased on the average 2.2 times. During the same period, New York's expenses increased some 3.5 times, a 50-percent greater rate.

The only way an entity which spends more than it takes in can keep afloat is by borrowing. Accordingly, the ultimate indicator of a city's ability to manage its financial affairs is its debt structure, and—given legal restrictions—particularly the short-term portion thereof. On June 30, 1969, New York had $671 million in short-term debt outstanding. By June 30, 1974, the figure had increased six times, to approximately $3.5 billion. And only the closing of the market for New York in April prevented the short-term borrowing load from approaching $6 billion this year. As it is, and taking into account State advances to be repaid by "Big Mac," short-term debt will be nearly $4.5 billion, a billion dollar increase in one year.

And even the growth in short-term debt does not tell the whole story. In recent years, some $700 million per year of deficit spending for current purposes has been "hidden" in the capital budget to be financed by long-term borowing. This practice alone now costs the New York taxpayer well in excess of $100 million per year.

By contrast, apart from bond anticipation notes—which can be considered a form of construction financing—few cities have any short-term debt at all. Each year Chicago issues some $300 million in notes, and pays them off annually when tax payments come in. Until May 5 of this year, Boston had $65 million in tax anticipation notes outstanding, but it retired them on schedule when 1975 taxes were paid this April. Again, except for bond anticipation notes, no other major American city reported any short-term debt.

In recent years, New York has faced the marketplace's demands for restraint, responsibility, and realism with spending, promises, and gimmickry. Capital borrowing for current expenditures, artificially high revenue estmates to "balance" budgets and support even more borrowing, and, above all, an inability to say no where more spending is concerned, make New York unique among our major cities. While the economic difficulties of recent years have caused most of us—from the individual taxpayer to other large cities—to tighten our already tight belts, New York has plunged onward, committing its own citizens to impossibly large financial burdens and now turning to the taxpayers of the nation for even more funds.

In the course of numerous meetings at all levels, we stressed this disturbing set of facts to city officials. And we were not alone. From the New York Times, from the New York Clearing House, from the Citizens Budget Commission, the same message was repeated again and again: get your spending into line with your ability to pay.

How did the city respond? Speaking bluntly, I think they thought we were all a bit naive. You could fight crime, you could fight pollution, you could fight poverty and ignorance, but—in New York—you could not underestimate the powerful forces for spending being brought to bear on the city's elected officials, driving the city into the slow and painful death of bankruptcy.

Now I know enough about New York to know that Mayor Beame and his colleagues would be in the fight of their lives the moment they touched their scalpel to the growing layer of fiscal fat which is strangling the city. One only has to look at that incredible pamphlet off-duty policemen, firemen, and others were handing out to tourists earlier this month to appreciate the kind of problem the Mayor was dealing with. But we make a tragic mistake when we resolve questions solely on the basis of which side is more threatening or more unscrupulous.

But as of early May, when I, and then the President, met with the Mayor and the Governor, no resolution of the problem was in sight. The issue as then presented was plain and simple: give us the money to get us through the immediate crisis, then we'll begin to worry about a solution.

As I have indicated, it had become clear that the only real solution lay in a responsible program of fiscal reform. Such a program would reopen the market and avert the possibility of a default of New York City. But because no such program had even been suggested by city officials, it was our responsibility to evaluate the constant suggestions that a default by New York would have a devastating impact on the capital markets, the banking system, and the national economy as a whole.

It was quickly apparent that the principal adverse effects would be based on psychological factors, not objective ones. To be sure, many parts of the economy—especially in New York City—would suffer severe harm. On the whole, however, our markets, our banking system, and our economy each are large and diversified enough to withstand the temporary inability of even an entity the size of New York City to meet its obligations.

But I have been around markets long enough to know that one ignores psychology at his own peril. Accordingly, before reaching a decision, we asked ourselves three more questions about the psychological effects of a default:

First, what impact would a default have on the securities markets, particularly the municipal markets?

Second, would a default influence the condition of the major banks?

And third, what impact would a default have on public confidence nationally?

With respect to the impact on the market, it is fair to say that there were differences of opinion. Certain market professionals from the private sector did tell us the effect could be devastating. But my staff and the Federal Reserve Bank of New York, which, as you know, serves as the focal point for our public securities markets, advised me that whatever impact did occur would be temporary, and, even so confined, would be negligible.

Three factors produced this judgment. First, it was uniformly believed that any default would be shortlived and that there was enough underlying value in New York City to assure that all holders would eventually be paid 100 cents on the dollar. Second, the municipal market had recently experienced the prospect of a major tax-exempt issuer default—New York State's U.D.C.—and had weathered it well. Third, New York's problems had been public knowledge since at least November, and the market, at least in large part, had reflected this risk by discounting the prices of New York City and other weaker issuers. The last judgment was confirmed by the strong rally in the municipal market when "Big Mac" was established.

We found the banking system even better equipped to handle whatever shock might occur. The New York City holdings of the major New York banks, while large in absolute terms, were only a fraction of 1 percent of the total assets of these institutions. The sophisticated investors, whose large deposits were in question, were aware of this fact, and were also aware that, upon a default, this portion of the banks' holdings of New York securities would hardly become worthless.

This lack of a realistic basis for fearing large withdrawals was coupled with a recognition that the system was designed to handle such an event, if it did occur. A primary reason for establishing the Federal Reserve System was to correct temporary imbalances of liquidity in our banking structure. And the System clearly would have been able to handle any imbalance which might have occurred in these circumstances.

Finally, working with Chairman Greenspan of the Council of Economic Advisers and senior economists at the Federal Reserve, we looked at potential consumer and business reaction. In view of the general knowledge of New York's situation and an awareness that at least many of the underlying problems were of the city's own making, we saw little risk that a default would be viewed as an indication of a more widesperad economic malaise.

Concluding that a default would not have precipitated an economic crisis did not mean that a default should not be avoided at virtually any cost. But when we reviewed our analysis of what other cities have done and are doing to meet the economic challenges of these times, another barrier to special treatment for New York became apparent. Many of our leading cities are having troubles these days, troubles largely attributable to the recession and unemployment levels, and to the impact of these phenomena on municipal revenues. But as I discussed earlier, and as confirmed by a recent Joint Economic Committee staff study, virtually all these jurisdictions have met their problems head on, recognizing that meaningful cuts in spending levels were a critical part of any solution. As we in this town are altogether too aware, spending cuts do not come easy for any elected official, especially when a direct impact on one'e own constituents can be identified. But throughout the country, brave local leaders have literally put their political futures on the line by insisting that all questions however, painful, be addressed and that the problems be solved in a responsible manner.

Under our system of government, it is not, and should not be, the job of the Federal government to manage the finances of State and local government. That function must be handled locally, by the government's duly elected leaders. But we do have a responsibility to those leaders not to undermine their efforts. And if we had provided funds to New York, what would we have said, for example, to the Mayor of Detroit or to the Mayor of Cleveland, each of whom has incurred the wrath of major political forces in his own city by taking steps to see that they pay their own way. No, if our system is to continue to function, it was clear we had to protect the credibility of local leaders. And aid to the one major city which had not taken action to meet its fiscal responsibilities would have destroyed that credibility overnight.

These were the elements of our decisionmaking process. As you can see, the decision was not made hastily, lightly, or without complete attention to all relevant considerations. It was not an easy decision, but I think events to date have shown it was the right one. With the Federal avenue closed off, so to speak, all parties could again turn their full attention to developing a solution at the appropriate governmental level.

Before concluding, I do want to mention what the city and State have done since May 14, because I think it does provide a basis for optimism. The formation of the Municipal Assistance Corporation—or "Big Mac" as it has come to be known—provides the basis for constructive action in two important areas.

First, MAC will refinance, and thus in effect reduce, New York City's short-term borrowing load by some $3 billion. A major problem in marketing New York City notes has been sheer volume; the market simply gets tired of the same issuer making massive claims on the market, month after month. Although New York's short-term borrowing demands will continue to be enormous by any standard, a 40-percent reduction should be of benefit.

Second, both in the directives of the legislation itself and in the ongoing activities of the MAC Board, valuable assistance in implementing a meaningful program of fiscal reform should be provided. The legislation directs the city to adopt reforms such as better accounting and the elimination of capital borrowing for expense items. Perhaps more importantly, the legislation makes the MAC Board a formal participant in the budget-making process. As such, the largely nonpolitical Board can act as a buffer for the other participants in making and implementing the hard decisions with respect to spending which are essential to a long-term solution.

In short, MAC has helped with the cash-flow crisis, MAC will reduce the short-term borrowing load, and MAC can provide needed technical and political assistance in making the necessary spending cuts. But the fact remains that the hard decisions must be made. And they must be made and implemented promptly to avoid a recurrence of the financial crisis in the fall.

Frequently over the past 3 months, the inevitable comparison between the finances of New York and the finances of the Federal Government has come up. The comparison is justified. The problem and its causes are the same, only our Federal printing press relieves us of one of the symptoms—the "cash-flow crisis" we have just experienced. More importantly, the solution is the same: fiscal responsibility.

Ladies and gentlemen: In tracing for you today the developments and reasoning that led to our decision of May 13 with regard to the city of New York, I have tried to avoid pinpointing responsibility on any individuals or administrations. There is no need to descend to that level. More than that, I would hope that all of us might recognize that the New York City experience raises questions that are much larger than any individual personalities, questions that relate to our philosophy and approach toward government.

Americans are rightfully concerned about the fiscal plight of the largest and richest city in the land because they know that the philosophy which has prevailed in New York—the philosophy of spend and spend, elect and elect—first took root and flourished here in Washington, D.C. As a Nation, we began planting the seeds of fiscal irresponsibility long ago. Forty of our last 48 budgets have been in deficit, and 14 out of the last 15. By the end of next fiscal year, the total Federal debt will be more than twice what it was less than a decade and a half ago. And by that same date, private holdings of Treasury securities will have increased 50 percent in only 18 months.

Neither man nor government can continue to live beyond their means for very long. A family that persists in such habits will eventually enter bankruptcy. A city will ultimately default on its loans. And a nation will foist upon its citizens the cruelest and most regressive tax of all, inflation.

There can be no doubt that the problems of inflation that we have experienced in recent years as well as the recession which arose from that inflation are both a product of our excesses of the past. When the Federal budget runs a deficit year after year, especially during periods of high economic activity such as we have enjoyed over the past decade, it becomes a major source of economic and financial instability. The huge Federal deficits of the 1960's and 1970's have added enormously to aggregate demand for goods and services, and have thus been directly responsible for upward pressures on the price level. Heavy borrowing by the Federal sector has also been an important contributing factor in the persistent rise in interest rates and to the strains that have developed in money and capital markets. Worse still, continuation of budget deficits has tended to undermine the confidence of the public in the capacity of our Government to deal with problems such as inflation.

We must stop promising more and more services to the public without knowing how we will pay for them. We must play fair with the American people, telling them not only what services we can deliver but how much they will cost—both now and in the future. And we must recognize that the taxpayer, on whom the entire pyramid of Federal, State, and local taxation must rest, can carry only so much. It is fruitless to spend more than he is able or willing to pay for.

For too many years, like the city of New York, we have been trying to burn the candle at both ends, living off our inheritance and mortgaging our future at the same time. Whether we can prevent the nation from falling into the same plight as our greatest city is now the central issue before us.

Middle East Policy

Exhibit 44.—Statement by Secretary Simon, August 14, 1974, before the Subcommittee on International Finance and Resources of the Senate Finance Committee, on a recently completed round of talks with leaders in the Middle East and Europe

I am delighted to have the opportunity to be here today to discuss my recent trip to the Middle East and Europe. As part of such discussion, I think it is important to focus on the effect on the U.S. and world economies of increased capital flows to the oil-exporting countries.

The purpose of my trip was to continue our recent diplomatic efforts to achieve a durable and lasting peace in the Mideast. I believe that peace and economic progress are interrelated issues. Without peace, we cannot have economic progress. With economic progress, however, we can minimize the possibility of renewed hostilities. Fortunately, the diplomatic efforts of the President and Secretary Kissinger in recent months have established a framework for peace and stability in the Middle East that hasn't existed for three decades, and President Ford intends to pursue this policy in the months ahead. After my own meetings, I am optimistic that we can help these countries strengthen their economies and achieve needed industrialization and development, which in turn will contribute greatly to the cause of peace.

Background

Before outlining the highlights of each of my visits, I think it would be useful to explain the background of how the trip developed. Prince Fahd of Saudi Arabia visited the United States in early June, and at that time we established a Joint Saudi-U.S. Economic Commission. This was a major step in establishing closer economic relations between the United States and Saudi Arabia, and we agreed to have working groups meet in Saudi Arabia in July. Subsequently, when the President visited Egypt and Israel and suggested that I visit those countries, we thought it would be useful to go to all three Mideast countries and to open the working group sessions in Saudi Arabia. Kuwait was the final stop on the Middle East portion of our trip and offered us an opportunity to bring the first high-level U.S. delegation to a country which has increasingly occupied a critical role not just in energy affairs but world economic affairs as well. The balance of our trip was devoted to continuing our economic consultations with Finance Ministers and other leaders in Germany, Italy, France, and England.

As I will describe in detail, all of our meetings, whether they were with heads of state, Finance Ministers, petroleum ministers, central bankers, or members of the private sector, were based on mutual concerns: striving for political stability and economic stability, and our shared pursuit for peace and economic prosperity.

Egypt

The visit to Egypt was in many respects one of the most intriguing aspects of our trip. While the visit was aimed at seeing how we could assist the Egyptians in strengthening their economy, I was especially aware of Egypt's unique historical role as a seat of political and cultural leadership in the entire Middle East.

We were there not only to offer assistance, but to learn as much as we possibly could about the dimensions of Egypt's economy, about their emerging economic aspirations, and, most important, about the shape of President Sadat's program to progressively return Egypt's economy to an open, and more liberal, system.

I would especially like to stress the point that in our meetings with President Sadat, Deputy Prime Minister Hegazi, and Finance Minister Fatah, the Egyptian leaders repeatedly reaffirmed their gratitude for the President's and Secretary Kissinger's role in securing an initial framework for peace in the Middle East.

Our stay in Egypt was marked with intense, frank, and cordial discussions which brought a number of tangible results:

In addition to groups that have already been formed in scientific and technological cooperation, medical cooperation, and cultural exchange, we agreed to establish a senior working group to focus on economic development and investment. A broad cross section of representatives from the Departments of State, Agriculture, Commerce, Treasury, and other agencies will participate and Assistant Secretary of the Treasury Gerald Parsky will serve as cochairman. The Egyptians agreed to name a cochairman shortly. This work group will contain five subcommittees to cover:

(1) Investment.
(2) Domestic development and industrialization.
(3) Foreign trade.
(4) Agriculture.
(5) Suez Canal reconstruction and development.

We exchanged documents activating the Investment Guarantee Agreement in order that the U.S. Overseas Private Investment Corporation (OPIC) may insure new U.S. private investments in Egypt. This step was made possible by the decision announced earlier to establish a joint commission to seek settlement of U.S. private claims against the Government of Egypt.

We discussed plans for detailed utilization of the transfer of official resources from the United States to Egypt through:

(1) The $250 million of economic assistance which has been proposed to the Congress for the current fiscal year and which I urge you to act upon favorable terms;

(2) A program of Public Law 480 sales of U.S. agricultural products to Egypt on the basis of long-term loans on favorable terms;

(3) Increased use of the facilities of the U.S. Export-Import Bank to assist other U.S. exports to Egypt on a long-term credit basis.

We also discussed ways in which we can work together in qualifying Egypt for the maximum in financial support from the World Bank, the International Monetary Fund, and other official agencies both national and international.

Not only did we discuss the transfer of financial assistance, but also of valuable technical assistance from the United States in many fields, including the fields of financial administration, including debt management; tax administration; statistics; agriculture; population control; building and electrical codes and standards; and many other areas.

Further, we agreed to explore the possibility of establishing a Project Development Institute which would assist in the development of viable projects by providing a mechanism for feasibility studies, thus serving as an inducement to increased investment in Egypt.

We also explored additional ways in which we can work together to attract private investment to Egypt not just from the United States but from all parts of the world, particularly investment made jointly with the benefit of U.S. technological contributions. In addition to activation of the guaranty program, mentioned above, we offered to assist:

In publicizing the provisions of the new Egyptian investment law,
In making widely known those areas in which Egyptian authorities believe there are promising opportunities for investment in Egypt, and
By negotiating a tax treaty to provide a secure base for investor activity.

After this first visit, I have concluded that there is great potential in Egypt for investment. They want investment and are looking for ways to attract it. For instance, while we were in Egypt, Dr. Hegazi announced the acceptance of permits from four major U.S. banks to establish offices in Egypt. This was a most significant indicator of Egypt's commitment to attracting U.S. investment and of moving to liberalize their economy.

As you know, Egyptian Foreign Minister Fahmi is leading a high-level delegation that is meeting here in Washington this week. In addition, members of Minister Fahmi's delegation will be meeting Assistant Secretary Parsky to discuss areas of economic and financial cooperation.

In my own view, this is further evidence of our common commitment to ensure that the spirit and momentum of our initial meetings in Cairo last month is carried forth.

Israel

After my talks in Egypt, I visited Israel. During our 1½ days of intensive consultations with Prime Minister Rabin, and other key members of the Israeli Cabinet, we moved in a deliberate fashion to find ways to attract investment to Israel and to expand trade with the United States. To assist in these efforts, we took the following actions:

Established a Joint United States-Israel Committee on Trade and Investment cochaired by Finance Minister Rabinowitz and me. We also agreed to establish four subcommittees dealing with (a) investment, (b) trade, (c) raw materials, and (d) research and development.

Invited Finance Minister Rabinowitz to visit the United States for the first meeting of the Joint Committee in early November, and he accepted.

Agreed to explore ways to establish a Joint United States-Israel Economic Council consisting of private U.S. businessmen and Israeli private business and government representatives.

We indicated that we are prepared to assist Israel by providing a broad range of technical assistance and expertise. We also agreed to explore the possibility of a tax treaty and other incentives that may stimulate private investment in Israel.

I believe my visit to Israel demonstrated that our new economic relationships in the other areas of the Middle East in no way signify a diminution of our sensitivities to Israel's needs and our desire to work cooperatively with them.

Saudi Arabia

My visit to Saudi Arabia which followed the talks in Israel was part of our continuing efforts to establish a closer economic relationship with the Saudis. The trip followed the President's June meeting in that country, as well as Prince Fahd's June visit to Washington, when we established the Joint Saudi-U.S. Economic Commission and the joint working groups to deal with the specific areas of industrialization, manpower and education, science and technology, and agriculture.

At the outset, it is important to point out that Saudi Arabia's growing accumulation of monetary reserves, which today exceed their ability to absorb them domestically, has confronted them with a two-part challenge:

First, how can they spend their resources at home in such a way as to diversify their economy and industrialize their country so that their reliance on oil will be diminished. Make no mistake about it, the Saudis are looking beyond the day of oil primacy.

Second, how can they invest their funds abroad in a fashion that will maximize profits without creating unwieldy and unwanted pressures on the world monetary system.

During the visit, we held intense and broad-ranging discussions not only on the economic goals of Saudi Arabia but also on their investment objectives as well. We outlined a proposal for investment in U.S. Treasury special issues, and began an initial discussion of the advantages both countries would share in negotiating a tax treaty between the United States and their country.

Further, we discussed the impact of world oil prices on the developed and less developed countries. They recognize the effects of high oil prices and have clearly been working toward achieving more reasonable prices. In this regard, I believe it's important to note that during our visit, Oil Minister Yamani announced the Saudis' intention to hold an oil auction in August. The amount of oil to be auctioned is, at this point, uncertain, but we received assurances that the bid price will be accepted.

Finally, I opened the initial meeting of the Joint Working Group on Industrialization. This group and the group focusing on manpower and education met for a week after I left. These groups had representation from our Departments of State, Commerce, Labor, HEW, and AID, and Assistant Secretary of the Treasury Gerald Parsky remained behind to coordinate both groups. I believe these groups accomplished a great deal during these first meetings. Let me briefly outline what was agreed to:

(1) We will enter into a comprehensive U.S. Government-Saudi technical cooperation agreement for reimbursement of technical services to our government;

(2) The U.S. Government will assign a number of U.S. Government experts to work full time in Saudi Arabia as part of the Joint Commission effort;

(3) During August, the U.S. Government will send experts to Saudi Arabia for a temporary period (i) to improve the Saudi statistical and industrial information base, (ii) to advise on customs, (iii) to improve on port management, and (iv) to advise on environmental and pollution standards.

(4) During September, the U.S. Government will send additional experts for a temporary period (i) to improve standards for industrial construction, (ii) to advise on the development of marine fisheries, (iii) to advise on establishment of international standards for protection of patents and copyrights, and (iv) to advise on the improvement of communication facilities.

(5) The U.S. Corps of Engineers will be requested to expand its role beyond that now performed for the Saudi Ministry of Defense to assist on important infrastructure projects needs for industrialization in Saudi Arabia.

(6) Two Saudi representatives will visit the Tennessee Valley Authority within the next 2 months to recommend the types of TVA assistance needed in the Saudi program to increase fertilizer production.

(7) Finally, the Joint Working Group on Industrialization will meet again in late September in Washington.

In addition, the Working Group on Manpower and Education agreed that:

(1) In August, the United States will send three technical experts to Saudi Arabia to evaluate current vocational training, including on-the-job training, and develop a proposal for the establishment of technical assistance for additional training programs;

(2) In September, the United States will send five experts to evaluate the overall Saudi educational system and recommend full assistance projects to implement improvements in the system;

(3) During September, Saudi experts will be sent to the United States to study government employee training and the petrochemical industry; and

(4) Finally, during August and September 1974, the U.S. group agreed to mobilize U.S. resources in the following priority areas: (i) Access for Saudi students to U.S. educational facilities, particularly in law and medicine, including medical internships, (ii) Institutional and program development for Saudi universities and colleges, particularly in business administration, industrial management, extension services (conducting special seminars), and technical services, (iii) Professional recruitment and exchange, including seconding arrangements for American professors to teach in Saudi Arabia, and visiting professors, (iv) Establishment of junior colleges, preferably utilizing existing university facilities, ad (v) Development of a technical-level training program in the petrochemical field.

We plan to hold the initial meetings of the third and fourth working groups, on agriculture and science and technology, in Saudi Arabia in September. We are hopeful that they will be as successful.

Kuwait

Following our stop in Saudi Arabia, we made a brief visit to Kuwait. Our meetings there were especially significant from a number of viewpoints.

First, they marked the first visit of a high-level delegation to this critical oil-producing country which, in the last decade, has come to occupy a position of growing importance in the world community.

Second, I had extensive and quite frank discussions with Kuwait's Minister of Oil and Finance Abdul Rahman Atiqi regarding the price of oil. There are still considerable differences of opinion on this subject, but it was a most constructive dialog and opened the way for future discussions.

Third, we had an opportunity to discuss the Kuwaitis' investment objectives, as well as their willingness to assist not only developing Arab countries, but countries throughout the world through such vehicles as the Kuwait Fund.

The Kuwaitis were most interested in receiving as much information as possible regarding the possibility of Treasury special issues. They recognized that the U.S. capital market is the most liquid and stable in the world economic community and were interested in the unique opportunities special issues avail to the large-scale investor.

With respect to energy issues, I think it was significant that they asked that we send Treasury energy experts to give them a thorough briefing on the econometric studies which support our view that lower oil prices are not only in the interests of the consuming nations, but the producting nations as well. These meetings took place within days after my departure from Kuwait.

Energy policy matters

Before discussing the European part of the trip, I think it would be appropriate to summarize certain oil policy issues that certainly were underlying my visits in the Mideast.

I am sure that members of this subcommittee are well aware of the viewpoint I have expressed about the present surplus and future declining price of oil. But I would like to add to the overview I have already given publicly.

At various times during my talks, I stressed the fact that cutbacks in production, even apart from the political and security implications for the producers, would turn out to be economically harmful to the producers for three reasons. In the first place, the price effects of such cutbacks would inevitably lead to such further intensification of research and investment relating to alternative sources of energy and to alternatives to energy use that the effect would be to reduce the total value which the exporters would receive for their oil over the life of their producing fields. Cutbacks might bring a higher price for a short period, but they would bring a more than offsetting reduction in revenues for a long time thereafter—in view of the importers' increased commitment to alternatives.

In the second place, maintenance of present costs of export oil—even with no increase—would threaten severe economic—and, in some cases, political—damage to a large number of consuming countries to an extent which could not help but cause damaging backlash on the producers as well.

In the third place, our Treasury studies of supply and demand elasticity indicate that reductions in demand need not be very great to reduce the total size of the oil market significantly. Reductions in demand due to present prices coupled with increases in competing supplies will result in a steady reduction in OPEC's market. Thus, Treasury studies show that for a wide range of plausible demand and supply elasticities, recent price increases, if maintained, will cost OPEC a sizable fraction of its sales.

I sensed real concern in Saudi Arabia and Kuwait about these questions. Both Governments have requested that we continue our discussions of energy issues and, in particular, they are interested in our estimates on the projected U.S. needs for oil from the oil-producing countries.

In conjunction with some of the discussions in the Middle East on the responsibility of oil producers to aid lesser developed nations, I would like to provide the subcommittee with the following examples of constructive actions taken by the OPEC countries:

1. Six OPEC countries have pledged over $3 billion to a special facility in the IMF to provide supplementary financing for oil-importing countries. Four more OPEC countries are considering contributions. It is contemplated that this facility would be somewhat below market rates, but not in the concessional area, and would help both developing countries and developed countries with balance of payments problems arising from increased oil costs.

2. Kuwait is expanding its Economic Development Fund from approximately $600 million to over $3 billion. Assistance from the fund will no longer be confined to Arab nations, and the new funds are to be lent on a concessional basis. Expansion of operations from current levels may be relatively slow because of the fund's shortage of qualified technical personnel, but the World Bank has offered technical assitance to overcome this staffing problem.

3. Iran is extending over $1 billion in bilateral project assistance on favorable terms to Middle East and South Asian countries in addition to providing special price and financing arrangements for certain of its oil exports. Saudi Arabia and Iraq are extending similar project and/or oil financing facilities in the region.

4. Venezuela is actively negotiating the establishment of a $500 million trust fund with the Inter-American Development Bank for concessional lending. Venezuela is also making a further $30 million available to the Caribbean Development Bank.

5. Negotiations were completed in May on a charter for a 24-member Islamic Development Bank, with an initial capital in excess of $1 billion. Formal approval is expected, with an operational target of end-1974.

6. On the basis of less definite information, Middle East OPEC countries appear to be considering special funds for Africa totaling perhaps $500 million, including a $200 million fund which would initially help with financing oil imports and then be recycled into longer term projects.

While we do not have complete and detailed information on all the financial initiatives, I think the preceding list amply indicates that oil producers are channeling a portion of their resources to the poorer countries, that at least a part of these resources is being made available on the favorable terms that the situation requires, and that we can anticipate still more constructive steps in the future.

Europe

After these discussions in the Mideast, I was pleased to have the opportunity to meet with a number of European leaders. In my view, a close acquaintance and frequent and informal conversations with those responsible for economic and financial policy abroad are more than a useful tradition—they are an essential part of our management of an increasingly complex world economy. There is no substitute for a face-to-face discussion of the current problems our nations face domestically as well as internationally. On this occasion, I particularly welcomed the chance to meet Minister Fourcade in France and Minister Colombo in Italy, since both had missed the Committee of Twenty meeting in Washington in June because of the press of domestic matters.

This subcommittee has expressed specific interest in the problems of recycling oil money, and I will offer some comments on that situation in light of my talks in Europe. But I do at the outset want to make clear that this was not the only topic of concern; specifically, the problem of inflation was very much on the minds of the leaders with whom I spoke.

Inflation is the No. 1 economic problem facing the world today. All of Europe is experiencing inflation rates unacceptable by past standards. And in a world grown increasingly interdependent through rapid growth of international commerce, it is increasingly recognized that we all share a common interest in the success of each other's anti-inflationary policies.

Inflation rates are too high everywhere. But they differ widely from country to country. Our record has not been good. But consumer prices have been rising even faster in Italy, in the United Kingdom, and in France. And even those countries can feel some relief that they are not experiencing the extraordinarily rapid increases that Japan has been suffering.

It was the German experience which particularly drew my attention. That country has within living memory suffered most severely from uncontrolled inflation and accordingly one finds there a low tolerance for inflation and strong support for policies of restraint. The German authorities have for an extended time followed firm policies of demand management. I am convinced that these policies explain why inflation in Germany is less virulent than in other countries in a fundamentally similar situation.

Our discussions in Europe did focus on the problems of financing oil surpluses and deficits and the ability of private financial markets to handle the anticipated vast flows of funds. Let me make clear at the outset that there was general recognition that the private markets face a serious challenge. But no one was talking about impending failure of financial markets generally or of the monetary system. Nor was there worry that oil monies will be capriciously shifted from one market to another, thereby disrupting the foreign exchange and financial markets. All of our experience confirms that the financial authorities of the Arab countries intend to manage their oil revenues in a conservative and responsible manner.

The problems of recycling oil revenues do not arise from this source. They derive rather from the very large magnitudes involved and the abrupt adjustments required to handle such magnitudes. OPEC oil revenues are presently running at an annual rate of some $100 billion. That is on the basis of present oil prices and subject to a great many uncertainties. Some of these revenues are spent on imports and other current consumption, and the balance is available for investments and loans and so on. There are uncertainties here, too, but again it is convenient to think in terms of perhaps some 60 percent of total OPEC oil revenues available for investment in one form or another—roughly $60 billion at the present annual rate. By any standards, this represents a lot of money to be recycled.

I should caution very strongly, however, against extrapolating these figures into the future. You know already my views about oil prices. In addition, there are estimates which suggest that the OPEC countries may be able to make rapid strides toward expanding their imports and spending their oil revenues. Given these prospects, there is, in my view, no basis for some of the extreme projections of OPEC investments exceeding the trillion dollar level within a decade or so.

But no one should ignore the potential difficulties facing both the private financial markets and governments in dealing with the large flows expected this year. That is the matter which we discussed in Europe.

As far as the private markets were concerned, we were careful to approach this question quite apart from the difficulties of a few individual banks which have overextended themselves in trading primarily in the forward exchange markets. Forward trading is important to the proper functioning of the foreign exchange markets, but clearly some of these institutions simply got in over their heads.

Apart from these cases, we observed that the private financial system was doing a remarkable job of handling very large expanded operations. The financial intermediaries are, of course, adjusting their practices in the face of changed circumstances, in particular proving themselves unwilling to pay the same rates for short maturity deposits they cannot easily use as for longer term deposits they can relend prudently. They are also becoming more active as brokers, arranging direct placements. And the lenders are exploring other channels for their funds, thus easing the pressures on the financial intermediaries. I refer here not only to the talks we have been having with Middle Eastern financial authorities about possible purchases of U.S. special securities but also about such developments as the recently announced Iranian advances to France and the United Kingdom and investment in the Krupp concern in Germany.

It is true, of course, that world capital markets are very large even in comparison to prospective OPEC oil monies. To take the U.S. market alone: U.S. corporate assets are estimated at well in excess of $2 trillion, and equity and debt securities outstanding at the end of last year amounted to some $1.8 trillion. Even the relatively young Eurocurrency market had at the end of last year, before the new oil prices had much impact on capital flows, grown to over $150 billion. Today, that market probably approaches $200 billion.

As for the role of governments in facilitating the flow of money through private markets and directly in the recycling process, the first responsibility of governments is to maintain those economic and financial conditions that are conducive to sound economic activity. In the present circumstances, this means firm policies to deal with inflation and the avoidance of sharp turns in policies. I can see nothing but trouble if we yield to inflation.

A second area of governmental responsibility involves the surveillance and supervision of banking practices. Cases of faulty management in the foreign exchange dealings of some banks, for example, suggest it is a time for careful attention by supervisory authorities to the practices of individual institutions. In my talks in Germany, I was interested to have an explanation of the steps being taken there to obtain better control of bank activities.

Yet another role of governments, or more commonly, of central banks, is that of assuring the smooth functioning of the financial system as a whole. The public authorities cannot be asked to provide compensation for the mistakes of management: They can properly be asked to see that the solvency problems of one institution do not snowball into severe liquidity problems for the entire system.

Beyond facilitating flows of funds through the private markets, there is also a proper role for governments directly in the recycling process.

Here I think first of the problems of the poorest countries most seriously affected by the oil price increases. I am encouraged by the evidence that the oil-exporting countries are recognizing their responsibilities by expanding their assistance, both directly and indirectly, to those hardest hit countries.

But there remains an urgent need to organize the necessary assistance for these countries. Progress toward that end was initiated at the June meeting of the Ministers of the Committee of Twenty when it was agreed that a new development council would be established and that it would give priority attention to the problems of these most seriously affected countries.

That C–20 meeting also agreed on another important step involving governments in the recycling process, by establishing the special oil facility in the International Monetary Fund. That facility will provide a very useful supplement for those countries which can afford its near-market terms but which are unable to obtain adequate financing through private markets.

Governments and central banks of the main countries have, in addition, an extensive network of swap arrangements developed first in the 1960's. Although not appropriate for long-term financing of oil deficits, they can serve usefully to assist in dealing with short-term pressures in the exchange markets.

The responsibility of governments does not end with these steps. In my conversations abroad, we were very keenly aware of the need to follow closely developments in the markets and, if necessary, develop new mechanisms to channel oil funds. We will be working on contingency plans which will allow us to act quickly and positively should need arise.

The breadth and diversity of U.S. capital markets suggest that we will attract a substantial share of OPEC funds. My European colleagues expressed some concern, in fact, that these flows to the United States would exceed levels needed to finance our increased oil bills. Although they recognized there was no evidence that such excessive inflows to the United States were in fact occurring, they were interested in what our reaction would be.

Our reaction to this potential problem is already a matter of record. Earlier this year we removed our capital controls and opened our markets to foreign borrowers again on the basis prevailing before imposition of restraints over a decade ago. Under these circumstances, should there be substantial investments in U.S. Government securities, this would reduce our official borrowing from domestic sources and free resources for lending abroad. We have offered OPEC nations an opportunity to place a portion of their funds in special U.S. Government securities, and there is deep interest on their part in such placements. But this is a matter of convenience, not an attempt to attract excessive investments here. No special inducements are offered—merely the opportunity of government-to-government transactions which enable the investor to transact very large sums without influencing the market against himself. It is a facility we would offer—and have offered—a number of foreign nations holding very large dollar balances.

To a large extent, I returned from my meetings in the Middle East and Europe reassured that a firm basis exists for dealing with the critical problems of the day in a cooperative framework. We have put the mechanisms in place that will enhance economic development and at the same time establish closer relationships with these countries. Strengthening their economies is in the best interest of the entire world. I believe we have taken the necessary first steps in that effort, and now we must work together to implement these initiatives. I am confident that we have the will and the resources to succeed in this critical task.

Exhibit 45.—Joint Communique on the First Session of the United States-Saudi Arabian Joint Commission on Economic Cooperation, February 27, 1975, Washington, D.C.

The United States-Saudi Arabian Joint Commission on Economic Cooperation, established in accordance with the joint statement issued by Secretary of State Kissinger and Prince Fahd on June 8, 1974, concluded its first session. The Joint Commission meetings, held in Washington, February 26–27, 1975, were chaired by Secretary of the Treasury William E. Simon, Chairman of the U.S. side of the Commission. The Saudi Arabian Delegation was led by Minister Muhammad Ibn Ali Aba al-Khail, Minister of State for Financial Affairs and National Economy.

High-level officials from the U.S. Departments of Treasury, State, Agriculture, Commerce, Health, Education, and Welfare, Interior, and Labor, and from the National Science Foundation also participated in the talks. Members of the visiting Saudi Arabian Delegation participating in the discussion included officials from the Ministries of Foreign Affairs, Commerce and Industry, Labor and Social Affairs, Agriculture and Water, and the Central Planning Organization, as well as high-level Saudi representatives from the Supreme Council of Higher Education, the Faculty of Sciences, and the Institute of Public Administration.

The members of the Commission exchanged views on the development of United States-Saudi Arabian economic cooperation since the visit of Secretary Simon last July to Saudi Arabia for preliminary discussions on economic cooperation. At that time, the Commission initiated the activities of its four working groups on Manpower and Education, Science and Technology, Agriculture, and Industrialization. Each of the joint working groups has met several times to define areas of potential economic cooperation and a number of U.S. technical experts and advisors have visited Saudi Arabia and submitted reports to the Saudi Arabian side of the Commission. The Joint Commission discussed further means of facilitating such continued cooperation through the Joint Commission framework.

In this regard the Commission was pleased to note the signing on February 13, 1975, of a Technical Cooperation Agreement (TCA) which establishes procedures for the furnishing of mutually-agreed technical and advisory services from the United States to Saudi Arabia on a reimbursable basis. The TCA should contribute significantly to the efficient channeling of American technical know-how to the Saudi Arabian national economy.

The Commission expressed its intention to expand the Joint Commission Office in Riyadh. This office serves as the principal point of coordination in Saudi Arabia for the development and implementation of mutually agreed projects under the United States-Saudi Arabian Technical Cooperation Agreement. The U.S. component of this office, to be known as the U.S. Representation to the Joint Economic Cooperation Commission Office, plans to begin operating by the middle of May 1975. The Saudi delegation announced that it would also be adding to the staff of its component of the Riyadh Joint Commission Office in the near future. Arrangements for accommodating these two staffs are to be discussed in Riyadh in the coming weeks.

The Commission noted with satisfaction the signing by the cochairmen of an OPIC Investment Guaranty Agreement between the two governments. The agreement should increase and broaden the interest of U.S. private enterprise in participating in Saudi Arabian economic development.

Industrialization and trade

The Saudi delegation reaffirmed its interest in acquiring U.S. technology through U.S. business participation for the development of major industrial projects in both the hydrocarbon and nonhydrocarbon areas.

The Commission agreed on the desirability of a broadly based business council designed to increase business cooperation between the two countries and enhance the contribution of U.S. business to Saudi Arabia's industrial development. In view of the important role of government in Saudi Arabia's development, concerned Saudi Arabian Government elements would join with private sector interests in Saudi Arabia and the United States as members of the Council. The Council would identify for study projects which appear feasible for joint ventures, note and make recommendations on financial, fiscal, or legal considerations bearing on cooperative efforts, arrange business symposia and visits in both countries, and be a center for disseminating information on business opportunities in both countries.

The Saudi Arabian Government will consider the possibility of organizing a group of Saudi businessmen to visit the United States within the next 2 months to meet with U.S. business firms and groups. The general purpose would be to increase the communications between the two private sectors. More specifically, the group would discuss various industrial proposals and projects.

The Commission noted with interest that trade relations between the Kingdom of Saudi Arabia and the United States have been developing at an accelerated rate. U.S. exports to Saudi Arabia nearly doubled in 1971, increased by 40 percent in 1973, and nearly doubled again in 1974, to $835 million. Expectations are that U.S. exports will continue to grow progressively. It is anticipated that U.S. exporters will play a significant role in supplying equipment, machinery, technology and services.

The Governments of the United States and Saudi Arabia agreed that participation in productive ventures in each other's economies should be mutually beneficial. They recognize that activities of this type in both countries would require close consultation to assure consistency with their national policies and objectives. Consequently, they agreed that each government would consult with the other regarding significant undertakings of this type.

The Commission agreed on the desirability of U.S. Government technical assistance in developing a statistical base for development in Saudi Arabia. The American side stated its readiness to send out teams of experts in a number of principal statistical disciplines to assist the Saudi Arabian Government in developing an effective statistical capability.

The Commission heard reports and exchanged views on the current status of a number of technical cooperation projects in the fields of vocational training, higher education, agriculture, water utilization and land use. science and technology, and statistics. A summary of these follows:

Vocational training

The Commission noted the series of recommendations by the American vocational training team which visited Saudi Arabia last fall. These recommendations, in support of the implementation of Saudi Arabia's 5-year plan vocational training goals, include U.S. Government advisory services in various fields of manpower development.

Higher education

It was agreed at the Commission meeting to send an American team to evaluate the academic and administrative structures of the Saudi Arabian university system, as well as the relationship of universities to high-level professional and technical education.

A second action area to be explored will involve United States-Saudi Arabian cooperation in the following areas: broadened student and faculty exchanges between the two countries, joint research projects, joint degree programs, the establishment of junior colleges in Saudi Arabia, and the training of academic, administrative, and technical personnel in Saudi universities.

Agriculture, water resources and land use

The Commission discussed U.S. Government technical services for joint agricultural, water and land projects. Priority was given to feasibility studies of major agricultural areas in Saudi Arabia, a study of the Central Research Laboratory and Agriculture Training Center of the Ministry of Agriculture and Water, and the establishment of a desalination center and laboratory.

It was agreed that a four-man U.S. Government team would go to Saudi Arabia for a 2-month period to discuss and reach agreement with Saudi Arabian counterparts on a detailed program for implementing a feasibility study for large agricultural areas, such as Wadi Dawasir.

The Commission also approved the immediate departure to Saudi Arabia of a research management team to plan a research program and determine organizational and management requirements for the Central Research Laboratory and Agricultural Training Center.

A U.S. Government proposal for the establishment of the desalination center will be sent to the Saudi Arabian Government in response to their request.

Projects in the areas of land management, water utilization and a national data bank would be implemented under the Technical Cooperation Agreement. Further discussions will be held immediately to decide on the implementation of these proposals.

Science and technology

It was agreed that a Saudi Arabian National Center for Science and Technology would be established to coordinate the growth of science and technology in Saudi Arabia and to support and fund mutually agreed upon program areas of interest to Saudi Arabia. It was further agreed that an initial U.S. Government team would be sent to Saudi Arabia as soon as possible to advise on the objectives and functions of the Saudi National Center. Additional U.S. expert teams to follow will work with Saudi Arabian experts to define the precise programs for the other agreed project areas.

Other areas

The Saudi delegation requested technical assistance over a limited period of time to its Government's Department of Public Works.

The United States agreed to review the requirements of the Saudi Arabian Public Works Department to determine the nature and extent of technical services desired.

Overall assessment

The Commission expressed satisfaction with the progress to date and considered the discussions at its first meeting a major step forward in the constructive development of mutually advantageous economic relations. With a view to keep close track of the Commission's efforts, the U.S. side decided to establish an Action Group. The U.S. coordinator will be Gerald L. Parsky, Assistant Secretary of the Treasury, the Department which is the U.S. coordinating agency for the work of the Commission. The Saudi side will consider a similar arrangement.

The Action Group and its Saudi counterpart will be charged with monitoring progress being made on a regular basis so as to insure that program goals are being met and to review and implement new proposals that may be agreed upon. The Action Group on the U.S. side will consist of representatives from the Departments of Treasury and State and the following U.S. action agencies: Agriculture, Commerce, Health, Education, and Welfare, Interior, Labor, and the National Science Foundation and other U.S. Government agencies as may become appropriate. Both sides agreed to consider holding the next Joint Commission meeting in Riyadh, Saudi Arabia, in October 1975.

Exhibit 46.—Remarks by Assistant Secretary Parsky, March 12, 1975, before the Mid-America Arab Chamber of Commerce, Chicago, Ill., on economic potential in the Middle East

I appreciate the opportunity to be here tonight to discuss economic aspects of our relations with the countries of the Middle East. Much is being said and written about the current mood of our country. We are told that the traditional American sense of optimism has been transformed into a nationwide attitude of doubt and gloom. I do not doubt that we are confronted with difficult times. The economy is in a recession while intolerably high rates of inflation still persist. At the same time, a rapid rise in the price of oil has caused serious effects on the economies of the world. And all of these problems are affected by the political tension that exists in the Middle East. Despite this situation, however, I think it is important to emphasize that we in the United States have had serious troubles before without wallowing in cynicism and pessimism. One of our greatest dangers today is to be swept up in a panic psychology, allowing our worst fears to dominate our thoughts and actions. If we become captives of the most extreme rhetoric—if we are too quick to expect the worst and too impatient to work for the best—then we are very apt to choose the wrong solutions to our problems. There is no question in my mind that we have the strength and resources to cure the ills of today, but we can only do so if we have the wisdom and courage to apply the proper medicine.

Someone once expressed the thought that a crisis need not stampede men into panic. Instead, it can provide a stimulus to the creative energies of man. As we assess the economic potential in the Middle East, let us keep this in mind. Peace and economic progress are interrelated. Without peace, economic progress will be short-lived. However, through economic progress, we can assist our efforts to achieve peace. This realization is at the heart of our approach to economic relations with the countries of the Middle East. Recognizing the interdependence of the world's economics, we believe that an atmosphere of respect and understanding, friendship and cooperation can help to temper the extremity of political disputes, can solidify political understandings and can help resolve the critical economic problems facing us.

Let us turn now to the specifics of our relationships with the countries of the Middle East. In doing so, we must recognize that the transfer of wealth to these countries carries with it several interrelated considerations. First, the countries seek to develop their own economies; second, because several countries cannot spend all of their revenues internally, they seek sound investment opportunities outside of their economies; and third, because these countries sense the possibility of a leadership role in the world, they seek opportunities to contribute to lesser developed countries. I would like to touch briefly on each of these responsibilities—*internal development*, *external investment*, and *participation in third countries*.

First of all, we have sought to develop our economic relationships in the most effective way: informally—as is the case with respect to our relations with Kuwait or the Emirates, or formally—through joint commissions we have established with several other Middle East countries.

I have participated actively in all of these relationships and, in particular, in our joint commissions, which I found to be a sound vehicle for dealing with the wide range of economic issues confronting us. Each commission has had to face its own set of problems because the countries vary considerably in their policies. This is an important point. Too often people view all of the Middle Eastern countries as one. They differ, however, in their priorities toward internal development as well as in their approach to external investment. To illustrate this, I think it would be useful to focus on three of these countries: Iran, Saudi Arabia, and Egypt.

Iran.—Iran has both substantial oil revenues—slightly over $20 billion in 1974—and the capacity to use them. Its already ambitious development plan was recently revised upward to reflect the sharp increase in foreign exchange earnings projected during the plan's term, ending March 1978, and extensive commitments have been made for foreign aid and investment. As a result, we expect that, by 1980, if not before, Iran's current account surpluses may be eliminated. Internally, Iran is seeking to develop its basic materials industry, especially oil, gas, petrochemicals, iron, steel, and copper. To accomplish this objective, it must reduce the bottlenecks to domestic development: in particular, a shortage of skilled manpower and an inadequate transportation system.

Recently our two countries announced a target of $15 billion for nonoil trade over the next 5 years. The Iranians estimate that, of this total—the bulk of which will be U.S. exports to Iran—about $5 billion will consist of normal trade commodities, $5 billion of military equipment, and $5 billion of goods for development projects.

Major Iranian development projects selected for cooperation between the two countries include a series of large nuclear plants, with associated desalinization plants, superhighways, housing facilities, hospitals, vocational training centers, establishment of an integrated electronic industry, a major port, and joint ventures to produce fertilizer, pesticides, farm machinery, and processed foods. As we work toward realization of these projects, we recognize that the answer does not lie with governmental involvement but rather with participation by the private sector. As such, we are establishing a joint business council to facilitate direct private sector contracts and exchanges of information on business opportunities.

As you can see, the goals of this country are most ambitious. Achievement of their objectives will of course depend in large part on personal leadership. I have been most impressed by the people I have met; in particular, the Minister of Economy and Finance, Hushang Ansary. He and others are determined to diversify the economy so that 25 years from now—the time frame when their oil will be depleted at current production rates—they will still be strong and assuming a leadership role in the world.

Saudi Arabia.—Saudi Arabia has not achieved the development that Iran has, but its oil reserves and potential surplus revenues provide it with ample resources to achieve its domestic development objectives. It is eager to modernize and diversify to improve its national living standard and lessen economic dependence on oil exports. The major obstacle, however, to such rapid development is the lack of human resources. The country has a small and scattered population, resulting in a limited domestic market; and a manpower shortage, with a large fraction of the skilled and unskilled labor force coming from abroad.

The leaders of this country recognize this, and Saudi Arabia's development plan calls for expenditures of $60 billion by 1980. Emphasis is being placed on industries that are capital—and energy—intensive: petrochemicals, steel and aluminum; and in industries which meet the area's geographic needs: water development and conservation, desalinization and oasis reclamation.

Our cooperative efforts with Saudi Arabia have involved both assistance to their governmental and administrative operations and facilitation of participation by our private sector in joint venture projects. As such, we have provided, on a reimbursable basis, more than a dozen experts to go to Saudi Arabia to identify problems and recommend technical assistance programs in: the development of statistical base, improving industrial infrastructure and documentation, improvement of customs procedures, development of environmental studies, improvement of port management, development of marine fisheries and helping Saudi Arabia's patent and trademark system reach full international standards.

Further, we recently agreed to send additional teams to examine higher education, agriculture, water resources and land use. A U.S. team will also be helping to establish the Saudi Arabia National Center for Science and Technology, which will eventually coordinate multifaceted science and technology programs.

These examples amply reflect the Saudis' keen desire to develop and to diversify their economy and to expand and upgrade its manpower base in as short a period of time as possible. The technical expertise and assistance provided will undoubtedly lead to a growing and more attractive market in Saudi Arabia for goods and services from the U.S. private sector.

Egypt.—At the other end of the spectrum, Egypt's relatively skilled labor force and literate population, its good climate and natural resources, and its large domestic market are key ingredients for economic development. However, heavy defense expenditures have left little for investment in the non-defense sector and have led to difficulties in all sectors of the economy. Egypt is receiving financial assistance from the U.S. Government—$250 million in fiscal year 1975—as well as from Europe, Japan, and the oil-producing countries of the area.

However, the real answer to successful development in Egypt is not increased aid, but capital investment. To achieve this, the proper climate for investment must exist. We have been exploring ways to facilitate this, and the Egyptians are making needed changes in their system to facilitate private investment and the inflow of private foreign capital. For example, we have made considerable progress on a tax treaty; a new investment law has been enacted and several American banks will be opening in Cairo soon.

External investment policies of Middle Eastern countries

All three of these countries offer great economic potential—their characteristics differ but the potential is there. As we assess the possibilities for internal development, we soon realize that the oil producers in the Middle East cannot now deploy all of their earnings effectively in internal development. Each, for somewhat different reasons, has a desire to participate in the economies of the industrialized nations of the world. And each recognizes their responsibilities to provide assistance to less developed countries.

One of the most important byproducts of the cooperative efforts—formal and informal—we have established with the oil producers is a more detailed understanding of their external investment policies. They recognize that the investment decisions they make today are their insurance for the future. After extensive discussions, I do no believe that there is a threat that the oil producers will use their investments to dominate or disrupt sectors of the U.S. economy.

First of all, the overall flows are not likely to approach some of the early projections. Of the $60 billion in surplus revenues accumulated by all OPEC members in 1974, $11 billion—or only 18 percent—was invested in the United States. And of that amount, well under $1 billion was placed in permanent investments— stocks, long-term corporate bonds, or real estate. And over the longer term, although we can expect a larger proportion of funds to be placed in long-term instruments, I do not see a disproportionate amount flowing to the United States. In fact, I believe that the oil deficits will have effectively disappeared by 1980, and that the new investments will begin to decline before they reach a cumulative total of $200–$250 billion. Given all of these factors, I would not expect to see overwhelming amounts of OPEC funds invested in the securities of U.S. companies. At most, there may be $5 billion invested in 1975 and that may be a high estimate; but in any event it is not an amount which would result in domination of any important sector of the economy or to disrupt our markets.

As with policies toward internal development, the approach to external investment differs among these countries. Kuwait, the Gulf States, and Saudi Arabia, which foresee a future of accumulating far more in revenues than they can hope to put to use domestically, regard their investment horizons as long term. The Kuwaitis are the most sophisticated and have some of the most knowledgeable people I've met in the field of foreign investment. They are exploring the entire spectrum of profitable long-term investment opportunities, from common stock to real estate. They will be seeking to acquire assets that are at least no less valuable, in their view, than oil in the ground.

Saudi Arabia's foreign investment experience is not so extensive as Kuwait's but it too recognizes the need to participate on a diversified basis in the consuming nations' economies. With our assistance, and that of U.S. financial institutions, it has developed an investment strategy which emphasizes stability—as reflected in its requiring a steady pattern of dividend payments; growth—as reflected in its requiring a steady pattern of earnings growth; and diversification. Based on my experiences in this country, I would be surprised if Saudi Arabia invested more than 10 percent in a particular industry and more than 5 percent in a particular company.

Iran's investment policies are significantly influenced by its internal development program. Iran will emphasize investments in companies which are in a position to help it expand its domestic industrial base by providing it with access to foreign products, increased technology, manpower skills, and resources. I do not believe that Iran will be interested in investing in real estate or highly speculative ventures. For example, the judgment it must make in determining whether to invest in Pan Am—and to my knowledge that transaction is not a fait accompli—will involve several factors: Whether the investment is sound in a financial sense, whether the relationship with Pan Am can benefit Iran's domestic economy, and whether it can enhance the economic relationship between our two countries.

On my recent trips to the Middle East and in the course of commission meetings with Iran and Saudi Arabia, I have discussed with government leaders the oft-expressed fears of OPEC capital controlling key industries in the West. As reflected in my remarks tonight, these countries neither have the desire to control companies, nor do they have the facilities to manage such companies. They view themselves like any institutional investor, seeking a diverse portfolio of investments which will yield the best long-term return.

Participation in third countries

Further, they have a desire to participate with the United States in third countries. Another byproduct of our economic dialog is the crystallization of a new concept for cooperation in assisting other less-developed countries. The OPEC governments have already recognized their responsibility through bilateral aid programs, about $9 billion in 1974. The new concept, which we have termed "triangular investment," will make it possible to combine the technology, equipment, and managerial skills of the industrialized countries and the capital of the oil-producing countries to undertake productive investment projects in less developed countries.

Insofar as U.S. participation in triangular investment is concerned, we expect the private sector to play the predominant role. The Government can help by identifying projects, by facilitating additional assistance in the form of Export-Import Bank loans or guarantees or OPIC insurance, and by helping to coordinate relationships with the lending governments. But the burden will be on U.S. private enterprise to respond to opportunities with the same kind of creative commitment which has made our economy the greatest in the world. It is both an opportunity and a challenge. But we in government would not be doing what we have been to facilitate such programs unless we believed that American business was up to the task.

Conclusion

As I stated at the outset, my activities in the Middle East reflect my view that economic issues should be dealt with separately from political issues. And I think the success we have had in making progress on a number of economic fronts in the midst of continuing political controversy confirms the correctness of this approach. Accordingly, I am especially concerned about the threat to continued progress on the economic front which I see presented by recent publicity given to the Arab League boycott.

The boycott, of course, represents a collision of the economic and political tracks—the use of economic measures to achieve political objectives. I have discussed this issue many times with Arab leaders. I have told them that we, as a government, oppose such a policy and will continue to encourage U.S. firms to refuse to support or participate in the boycott in any way. They have emphasized to me that they regard the boycott as part of the continuing conflict with Israel and feel that it must be dealt with in that context. I have stressed that no one profits from this collision between economics and politics. The mutual benefits of full economic cooperation are simply too great to risk by such political activities.

At the same time, however, I do not believe that the answer to the boycott issue lies in increased confrontation, nor is it properly addressed by altering our traditional policies of a free and open market for trade and investment. Instead, it must be pursued directly with the Arab countries and increasing our economic ties can assist this process.

The diversity of subjects I have dealt with tonight was designed to describe the breadth of our economic relationships with the countries of the Middle East.

I recognize that at any moment the political conflict can deal a severe blow to our economic efforts. However, we must not let a political possibility deter development of the economic potential. In the past, we in the United States could draw inspiration from stewardship, now we must find it in partnership. As such, we must seek political and economic relations which will strengthen the ability of free people to work toward a common goal. As Woodrow Wilson once said, "the highest and best form of efficiency is the spontaneous cooperation of a free people." Nowhere in the world do I see the need for such an approach as much as in the Middle East. The economics are there. If we pursue them cooperatively and in a spirit of promoting peace, we will not only benefit ourselves but more importantly, the entire world.

Exhibit 47.—Joint Statement of United States-Israel Joint Committee for Investment and Trade, May 13, 1975, Washington, D.C.

The United States-Israel Joint Committee for Investment and Trade, established during the July 1974 visit to Israel of U.S. Secretary of the Treasury William E. Simon, met in Washington, D.C. on May 12–13, 1975. The meeting was chaired jointly by Secretary Simon and Minister of Finance Yehoshua Rabinowitz. Other senior officials of the two governments also participated. (A list of senior participants is attached.)

The meeting, which continued the dialog established during Secretary Simon's visit to Israel in July 1974, underscored the warm and friendly relationship between the countries and helped broaden the ties between them.

During the meeting, the Israeli members of the Joint Committee briefed the U.S. delegation on the current economic situation in Israel, Israel's development plans and its economic forecasts. The U.S. members reviewed current economic developments in the United States and explained recent policy proposals aimed at achieving greater stability within the U.S. economy. Mr. Avraham Agmon, Director General of the Ministry of Finance, and Assistant Secretary of the Treasury Gerald L. Parsky briefed the Joint Committee on the work of the Subcommittees on Capital Investment, Trade, Raw Materials, and Research and Development, which had met in Washington in September 1974 and in Jerusalem in October 1974. Secretary Simon and Minister Rabinowitz expressed their satisfaction with the work of the four joint subcommittees, which served as a basis for the Committee's deliberations.

At the conclusion of the Committee's session the Minister of Finance and the Secretary of the Treasury, as cochairmen, announced their agreement on a number of principles and programs aimed at expanding economic cooperation between the two countries particularly by increasing the opportunities for trade and investment and for cooperation in research and development.

The Committee agreed that measures designed to expand cooperation between Israel and the United States are consistent with both countries' deep interest in achieving a just and lasting peace in the Middle East. The Committee felt that its deliberations and conclusions should increase and broaden the interest of U.S. private business enterprises in participating in Israel's economic development and in seeking out new opportunities to expand the economic relationship between the United States and Israel.

I. Economic cooperation

The Israeli members described the favorable environment for foreign investment in Israel and reaffirmed their interest in U.S. investments in Israel and in acquiring U.S. technology through U.S. business participation in industrial projects in Israel. The United States recognized the importance of United States and other foreign investment to the economic growth of Israel and pointed to a number of additional factors that could further improve the investment climate. The United States and Israel recognized that investment in Israel serves the common interest of the United States and Israel.

The joint business council which the parties agreed to seek to establish will be broadly based and will be charged with enhancing the participation of U.S. business in Israel's industrial development. The council would identify projects which appear feasible for U.S. private sector investments and joint ventures, arrange business symposia and visits in both countries, and participate with other interested parties in disseminating information on business opportunities in both countries.

The members of the Committee reaffirmed the policies of their governments to oppose restrictive trade practices or boycotts against countries friendly to either. The United States side noted President Ford's February 26 statement that religious or ethnic discrimination is totally contrary to the American tradition and has no place in the free commerce of the United States.

II. Treaty to avoid double taxation

Minister Rabinowitz and Secretary Simon initialed today a treaty on the avoidance of double taxation. The treaty recognizes Israeli compulsory loans as creditable taxes for U.S. income tax purposes and incorporate a new rule on the treatment of Israeli Government grants to U.S. investors. Both parties agreed to present the treaty for ratification, according to each country's constitutional procedures, as soon as possible. The Committee members expressed their confidence that the tax convention initialed by the Ministers would contribute toward reducing obstacles to trade and investment.

III. Encouragement of investment

The Joint Committee noted with satisfaction efforts by the U.S. Overseas Private Investment Corporation (OPIC) to promote investment ties between the two countries. The Committee noted that OPIC is prepared:

(a) To guarantee loans to qualified investment projects in Israel involving U.S. companies, or their subsidiaries;

(b) To participate, where appropriate, in financing industrial projects in Israel sponsored by U.S. investors through purchase of subordinated convertible debentures issued by such enterprises in Israel; and

(c) To include in its publications information about investment opportunities in Israel, incentives, economic data, and other information of interest to potential investors.

The United States also indicated its willingness to use its other resources, particularly the facilities of the Department of Commerce, to facilitate investments in Israel, and among other things to publicize within the U.S. business community information on investment opportunities in Israel, specific incentives offered by the Government of Israel, and other forms of assistance to investors available from both U.S. Government agencies and Israeli authorities. The Department of Commerce will also organize seminars in the United States and sponsor missions to Israel of prominent U.S. industrialists and businessmen. The promotion of trade missions will be a major target.

IV. Development of trade

The Joint Committee noted the growth of trade between the two countries and emphasized the importance of a continued increase in mutual trade opportunities. The Committee agreed on the desirability of further promoting trade between the two countries by expanding the dissemination of information on bilateral trade opportunities through the programs of the U.S. Department of Commerce and the Israeli Ministry of Commerce and Industry, and through national and binational organizations.

The Israeli members of the Committee noted with appreciation the assistance accorded to Israel through the use of the facilities of the Export-Import Bank. The Committee expressed its satisfaction with the harmonious relationship Eximbank has enjoyed with Israel since the founding of the State, and Israel's excellent record in meeting its obligations. The U.S. members reaffirmed Eximbank's current policy of providing financing for U.S. exports to Israel within the limits permitted by the Bank's resources.

The U.S. members provided clarification of Eximbank policies on other issues of particular concern to Israel. It was agreed that the facilities of the Eximbank will continue to be available and active in financing U.S. exports to Israel. The U.S. delegation noted that Eximbank is also prepared to guarantee to a U.S. lessor, payments by Israeli lessees for U.S. equipment provided to Israel under leasing agreements.

The Committee welcomed passage by the U.S. Congress of the Trade Act of 1974, which provides the basis for trade negotiations between the United States and Israel in the context of the multilateral trade negotiations (MTN). The parties noted that U.S. authority under the act allows the reduction to zero of most duties of 5 percent or less and reduction of up to 60 percent on most higher duties. Israel's negotiating authority also will be sufficient to allow the elimination or reduction of tariffs on a range of items of interest to U.S. suppliers. During the Committee sessions, an exchange of views occurred on tariff and nontariff barriers which were likely to be negotiated in the MTN. The Committee discussed the provisions of the act concerning the "generalized system of preferences" and agreed that the two governments will hold early consultations with the view of extending such preferences to Israel, consistent with the provisions of the act.

Israel has been approved as a supplier of AID-financed commodities and services and as a supplier for offshore procurement of Department of Defense (DOD); Israel will be informed about further opportunities.

A procedure has been developed to assist Israeli producers to sell products and spare parts to DOD suppliers, and DOD will facilitate such purchases and take measures to assure Israeli producers that they will get full and fair consideration in bidding for DOD procurement contracts within opportunities permitted under present legislation.

The Committee agreed that government officials of both parties engaged in promotion of foreign trade, including the commercial attaches of both countries will meet from time to time to discuss in detail, ways and means to generate export promotion activities of all kinds to be organized in both countries, review the effectiveness of current promotion activities and recommend new promotion programs where needed.

The Committee took note of the U.S. Department of Commerce's planned "intellectual assets" trade mission, to be composed of U.S. executives interested in commercial, trade, and technology transfer.

V. Supply and storage of raw materials

The members of the Committee recognized the special circumstances that characterize Israel's trade, particularly in food and feedgrains, and the importance of assuring Israel's access to raw materials. In order to meet Israel's special needs and circumstances to the maximum extent feasible, the Department of Commerce will use its good offices as appropriate to facilitate Israeli purchases of essential raw materials from U.S. private sources. The Israeli Government will send a mission to acquaint itself with these sources, and discuss contingent plans to assure supply. The Government of Israel will submit to the U.S. Government a detailed annual plan of its grain and raw material purchases in the United States.

In the event that it becomes necessary for the U.S. Government to impose short-supply export controls, these purchase plans will enable the United States to give sympathetic consideration to Israel's situation and allow Israel equitable access to U.S. supplies of commodities and raw materials during the period of short supply.

The Committee noted that a procedure has been developed to provide for potential purchases by Israel directly from the excess stockpile administered by the General Services Administration (GSA).

The Committee also took note of Israel's need to expand and modernize its food and raw material storage and warehousing facilities. The Committee recognized the need to attract investment and technology for the expansion of storage facilities and recycling plants in Israel and agreed to consider ways of facilitating these activities. To this end, a U.S. technical team will visit Israel shortly for an onsite survey of Israel's existing storage facilities and will help develop a construction plan for additional facilities. An Israeli mission will also visit the United States to study U.S. storage technology.

VI. Scientific cooperation

The Committee reviewed favorably the progress achieved under the jointly funded United States-Israel Binational Science Foundation which had been established in 1972. Both sides agreed that the foundation has played a useful role, and that it would be desirable to strengthen our scientific relations. It was agreed, subject to any required legislative approval, to explore means to widen the scope of operations of the foundation and strengthen its financial basis. Negotiations to this end will take place soon and the conclusions and recommendations will be submitted to the Committee at its next session.

The Committee reviewed the status of the proposed joint water desalting project, which has undergone a lengthy period of evaluation. The Committee noted that the Congress has previously authorized and appropriated up to $20 million as the American share of the capital and initial operating costs of the project. Both sides agreed that it was now feasible to proceed with the arrangements for the design, construction, and initial operation of a large-scale prototype plant and to negotiate a technical agreement subject to the necessary consultations with the Congress. A U.S. technical mission will visit Israel in the near future.

VII. Industrial research and development

The Committee discussed the importance of expanding industrial research and development in Israel. The U.S. Department of Commerce and the Israel Ministry of Commerce and Industry were designated as focal points to facilitate cooperative industrial research and development activities. These agencies will encourage direct contact between departments of the two Governments and bodies in the private sectors such as the Industrial Research Institute and the Licensing Executive Society, will assist in defining possible cooperative ventures, and will promote the exchange of technical information between American and Israeli organizations in the science and technology field.

The Joint Committee agreed to establish a United States-Israel steering committee for industrial research and development composed of representatives from interested agencies of the two Governments. This steering committee will outline policies and formulate priorities to enhance mutual research and development efforts with specific industrial applications.

The members of the Committee agreed that the two Governments will undertake to encourage the dissemination of information on Israel's research and development potential and capacity within professional and industrial organizations in the United States, especially through greater exchanges of people and information between Israel and the United States.

The Joint Committee also welcomed a U.S.-Israel industrial research and development council in which U.S. representation would be from the private sector. The Council, which would include leading research and development executives, scientists, and engineers, would assist in promoting closer links between United States and Israeli enterprises in the science and technology area.

The parties agreed on the desirability of developing a program to support mutually beneficial industrial research and development activities in Israel. To this end, it was agreed that the two Governments would begin as early as possible discussions to formalize the program's scope and organization, and to determine the financial arrangements that the two Governments would undertake in support of the program and its management.

VIII. Future meetings

The members of the Committee decided that future meetings of the Joint Committee for Investment and Trade should take place at least once each year to review issues affecting the economic relationship between the two countries and to develop means of expanding economic cooperation between the two Governments as well as between the people of both countries, including exploring the possibility of entering into appropriate, formal arrangements which will regulate the various joint activities and define broad principles of cooperation. The next meeting of the Joint Committee will be held in Jerusalem.

The Committee announced establishment of a joint steering group to oversee implementation and coordination of the measures agreed upon by the Committee. The steering group, which will report to the cochairmen of the Joint Committee, has also been charged with the responsibility of investigating possible new cooperative efforts and reviewing outstanding bilateral economic issues. In addition, it will undertake preparations for future meetings of the Joint Committee.

SENIOR PARTICIPANTS

UNITED STATES-ISRAEL JOINT COMMITTEE FOR INVESTMENT AND TRADE

May 12–13, 1975, Washington, D.C.

United States

William E. Simon, Secretary of the Treasury, Cochairman
Charles W. Robinson, Under Secretary of State for Economic Affairs
John Tabor, Under Secretary of Commerce

Gerald L. Parsky, Assistant Secretary of the Treasury for Trade, Energy, and Financial Resources Policy Coordination
Alfred L. Atherton, Jr., Assistant Secretary of State for Near Eastern and South Asian Affairs
Marshall T. Mays, President, Overseas Private Investment Corporation (OPIC)
Walter C. Sauer, First Vice President and Vice Chairman, Export-Import Bank of the United States

Israel

H.E. Yehoshua Rabinowitz, Minister of Finance, Cochairman
H.E. Simcha Dinitz, Ambassador to the United States
Avraham Agmon, Director-General, Ministry of Finance
Dr. Moshe Mandelbaum, Director-General, Minister of Commerce and Industry
General (Res.) Moshe Goren, Director, Israel Investment Authority
Ze'ev Sher, Economic Minister, Embassy of Israel

International Monetary and Investment Affairs

Exhibit 48.—Statement by Secretary Simon, September 18, 1974, before the Permanent Subcommittee on Investigations of the Senate Committee on Government Operations, concerning domestic and international energy policies

I am pleased to participate today in your investigation into various aspects of our domestic and international energy policies. It is important, I think, for the Congress and the administration jointly to discuss possible policies to respond to the ever-changing world energy situation.

The problem we are discussing here today—the abrupt increase in the price of oil—is one of major importance to all participants in the world economy. For oil-consuming nations, whether industrial or developing, oil price increases have fanned inflation, adversely affected living standards, distorted economies and created payments problems. For oil-producing countries, high prices have brought exceptionally high incomes in the short run, but also the danger of a drastic erosion of their income in the longer run.

Consuming nations should not accept the indefinite continuation of oil prices at current levels. Producers will not lower prices until they come to realize that lower prices will be in their own best interest. If progress is to be made toward lower prices, consuming and producing nations must develop a common understanding of the extent and nature of the price problem, and where each nation's self-interest ultimately lies. If this is to be achieved, and I cannot emphasize this too strongly, we in the United States must be willing to back up our talk with concrete actions both domestically and in the international arena. Only if oil producers can be made to understand the gravity of our problem and our resolution to redress it through our own efforts, if necessary, can they be persuaded that the prompt reduction of oil prices will be to their advantage.

Before discussing the actions that we have undertaken, and those that still must be initiated, I would like to review the current international oil situation and the impact of the higher prices.

The OPEC countries will probably receive about $80 billion in 1974 in payment for petroleum operations—over five times what they received in 1972. Current prices and production rates are actually generating payments at an annual rate of $100 billion per year, but the timelags are such that their total receipts for the calendar year are likely to be some $20 billion lower. They will receive perhaps $5 billion from exports of other commodities and services. Of these $85 billion of receipts, the OPEC countries will probably spend about $30 billion on imports of goods and services, leaving some $55 billion to invest outside their borders.

As has become increasingly clear in recent months, high oil prices that have generated these revenues have also created or have exacerbated a number of serious economic problems.

Most directly, the oil price increase has been a major contributor to worldwide inflation.

Measurement of the inflationary impact of the oil price increase is of course a complex task, but some preliminary estimates are available. The impact of increased oil prices as a percentage of GNP are themselves sizable, on the order of 1 to 3 percent for the major industrial countries, but even these considerably understate the full inflationary impact of the oil price increases. More comprehensive estimates suggest that the quadrupling of oil prices over the past year, when its effects are fully felt, will have contributed in the range of 5 to 8 percentage points to the increase in our Wholesale Price Index. This is on the order of almost half the increase in the U.S. Wholesale Price Index from midyear 1973 to midyear 1974 of roughly 14 percent. For many other oil-importing nations the contribution of the oil price increases to inflation will be even greater.

As one facet of the inflationary shock of high oil prices we can see how the sectoral balances in national economics have been altered. Sectors in which petroleum represents a high input face relatively higher costs and weaker demand than others. Our automobile industry is suffering from significantly reduced sales. Our airlines industry is pleading for special governmental relief from the vastly increased fuel costs. Electric utilities find it difficult to attract the investment money they need. These sudden shifts cause the loss of output and create unemployment even when some sectors of the economy are still at full capacity. A fall in the price of oil would alleviate these problems and permit recovery in output and employment.

In addition to directly affecting prices, employment, and output, high oil prices affect the performance of the world economy through their impact on the international financial system. With the OPEC countries running large surpluses in their goods and services balance, the oil-importing countries as a group cannot avoid equivalent deficits. They are simply unable to pay for their oil imports in full with goods and services at this time. They are compelled to borrow. This is a drastic change for the industrial nations of the world which, collectively, have been accustomed to surpluses in their goods and services account and to being net lenders on the international scene. The developing countries, which have been borrowing to finance their economic development, now find they must borrow to finance essential current consumption as well, unless they are prepared to cut back on their development programs or depress the living standards of their people. It is not clear that the oil-importing countries are all prepared to accept the vast amount of borrowing implied by these changes, at least at current levels of output and real income.

Of course, a willingness to borrow does not necessarily create the ability to do so. It is true that since the OPEC countries have no alternative to lending their surpluses abroad, funds are available in the aggregate to meet the new deficits of the industrial countries and the larger deficits of the developing nations. Lenders, however, are likely to prefer lending to the strong rather than to the weak.

As the external debts of the oil-consuming countries grow—particularly if the borrowed funds are used largely to finance consumption rather than to increase output—private lenders are likely to become increasingly reluctant to extend further credit to borrowers in weaker countries. Consequently, governments are faced with the need to supplement the private markets and to work out techniques for officially channeling funds to certain borrowers. The IMF has inaugurated a new special oil facility; understandings have been reached which permit the use of gold reserves as collateral, thereby facilitating the negotiation of bilateral credits; the Governors of the International Monetary Fund and the International Bank are preparing to establish at the end of this month a Ministerial Committee on the Transfer of Real Resources which will take up, as its most urgent task, the problems faced by the developing countries most seriously affected by the oil price increase.

For a fuller description of the recycling issues and our responses to them, I am providing a more detailed paper to the committee.

Each of these problems is to one degree or another manageable, but that does not in any way justify the present price of oil in world markets, or reduce our determination to resolve the root cause of the problems—the high oil prices themselves. None of these problems would be plaguing us today if the operation of the world oil market were free from manipulation by the governments of oil-producing states. Underlying market forces prove that there is a large potential oil surplus which, in a free market, would be reflected in lower prices. The high oil prices had scarcely taken effect when growing production levels and decreased demand caused considerable softening of the oil market.

During the summer, when oil demand is at its seasonal low, the level of actual excess production approached 3 million barrels a day. The excess was absorbed by substantial increases in inventories, including inventories at sea created by ordering tankers to steam at speeds as low as 5 knots. In August, the surplus seems to have fallen to about 500,000 barrels per day due to reduced production in Venezuela, Kuwait, Saudi Arabia, and elsewhere. Our latest evidence is that production is slightly up once again, and that the surplus may now approach 900,000 barrels per day.

Nor is this the full story: Current production potential is even higher than current production, perhaps by as much as 4–5 million barrels per day.

If the oil market were free from interference, the price would drop. Governments of the oil-producing countries are, however, acting determinedly and in substantial concert to maintain present prices. How long OPEC members will be able to continue this policy in the face of new production elsewhere and the need to agree on mutually satisfactory production cuts among themselves is unclear. What is clear, however, is that a small number of producing states are exercising a monopoly power, manipulating the oil market by limiting production and raising prices. As long as this continues the consuming nations cannot rely solely on market forces to generate a decline in price.

The policy the producers are pursuing is bad policy—bad from the standpoint of their own interests. Some of the pitfalls are of a political nature. But in economic terms, cutting back production in the attempt to preserve the high price is extremely shortsighted. This policy will cause consuming nations to go all out for the conservation of energy, to step up investment programs which expand the production of oil in non-OPEC areas as well as nonoil sources of energy and to intensify research and development of new techniques for obtaining energy. The OPEC countries will, in a relatively short period of time, find their market for oil tending sharply downward. And once gone, even lower prices will not bring it back.

Our Treasury studies of supply and demand elasticity for oil indicate that reduction in demand need not be very great to reduce the total size of the market for OPEC oil significantly in future years. Reductions in demand due to present prices coupled with increases in competing supplies will result in a steady reduction in OPEC's market. For a wide range of plausible demand-supply elasticities, recent price increases, if maintained, will cost OPEC a sizable fraction of its sales beginning later this decade.

Even now, one can see significant developments that should bring home the validity of these predictions to OPEC leaders. The worldwide consumption of oil has been held to below preembargo levels, with most major consuming nations experiencing reductions in demand of 3–5 percent below 1973 levels. In addition, new discoveries of oil have been accelerated outside the OPEC nations. In fact, significant discoveries have been made in 26 separate areas of the world since 1973. Some of the finds hold considerable promise for relieving the world's dependence on the OPEC nations. Moreover, there is an increasing substitution of fuels throughout the world in an effort to decrease dependence on oil. As a result, world coal production may be some 70 million tons higher in 1974 than would have been expected without the oil price increases. Yet these efforts are just beginning.

The implications of these developments for OPEC are clear: Unless prices fall, the demand for oil exports from the current oil producers will be sharply lower in 1980–85 than it is now. This simple message has yet to sink in, apparently, but it is one that we will continue to deliver.

Of course, 1980 is 6 years away, and consuming nations cannot absorb the economic impact of the current oil prices for that length of time. If we cannot convince the oil producers that lower prices are in everyone's ultimate self-interest, we must be prepared, as a Nation and as a member of the international community, to take concrete actions in defense of our economic interests. We must demonstrate our determination to escape the OPEC grip.

In particular, we must take action to:

Develop our domestic energy resources,

Limit our domestic energy demand, and

Forge effective consumer nation unity.

In designing our future policies, we must recognize that the policy problems generated by $10/bbl. oil differ from those caused by $3/bbl. oil. The energy market operates in another world from the one we knew a year ago. With the advent of the new price levels, there is no need for massive governmental interference in the domestic market in an effort to avoid dependence on imported oil at some future date. What is needed now is a willingness to remove the Government from areas where its activities have been an impediment to greater domestic output and conservation.

With this in mind, the administration has taken or intends to take a variety of actions in both the domestic and foreign arenas.

The goals of our domestic program are:

To reduce our near-term dependence on imported oil through domestic supply increases and conservation, and

In the longer term, to reduce that dependency further through the exploitation of other domestic sources of energy, including alternative fuels and technologies.

Appropriately designed and implemented, Project Independence will provide a context in which market-oriented energy policies can be effective. Clearly, the Government has posed and continues to pose a major obstacle in the short and medium term to efficient market allocation in energy. We regulate the price and distribution of natural gas; we manipulate the pricing and distribution system in oil; we require lengthy and cumbersome processes for obtaining licenses and rate approvals; and we impose environmental restraints, sometimes of questionable validity, upon both the production and combustion of fossil fuels.

Thus, as we develop our long-range energy policies, we must also set some short-term goals. These goals should be clearly understood and stated and explained at each step to the American people. In my mind, the framework should involve several major areas of action, including passage of a legislative package, changing of existing regulatory procedures, and conservation efforts.

First, we must make an all-out attempt to produce additional supplies of oil. The potential for this production could be met through a variety of measures such as: opening Elk Hills and Naval Petroleum Reserve No. 4 to fuller development and production, reopening the Santa Barbara Channel to production with appropriate environmental safeguards, reevaluating upward the maximum effective rate of certain oilfields.

Second, we should move towards the removal of price controls from oil and natural gas, and phase out the regulations and allocation programs which now disrupt production and marketing patterns.

Third, we need to accelerate our Federal leasing programs on Federal lands for both oil and coal.

Fourth, and related to all of these, we must decide on a package of energy legislation and work with the Congress to insure that it will be passed promptly. This effort is badly needed to break the logjam of nearly 800 energy bills which are pending in Congress this year. Hopefully, Congress will approve legislation needed to achieve our goals and which will also include: deepwater ports legislation, an energy facilities siting bill, legislation to create the Energy Research and Development Administration, the energy tax package, the Surface Mining Act, and legislation creating the Department of Energy and Natural Resources.

Our ultimate goal should be one of moving the United States from its present nonrenewable hydrocarbon energy base to a renewable energy base. Achievement of these goals will, of course, include the development of solar, geothermal, nuclear, and eventually fusion power. The switchover to these sources will extend over a period of many years, but what is needed now is a clear national commitment to increase our domestic energy production in areas and forms consistent with market forces. Such a commitment need not, and should not, imply that essential social and environmental concerns must be neglected. On the contrary, such concerns must be fully taken into account. But protection against social abuses must be provided without unduly dampening incentives to expand production.

We will not be able to convince OPEC nations that we will succeed in reducing our vulnerability unless we act in the areas I have mentioned and unless we take further steps to reduce our demand for oil in the short run. We must make a national commitment to energy conservation, which will only succeed if it is undertaken on a solid foundation of demand restraint made effective through new energy-related taxes or tariffs. We must develop much greater efficiency in the use of energy. Measures to implement this commitment would give us added weapons for dealing with the inflationary and economic disruptions caused by the present price levels of oil imports.

The second major prerequisite for effective action on prices is consumer nation unity. We have been promoting this objective in three major ways:

First, we have been developing, in the Energy Coordinating Group (ECG) established at the Washington Energy Conference, a program of joint action in order to guard ourselves against future oil supply embargoes. This program is now embodied in a draft International Energy Program (IEP) which we hope to put in final form as a recommendation to member governments later this week in Brussels.

The emergency cooperation program included in the IEP is designed to protect us against the sort of oil blackmail we faced last year. We must be free from this threat if we are going to guard our interests in the world oil market. Basically, the emergency program now under discussion in the ECG would call for commitments by the participating countries in four areas:

We would agree to come to each other's aid in the event any consuming nation was singled out for an oil cutoff—the one-for-all and all-for-one principle—and we would therefore hope to deter embargoes as well as spread their burden should they occur.

We would all agree to cut our consumption of oil by a common percentage in an emergency.

We would agree to develop a common level of emergency self-sufficiency, largely through use of oil stocks, so that by drawing on these stocks we could endure a large cutback longer.

We would reallocate the available oil among the countries of the group, taking into account the prescribed consumption restraint and stock draw-down obligations in order to equalize, to some degree, oil supply losses.

This program is not a permanent solution to the problem of our heavy dependence upon imported oil, which in turn is the basis for OPEC's success in raising oil prices to their present levels. Therefore, we have also embodied in the IEP the second major thrust of our program for consumer nation unity. This second initiative is the creation of a framework for a cooperative effort to reduce, over the long term, consumer nation dependence on imported oil.

As an initial focus for our efforts we have included programs for cooperative action in the areas of research and development, the accelerated development of conventional resources, conservation, and uranium resources. As the IEP reaches fruition and a new International Energy Agency comes into being, we hope to be able to develop a more detailed and comprehensive program, for only by mutually reducing our dependence on imported oil will we be able to reduce our ultimate vulnerability to oil suppy and price manipulation.

We are confident that this major international initiative will be concluded shortly, probably in October, and we attach great significance to it.

The third major area in which we are developing consumer nation unity is in cooperation to mitigate the effects of high oil prices. We have participated in the creation of a special facility within the International Monetary Fund for loans to countries experiencing financial difficulties because of the high oil prices. We have also been cooperating with other consumers in the Development Assistance Committee of the OECD and in the World Bank in a reexamination of aid allocations so as to concentrate assistance on the most severely impacted less developed countries. We have actively supported the establishment of a new Ministerial Committee in Real Resources Transfer, to be established by joint action of the IMF and the World Bank, which would focus urgently on the needs of developing countries.

Both in the IMF and in the OECD we have participated with other nations in a voluntary pledge to refrain from mutually destructive trade policies. In all of these various organizations, we have been attempting to maintain and to build a framework of mutual assistance and cooperation in dealing with our common problem of high oil prices.

In working for consumer nation unity we have no desire to provoke a confrontation with the oil-producing countries. Many of them are participants in the financing arrangements. We are trying to develop understandings with oil producers on our mutual interests. We seek to show the producers that they have lost sight of the important interconnections of the world economy, as well as the long-term dynamics of the market system. We seek their understanding that price levels unrelated to market conditions, unrelated to revenue needs of the producers, and unrelated to the prices of long-term substitute supplies promise short-term hardship and longrun instability, for us now and for the oil exporters later. Only if we can re-create a mutuality of understanding with producers will we be able to avoid the unfortunate consequences of the present level of oil prices. In order to facilitate this understanding, as well as for reasons related to peace in the Mideast, we have been developing a series of programs under the aegis of our joint commissions with the Saudis and the Iranians. We have also been in close contact with other oil producers in a less formal way.

Our intentions in all of this are clear: We want to help these nations achieve their aspirations of becoming advanced industrial and agricultural societies. We believe that their desire to modernize their economies is both legitimate and laudable, but we believe that they should understand that their long-term interests lie in maintaining good relations with industrialized nations and in following pricing and supply policies that guarantee them something other than a declining market for their oil.

I have attempted to outline our analyses of the current situation in the world oil market, and the steps we are taking or hope to take to deal with it. I believe that the policies we have adopted are both sound and fair, and I would hope that others would see them in a similar light. I have been disappointed in the results of the efforts we have made to date, particularly the recent actions by the oil producers at the OPEC meeting in Vienna. Due to the immense significance of the problem of high oil prices, and due to its serious impact on the world economic system, we may be forced to reassess certain aspects of our policy, as well as to develop new policies that will increase our leverage. We would do this most reluctantly, but we as well as others must recognize the seriousness of the problem and the absolute necessity to find a solution to it.

In any event, we will need to demonstrate our willingness to take effective action in the energy area, and effective action will require the cooperation and determination of the administration, the Congress, the American people, and other consuming nations. I hope that we can have the support of you gentlemen in furtherance of our efforts.

Exhibit 49.—Statement submitted to the Senate Permanent Subcommittee on Investigations in conjunction with testimony by Secretary Simon, September 18, 1974, concerning the financial and economic consequences of the price of oil

The current and expected magnitudes of money flows associated with international trade in oil have to be estimated. Official reports from oil-exporting countries are fragmentary and available only with long timelags. Several important countries have not yet disclosed information on their receipts in 1972. Only a few countries have reported receipts for any part of 1974.

We estimate that OPEC countries received $15 billion from oil trade in 1972 and $25 billion in 1973. Our current estimate for receipts in 1974 is $80 billion. Current prices and production rates are generating payments at an annual rate of $100 billion, and some analysts are using this figure for calendar 1974. The lags in actual payments are substantial, however, and our $80 billion estimate takes these lags into account.

Estimates are highly uncertain because the unprecedented changes in price imposed by the governments of oil-exporting countries over the last year have caused the importing countries to reduce the consumption of oil and to seek alternative sources of energy. The volume of oil trade in prior years is no longer a reliable base for estimating volume in the future. Thus, estimates of the volume of oil likely to move in international trade in 1974 and the period ahead vary widely. Furthermore, contractual arrangements between the governments of the oil-producing states and the major producing companies are in process of renegotiation, and terms under which oil will be produced and exported as well as the division of beneficial ownership of the oil-producing companies is not yet known.

In estimating money flows associated with international trade in oil, it is essential to distinguish between payments by importers of crude, petroleum, and petroleum products in various countries throughout the world to the sellers of such products, primarily the international oil companies and, in turn, the payments by these companies to the governments of the oil-exporting countries.

There are important differences between the amount of the payments by the oil importers and amounts received by the governments of the oil-exporting countries from oil operations. These differences include the cost of transportation, in some instances the cost of processing oil (if such processing is done in countries where it essentially constitutes a transit trade), the profits of the companies, and changes in receivables and payables. In the early part of 1974, changes in receivables and payables were extremely large, and the investment incomes being shown by the international oil companies were large. Both the changes in receivables and payables and the figure for investment incomes are, however, subject to major modification because the contractual relationships between the companies and the governments of the oil-exporting countries are not yet settled and are subject to retroactive adjustment.

The uncertainty in these contractual relationships results primarily from the lack of firm understandings concerning the amount of oil considered by the governments of the oil-exporting countries to be their share of the output, and the price paid by the companies for the amount of oil repurchased by them from the governments. Thus the companies do not necessarily know the total costs of the oil they have sold. Furthermore, in some instances, they are also exposed to uncertainties with respect to the prices they can charge to the final importers.

These uncertainties not only affect the profit obtained this year, but also the size of the debt the companies have to the oil-exporting countries. This debt arises primarily from the delay in the payments of the difference between the ultimate total price of the repurchased oil, and the interim payments which presumably have been made currently, in relation to actual oil shipments at prevailing tax and royalty rates.

We estimate that OPEC receipts from petroleum operations were about $30 billion in the first half of 1974, with $50 billion to come in the second half.

There are also wide variations in the estimates of the payments expected to be made by the OPEC countries for imports of goods and services—purchases on current account. Our best guess is that in calendar year 1974 the OPEC countries will make payments for goods and services imports totaling roughly $30 billion, of which $12 to $13 billion may have accrued in the first half of the year. Since we estimate that these countries will earn about $5 billion from exports not associated with petroleum, our estimate of their surplus on current account, excluding any government grants, is roughly $55 billion.

U.S. exports to oil-producing countries [1]

[In millions of dollars]

	1970	1971	1972	1973	1973				1974	
					Q-1	Q-2	Q-3	Q-4	Q-1	Q-2
Total exports to oil-producing countries	2,583	2,869	3,323	4,456	1,032	1,081	1,066	1,277	1,507	1,850
Latin America	1,269	1,298	1,445	1,705	401	406	409	489	556	691
Venezuela	759	787	924	1,032	248	244	249	291	338	457
Ecuador	127	134	134	173	32	44	43	54	60	82
Bahamas	173	141	144	208	47	46	45	70	70	64
Trinidad	84	117	121	133	36	32	34	31	44	39
Netherlands Antilles	126	119	122	159	38	40	38	43	44	49
Middle East	623	875	1,142	1,599	369	368	375	487	542	737
Iran	326	482	559	771	185	190	173	223	237	345
Iraq	22	32	22	56	6	7	17	26	39	34
Syria	11	23	20	21	4	4	9	4	8	7
Kuwait	62	84	111	119	32	26	25	36	36	49
Saudi Arabia	141	164	314	442	100	101	104	137	138	215
Qatar			13	19	4	5	5	5	7	10
United Arab Emirates	[2] 49	[2] 66	69	121	24	24	29	44	56	53
Oman			7	9	1	2	3	3	5	5
Bahrain	12	24	26	41	13	9	10	9	16	19

Indonesia	266	263	308	442	102	94	106	140	121	119
Africa	425	433	428	710	160	213	176	161	288	303
Algeria	62	82	98	160	30	42	37	51	85	68
Tunisia	49	42	55	60	8	20	9	23	25	13
Libya	108	78	85	104	28	32	24	20	21	32
Egypt	77	63	76	225	50	73	67	35	118	108
Nigeria	129	168	114	161	44	46	39	32	39	82
Exports of special category (military):										
Latin America	(39)	(55)	(63)	(55)	(16)	(18)	(10)	(12)	(11)	(12)
Middle East	(352)	(445)	(362)	(636)	(150)	(129)	(148)	(209)	(204)	(230)
Africa	(48)	(35)	(13)	(10)	(2)	(3)	(3)	(2)	(5)	(13)
Exports excluding special category:										
Latin America	1,230	1,243	1,382	1,650	385	388	399	477	545	679
Middle East	271	430	780	963	219	239	227	278	338	507
Africa	377	398	415	700	158	210	173	159	283	290

[1] Excluding Canada.
[2] Includes exports to Qatar, United Arab Emirates, Oman, and Yemen Arab Republic.

The $30 billion figure for current imports of goods and services takes into consideration the inevitable timelags which these countries encounter in spending the increased revenue available to them. There are delays in planning the expenditures of funds whether these monies are spent on consumer goods, capital equipment, or armaments. Even when decisions have been made as to the goods to be purchased, it takes time to negotiate contracts for the desired goods and services and additional time to obtain deliveries. Many of the oil-exporting countries hope to use the bulk of their increased earnings for industrial development and for the strengthening of their military establishments. The timelag between orders and delivery for goods of this nature can extend for several years, and although some contracts may call for progress payments, there are substantial lags in the expenditures of funds associated with imports of this type.

U.S. imports of petroleum and products were about $4.7 billion in 1972 and $8.1 billion in 1973. (These figures include imports into the Virgin Islands, which are not included in the figures for U.S. trade published by the Bureau of the Census and $1.1 and $1.4 billion, respectively, for imports from Canada, which is not a member of OPEC.) For the first half of 1974, U.S. imports were about $11.8 billion ($10 billion excluding Canada), and in the last two quarters of the year, they may amount to about $14 billion ($12 to $12.5 billion excluding Canada).

Investment incomes derived by U.S. corporations from their foreign affiliates operating in petroleum production, processing, and marketing amounted to $2.8 billion in 1972, and $4.3 billion in 1973. The figures for the first half of 1974 are not yet available, but, subject to later revision to take account of retroactive changes in contracts with the oil-exporting countries, may have been $3½ to $4 billion.

We do not have separate figures on payables and receivables of the U.S. petroleum companies from their international operations, but rough estimates would indicate that their debts to the oil-exporting countries may have risen during the first half of 1973, perhaps by as much as $5 billion. Both the investment incomes of U.S. oil companies and the increase in their payables to the oil-exporting countries arise from their worldwide operations and not only from U.S. imports.

Table 1 shows U.S. merchandise exports to each of the OPEC countries for the years 1970 to 1973 and quarterly for 1973 and the first half of 1974. Data on exports of services to these particular countries are not available but are not believed to be significant.

As mentioned above, crude Treasury estimates suggest a balance of payments position for the OPEC countries combined in the calendar year 1974 as follows (in billions of dollars):

Receipts associated with petroleum trade	80
Other goods and services exports	5
Imports of goods and services	—30
Balance on current account excluding government grants	55

These estimates suggest that the OPEC countries will have roughly $55 billion to invest in 1974. Many of these countries appear to attach great importance to maintaining as much anonymity with respect to their investments as possible. Thus very little information is provided by the authorities of any of these countries on the disposition of their investments. We have pieced together information derived from many different sources. What we have is fragmentary. Many of the reports cannot be confirmed. We can do no more than offer a very rough guess as to where funds may have been invested thus far in 1974. We estimate that the OPEC countries may have had a surplus of somewhere between $25 and $28 billion between January 1 and August 31, 1974. Of that $25 to $28 billion, about $7 billion appears to have been invested in the United States. Roughly $4 billion was invested in various types of marketable U.S. Government securities including some so-called agency securities. Most of the remainder was placed with commercial banks in the United States, although a few hundred million dollars may have gone into corporate securities and real estate.

We suspect—although we have no firm supporting evidence—that $2 billion or more was invested in Europe through direct placement loans to official or quasi-official agencies, plus direct purchases of private securities and real estate. At least $3 billion may have been invested in the United Kingdom in sterling, some of which no doubt involved purchases of British Government securities and some sterling deposits in British banks.

We have received a good many reports of commitments by OPEC countries to developing countries and multilateral lending institutions. Some of these reports appear to reflect firm commitments and some reflect tentative agreements or statements of intent which have not yet been translated into firm programs for action. Altogether the reported commitments would add up to more than $15 billion. Terms of these commitments vary widely. Some call for outright grants. Some involve soft loans and some loans on near commercial terms. Some call for immediate disbursement, but most imply that the funds will be disbursed over a considerable number of years. We are not able to determine the amount of money which has actually been transferred under these and earlier commitments thus far in 1974. We think it reasonable to conclude, however, that as much as $3 billion was transferred during this period to developing countries and the multilateral banks including purchases of IBRD bonds amounting to approximately $500 million.

Our assumption is that most of the remaining $10 to $13 billion (of the $25 to $28 billion surplus) is currently being held in Eurodollar and other Eurocurrency deposits in banks outside the United States, largely in London.

In the past few months, there appears to have been some evolution in the pattern of investment by the OPEC countries, with a larger share of the funds going into long-term, direct-placement loans and into the securities of major governments than appeared to have been the case in the earlier months of the year. This very logical development may have come about in part because the OPEC governments have had more time to plan the investment of their funds, whereas initially they were merely left on deposit with commercial banks. In part, it may have come about because banks have, in some cases, reduced their offers for large-scale short-term deposits, thus creating a financial incentive for the investing governments to look for other outlets for their money. Banks are increasingly serving as brokers in arranging the direct placement of OPEC funds with longer term borrowers, and OPEC countries have increasingly gone into national capital markets to buy government securities. Special arrangements have also been made for direct loans to governments in several cases and in one case, for a $1 billion deposit as an advance payment for imports.

Prospects for payment in goods and services

The capacity of the various exporting countries to absorb imports differs materially. There is little doubt that countries with sizable populations such as Indonesia, Iran, Nigeria, Algeria, and Venezuela will have little difficulty in using their oil income for imports of goods and services. For these countries, surpluses are temporarily deriving simply from the fact that it takes time to plan, procure, and obtain delivery for the types of goods they wish to buy. Libya cannot easily use all of its income for capital equipment or civilian consumption but has been placing large orders for military equipment and may extend grants to nations with which it is in sympathy.

The countries of the Arabian Peninsula, however, have relatively small populations, and their requirements for imported goods and services are limited. Some of these countries might continue to run substantial surpluses for some years to come if the oil price were to stay at its present level. Even these countries, however, expect to increase their imports very substantially and quite rapidly. The Government of Saudi Arabia, for instance, is currently budgeting expenditures of $12.5 billion, approximately four times the level of the previous budget year. This increase can be expected to result, directly or indirectly, in an increase in imports of almost the same magnitude, although there will, no doubt, be a substantial timelag involved.

Each of the oil-producing countries has its own priorities and is developing its own plans with respect to the use of its oil revenues. All of the countries are placing great emphasis on industrial development. They see an unprecedented opportunity to move into the processing of oil and gas and the production of manufactured items in which oil and gas constitute a major input.

In some cases there are likely to be major outlays to improve and expand the infrastructure of the country. Several of the countries have extensive plans for strengthening their military establishments and can be expected to utilize a substantial percentage of their surpluses for military equipment. The United States will probably be a major supplier of military equipment, although by no means the only country furnishing arms. Much of the military equipment being ordered by these countries is currently in short supply, and delivery is expected to be staggered out over an extended period of time.

The scope for substantial development efforts by the oil-producing countries permits the utilization of a significant portion of the receipts of these countries. Announced objectives, both interregional and international, must be translated into major flows. Transfers can be of both a pure development nature or can represent long-term investments on more commercial terms, or both.

In investing their surplus funds, the governments of the oil-producing countries will have access to a wide variety of financial instruments in many parts of the world. They will have the same opportunities as are open to any large investor and will be able to employ talented investment advisors. Each nation will no doubt choose its own investment strategy, and there is no reason to expect they will all make the same choices. Some may place primary emphasis on the income yield of their investments while others may give greater weight to the question of the preservation of their capital. Some of these counrties have apparently also placed a high value on anonymity—that is, placing their funds in such a way that the identity of the owners cannot be traced. Some may fear that host countries, if able to identify the beneficial owners of large investments, might use their capability to freeze the assets to induce modification of government policy. In the final analysis, unless the OPEC countries choose to leave their oil in the ground, a very poor investment, or give their money away, they must invest the funds they do not spend on imports of goods and services for some kind of financial asset. Today's $10 per barrel of oil if left in the ground as an investment alternative to financial assets earning 8 percent, would have to rise in price to $21.59 per barrel by 1984, an unlikely prospect.

Our expectation has been that these countries would invest in a very wide variety of assets in a great many countries. We see no reason to assume that their investments will seriously disrupt world markets. While huge in terms of international payments patterns and transfers of wealth, these OPEC current account imbalances represent only a small fraction of world financial markets. Thus we would not expect the oil payments situation to substantially alter average yields in world financial markets, nor to cause serious difficulties for financial markets in absorbing such funds. It is quite possible that there will be some impact on the yield structure of financial assets due to stronger liquidity preferences on the part of OPEC investors than on the part of the average investor. Indeed, some decline in short maturity rates relative to longer maturity rates has already occurred in the Eurodollar market. It is not clear, however, whether there will be a lasting shift toward lower short-term rates. As OPEC investors decide on more diversified investment strategies and private lenders and borrowers adjust to the new patterns of lending, there may be little long-term impact on the maturity structure of financial yields.

Furthermore, the drive to develop alternative sources of energy will increase the demand for capital. Thus, despite the prospect of huge OPEC surpluses, we look to a world which is short of investment capital.

Indeed, the more difficult problem is to provide increased domestic savings to finance our investment needs, not to find profitable outlets for OPEC investments.

It would be virtually impossible to make additional real transfers on the order of $50 to $80 billion from oil-consuming to oil-producing countries over the space of a year. This is due more to the lack of ability of the oil producers to absorb quickly such a huge increase in real resources than an inability of the oil-consuming nations to provide these resources. This does not mean, however, that a problem of overall payments imbalance need exist. The excess of oil country receipts over their imports of goods and services will be matched by an accumulation of financial assets.

To the extent that these financial instruments have competitive rates of return, their real economic value will equal the aggregate current account imbalance between oil producing and consuming nations. (While there is concessionary financing, of course, accumulated assets will be valued at less than the current payments imbalance.) As was indicated above, there would be little problem with the world's financial markets providing attractive investment opportunities such that OPEC producers can invest their oil receipts in profitable investments. Over time as OPEC absorptive capacity grows, the accumulation of financial assets by the oil producers could be expected to reverse itself. Thus, much of the real transfer of goods and services in payment for oil would be deferred until later years when the OPEC countries as a group become "mature creditors," absorbing a greater value of goods and services than their current export receipts. The fact that transfer of real goods and services would follow a different time pattern than oil receipts would not imply that a balanced real value of claims would not occur during the interim.

The lack of good assets for oil producers to invest their receipts does not, however, imply that there may not be serious problems associated with the current level of oil prices.

For many countries, increased oil payments represent an intolerable tax on their meager resources, one which they cannot reasonably be expected to pay either currently, or in later years through commercial borrowing. Likewise increased oil prices have contributed severely to an already unprecedented rate of world inflation. Solution to the financial problems associated with the oil price increases must not be confused with solution to the real underlying economic problems. The resolution of such problems must be in a lowering of oil prices.

It is essential that the oil-producing states come to recognize that their own national interests lie in lower oil prices, both in terms of their narrow self-interest in maintaining their markets for future oil sales and because of their stake in the operation of the international economic system.

Current recycling problems

The sudden appearance of large OPEC surpluses has created strains on the banking system. But these strains have induced the banks and other financial institutions to devise new methods and new techniques which enable them to cope with most of the problems. The system is in no real danger. We must be sure that regulatory and supervisory authorities in the various countries watch carefully to guard against mismanagement and speculative excesses by banking institutions. The Comptroller of the Currency is expanding the examination of international banking operations. The German authorities, who had earlier established new procedures and guidelines to limit foreign exchange transactions by banks, have established a "liquidity bank" and have proposed legislation to revise certain banking laws.

We must make sure that our procedures for assuring the liquidity of our financial systems are effective. Central bankers from the major countries announced last week that this is being done.

We have no indication that the banks cannot handle the intermediation problem. As their financial assets grow, many of the oil-producing countries are coming to realize that they will not be able to use their money for goods and services in the near future and that they would be well advised to place these funds in longer term maturities. We have already seen some indications that a significant portion of the funds being placed with the banks is going into medium-term time deposits and certificates of deposit.

As time passes we expect the financial system to adapt to the increased volume of oil-producer surpluses and new investment channels to be opened up through which funds can be recycled. The Eurocurrency market apparently continued to expand very rapidly through the early part of the year. In the last few months, however, its overall growth appears to have leveled out. While partly a reflection of factors unrelated to oil payments, this may also be due in part to the banks encouraging OPEC lenders to go elsewhere. There will, no doubt, continue to be strains on the system, but we see no reason why these strains cannot be dealt with. The system remains sound.

At the same time, it must be recognized that the longer the OPEC surpluses (and, consequently, the oil-importing-country deficits) continue, the more difficult it will become for countries in a weaker financial position to borrow through the private markets.

Both Italy and the United Kingdom are currently experiencing very large current account deficits, deficits which are only partially attributable to the oil-price increase. Recently, the Italians have had some difficulty in finding financing through the private markets which would be adequate to meet their needs, and they have turned to the IMF and to their EEC partners for help. The United Kingdom has undertaken some official and quasi-official borrowing in the international capital market but has not had any difficulty in attracting enough foreign capital to meet its financing requirements.

With these countries as with others, however, the ability to obtain financing from private sources will depend heavily on the private market's assessment of the countries' economic outlook. If the private markets are convinced that the governments of these countries are moving resolutely to reduce inflation and to eliminate deficits other than those attributable to the petroleum price, they should be able to find financing.

There are a number of developing countries whose prospects even before the oil price increase were such that they had little or no recourse to private markets. Some of these countries have been very seriously affected by the oil price increase, and it is going to be necessary for governments to focus urgently on this problem. A ministerial committee will be established through a joint resolution of the IMF and the IBRD at the end of this month. One of its first tasks will be to seek a solution to the problem of these most seriously affected countries.

Outlook for oil-importing countries

The oil price increase has radically transformed the balance of payments prospects of most of the major industrial nations in the world as well as many developing countries. Nations which have been accustomed to trade and service surpluses and net capital exports now find themselves faced with heavy trade and payments deficits and a need to borrow. The size and speed of the required adjustment will cause economic strains and political pressures. There will be a temptation for each country to attempt to improve its position. Thus there is a danger of a resort to "beggar-thy-neighbor" policies. Fortunately, this danger is fully recognized by the governments of these nations. The 24 members of the OECD last May undertook a pledge to refrain from the introduction of new trade measures which would either restrict imports or subsidize exports. The IMF has invited all of its members to undertake a voluntary pledge to refrain from trade measures for balance of payments purposes. These are healthy indications of the widespread recognition of the dangers and of a determination to resist the pressures of mutually damaging policies. The United States will be exerting every effort to prevent the adoption of mutually damaging policies.

Exhibit 50.—Statement by Secretary Simon as Governor for the United States, October 1, 1974, at the joint annual meetings of the Boards of Governors of the International Monetary Fund and the International Bank for Reconstruction and Development and its affiliates, Washington, D.C.

Our recent annual meetings have reflected encouraging changes in the international economic scene. Three years ago, our attention was focused on the new economic policy introduced by the United States to eliminate a longstanding imbalance in the world economy. Two years ago we launched a major reform of the international trade and payments system. Last year we developed the broad outlines of monetary reform.

This year circumstances are different. We face a world economic situation that is the most difficult since the years immediately after World War II.

Our predecessors in those early postwar years responded well to the great challenges of that period. I am confident we can also respond appropriately to the challenges of our day. But first we must identify the issues correctly.

Let me declare myself now on three of these key issues.

First, I *do not* believe the world is in imminent danger of a drift into cumulative recession—though we must be alert and ready to act quickly should the situation change unexpectedly. I *do* believe the world must concentrate its attention and its efforts on the devastating inflation that confronts us.

Second, I *do not* believe the international financial market is about to collapse. I *do* believe that situations can arise in which individual countries may face serious problems in borrowing to cover oil and other needs. For that reason we must all stand prepared to take cooperative action should the need arise.

Third, I firmly believe that undue restrictions on the production of raw materials and commodities in order to bring about temporary increases in their prices threaten the prosperity of all nations and call into question our ability to maintain and strengthen an equitable and effective world trading order.

The inflation problem

With respect to the first of these issues, it is clear that most countries are no longer dealing with the familiar trade-off of the past, balancing a little more or less inflation against a little more or less growth and employment. We are confronted with the threat of inflationary forces so strong and so persistent that they could jeopardize not only the prosperity but even the stability of our societies. A protracted continuation of inflation at present rates would place destructive strains on the framework of our present institutions—financial, social, and political.

Our current inflation developed from a combination of factors: In addition to pressures emanating from cartel pricing practices in oil, we have suffered from misfortune—including bad weather affecting crops around the world; bad timing—in the cyclical convergence of a worldwide boom; and bad policies—reflected in years of excessive government spending and monetary expansion. As financial officials, we cannot be held responsible for the weather, but we must accept responsibility for government policies, and we must recommend policies that take fully into account the circumstances of the world in which we find ourselves.

In today's circumstances, in most countries, there is, in my view, no alternative to policies of balanced fiscal and monetary restraint. We must steer a course of firm, patient, persistent restraint of both public and private demand, and we must maintain this course for an extended period of time, until inflation rates decrease. We must restore the confidence of our citizens in our economic future and our ability to maintain strong and stable currencies.

Some are concerned that a determined international attack on inflation by fiscal and monetary restraint might push the world into a deep recession, even depression.

I recognize this concern, but I do not believe we should let it distort our judgment.

Of course, we must watch for evidence of excessive slack. The day is long past when the fight against inflation can be waged in any country by tolerating recession. We must remain vigilant to the danger of cumulative recession. But if there is some risk in moving too slowly to relax restraints, there is also a risk—and I believe a much greater risk—in moving too rapidly toward expansive policies. If we fail to persevere in our anti-inflation policies now, with the result that inflation becomes more severe, then in time countermeasures will be required that would be so drastic as to risk sharp downturns and disruptions in economic activity.

There is a tendency to lay much of the blame on the international transmission of inflation. Certainly with present high levels of world trade and investment, developments in any economy, be they adverse or favorable, are quickly carried to other economies. But that does not absolve any nation from responsibility to adapt its financial policies so as to limit inflation and to shield its people from the ultimate damage which inflation inflicts on employment, productivity, and social justice in our societies.

Recycling and the strength of capital markets

In addition to inflation, public concern has centered on methods of recycling oil funds and on whether we need new institutions to manage those flows.

So far, our existing complex of financial mechanisms, private and intergovernmental, has proved adequate to the task of recycling the large volumes of oil monies already moving in the system. Initially, the private financial markets played the major role, adapting in imaginative and constructive ways. More recently, government-to-government channels have increasingly been opened, and they will play a more important role as time goes by. New financing organizations have also been established by OPEC countries. Our international institutions—and specifically the IMF and World Bank—have redirected their efforts to provide additional ways of shifting funds from lenders to borrowers. The IMF responded rapidly in setting up its special oil facility.

In our experience over the period since the sharp increase in oil prices, three points stand out:

First, the amount of new investments abroad being accumulated by the oil-exporting countries is very large—we estimate approximately $30 billion thus far in 1974.

Second, the net capital flow into the United States from all foreign sources, as measured by the U.S. current account deficit, has been small, about $2 billion so far this year. During the same period our oil import bill has been about $12 billion larger than it was in the comparable period last year.

Third, markets in the United States are channeling very large sums of money from foreign lenders to foreign borrowers. Our banks have increased their loans to foreigners by approximately $15 billion since the beginning of the year, while incurring liabilities to foreigners of a slightly larger amount. This is one kind of effective recycling. And while some have expressed concern that excessive oil funds would seek to flow to the United States, and would require special recycling efforts to move them out, the picture thus far has been quite different.

No one can predict for sure what inflows of funds to the United States will be in the future. But it is our firm intention to maintain open capital markets, and foreign borrowers will have free access to any funds which come here. The U.S. Government offers no special subsidies or inducements to attract capital here; neither do we place obstacles to outflows.

Nonetheless, some have expressed concern that the banking structure may not be able to cope with strains from the large financial flows expected in the period ahead. A major factor in these doubts has been the highly publicized difficulties of a small number of European banks and one American bank which have raised fears of widespread financial collapse.

The difficulties of these banks developed in an atmosphere of worldwide inflation and of rapid increases in interest rates. In these circumstances, and in these relatively few instances, serious management defects emerged. These difficulties were in no way the result of irresponsible or disruptive investment shifts by oil-exporting countries. Nor were they the result of any failure in recycling or of any general financial crisis in any country.

The lesson to be learned is this: In a time of rapid change in interest rates and in the amounts and directions of money flows, financial institutions must monitor their practices carefully. Regulatory and supervisory authorities too must be particularly vigilant. We must watch carefully to guard against mismanagement and speculative excesses, for example, in the forward exchange markets. And we must make certain that procedures for assuring the liquidity of our financial systems are maintained in good working order. Central banks have taken major steps to assure this result.

Although existing financial arrangements have responded reasonably well to the strains of the present situation, and we believe they will continue to do so, we recognize that this situation could change. We should remain alert to the potential need for new departures. We do not believe in an attitude of laissez-faire, come what may. If there is a clear need for additional international lending mechanisms, the United States will support their establishment.

We believe that various alternatives for providing such supplementary mechanisms should be given careful study. Whatever decision is made will have profound consequences for the future course of the world economy. We must carefully assess what our options are and carefully consider the full consequences of alternative courses of action. The range of possible future problems is a wide one, and many problems can be envisaged that will never come to pass. What is urgently needed now is careful preparation and probing analysis.

We must recognize that no recycling mechanism will insure that every country can borrow unlimited amounts. Of course, countries continue to have the responsibility to follow monetary, fiscal, and other policies such that their requirements for foreign borrowing are limited.

But we know that facilities for loans on commercial or near-commercial terms are not likely to be sufficient for some developing countries whose economic situation requires that they continue to find funds on concessional terms. Traditional donors have continued to make their contributions of such funds, and oil-exporting countries have made some commitments to provide such assistance. Although the remaining financing problem for these countries is small in comparison with many other international flows, it is of immense importance for those countries affected. The new Development Committee which we are now establishing must gave priority attention to the problems confronting these most seriously affected developing countries.

Trade in primary products

For the past 2 years, world trade in primary commodities has been subject to abnormal uncertainties and strains. Poor crops, unusually high industrial demand for raw materials, transport problems, and limited new investment in extractive industries have all contributed to tremendous changes in commodity prices. Unfortunately, new forms of trade restraint have also begun to appear.

In the past, efforts to build a world trading system were concentrated in opening national markets to imports. Clearly, we need now also to address the other side of the equation, that of supply.

The oil embargo, and the sudden and sharp increase in the price of oil, with their disruptive effects throughout the world economy, have, of course, brought these problems to the forefront of our attention.

The world faces a critical decision on access to many primary products. In the United States we have sought in those areas where we are exporters to show the way by maximum efforts to increase production. Market forces today result in the export of many items from wheat to coal which some believe we should keep at home. But we believe an open market in commodities will provide the best route to the investment and increased production needed by all nations.

We believe that cooperative, market-oriented solutions to materials problems will be most equitable and beneficial to all nations. We intend to work for such cooperative solutions.

Prospects for the future

In the face of our current difficulties—inflation, recycling, commodity problems—I remain firmly confident that, with commitment, cooperation, and coordination, reasonable price stability and financial stability can be restored.

The experience of the past year has demonstrated that although our economies have been disturbed by serious troubles, the international trade and payments system has stood the test.

Flexible exchange rates during this period have served us well. Despite enormous overall uncertainties, and sudden change in the prospects for particular economies, exchange markets have escaped crises that beset them in past years. The exchange rate structure has no longer been an easy mark for the speculator, and governments have not been limited to the dismal choice of either financing speculative flows or trying to hold them down by controls.

Another encouraging fact is that the framework of international cooperation has remained strong. Faced with the prospect of severe balance of payments deterioration, deficit countries have on the whole avoided shortsighted efforts to strengthen their current account positions by introducing restrictions and curtailing trade.

In the longer run, we look forward to reinforcing this framework of cooperation through a broad-gaged multilateral negotiation to strengthen the international trading system. In the "Tokyo Round," we hope to reach widespread agreement, both on trade *liberalization* measures—helping all countries to use resources more efficiently through greater opportunities for exchange of goods and services—and on trade *management* measures—helping to solidify practices and procedures to deal with serious trade problems in a spirit of equity and joint endeavor. It is gratifying that more and more governments have recognized the opportunities—and the necessity—for successful, creative negotiations on trade.

We in the U.S. Government recognize our own responsibility to move these negotiations along. Early last year we proposed to our Congress the Trade Reform Act to permit full United States participation in the trade negotiations. It is clear that in the intervening months the need for such negotiations has become all the more urgent. We have therefore been working closely with the Congress on this crucial legislation, and we shall continue to work to insure its enactment before the end of this year.

In the whole field of international economic relations, I believe we are beginning to achieve a common understanding of the nature of the problems we face. There is greater public recognition that there lies ahead a long, hard worldwide struggle to bring inflation under control. Inflation is an international problem in our interdependent world, but the cure begins with the policies of national governments. Success will require, on the part of governments, uncommon determination and persistence. There is today increasing awareness that unreasonable short-term exploitation of a strong bargaining position to raise prices and costs, whether domestically or internationally, inevitably intensifies our problems.

Finally I am encouraged that our several years of intensive work to agree on improvements in the international monetary system have now begun to bear fruit. The discussions of the Committee of Twenty led to agreement on many important changes, some of which are to be introduced in an evolutionary manner and others of which we are beginning to implement at this meeting.

For the immediate future, the IMF's new Interim Committee will bring to the Fund structure a needed involvement of world financial leaders on a regular basis, providing for them an important new forum for consideration of the financing of massive oil bills and the better coordination of national policies. The Interim Committee should also increasingly exercise surveillance over nations' policies affecting international payments, thereby gaining the experience from which additional agreed guidelines for responsible behavior may be derived.

Moreover, discussions in the Interim Committee can speed the consideration of needed amendments to the Fund's Articles of Agreement. These amendments, stemming from the work of the Committee of Twenty, will help to modernize the IMF and better equip it to deal with today's problems. For example, the Articles should be amended so as to remove inhibitions on IMF sales of gold in the private markets, so that the Fund, like other official financial institutions, can mobilize its resources when they are needed. In order to facilitate future quota increases, the package of amendments should also include a provision to modify the present requirement that 25 percent of a quota subscription be in gold. Such an amendment will be a prerequisite for the quota increase now under consideration. And the amendment will be necessary in any event for us to achieve the objectives shared by all the participants in the Committee of Twenty of removing gold from a central role in the system and of assuring that the SDR becomes the basis of valuation for all obligations to and from the IMF.

Preparation of an amendment to embody the results of the current quinquennial review of quotas offers us still another opportunity to reassess the Fund's role in helping to meet the payments problems of member nations in light of today's needs and under present conditions of relative flexibility in exchange rates.

The trade pledge agreed by the Committee of Twenty provides an additional framework for cooperative action in today's troubled economic environment. It will mitigate the potential danger in the present situation of self-defeating, competitive trade actions and bilateralism. The United States has notified its adherence to the pledge, and I urge other nations to join promptly in subscribing.

The new Development Committee, still another outgrowth of the work of the Committee of Twenty, will give us an independent forum that will improve our ability to examine comprehensively the broad spectrum of development issues. We look forward to positive results from this new Committee's critical work on the problems of the countries most seriously affected by the increase in commodity prices and on ways to insure that the private capital markets make a maximum contribution to development.

The World Bank and its affiliates

International cooperation for development is also being strengthened in other ways, notably through the replenishment of IDA. A U.S. contribution of $1.5 billion to the fourth IDA replenishment has been authorized by Congress, and we are working with our congressional leaders to find a way to complete our ratification at the earliest possible date. A significant new group of countries has become financially able to join those extending development assistance on a major scale. We would welcome an increase in their World Bank capital accompanied by a commensurate participation in IDA.

The United States is proud of its role in the development of the World Bank over the past quarter-century. We are confident that the Bank will respond to the challenges of the future as it has so successfully responded in the past.

One of these challenges is to concentrate the Bank's resources to accelerate growth in those developing countries with the greatest need.

A second challenge is to continue the Bank's annual transfer of a portion of its income to IDA. The recent increase in interest rates charged by the Bank is not sufficient to enable the Bank to continue transfers to IDA in needed amounts. We urge that the Bank's Board promptly find a way to increase significantly the average return from new lending.

A third challenge is that the Bank find ways to strengthen its commitment to the principle that project financing makes sense only in a setting of appropriate national economic policies, of effective mobilization and use of domestic resources, and of effective utilization of the private capital and the modern technology that is available internationally on a commercial basis.

I should mention also that we are concerned about the Bank's capital position. We should encourage the Bank to seek ways to assist in the mobilization of funds by techniques which do not require the backing of the Bank's callable capital.

Within the Bank group, we are accustomed to thinking mainly of the IFC in considering private capital financing. While now small, the IFC is, in my view, a key element in the total equation, and should be even more important in the future. But the Bank itself needs to renew its own commitment to stimulation of the private sectors of developing countries.

Finally, let me emphasize that the capable and dedicated leadership and staff of the World Bank have the full confidence and support of the United States as they face the difficult challenges of the current situation.

Conclusion

Ladies and gentlemen, the most prosperous period in the history of mankind was made possible by an international framework which was a response to the vivid memories of the period of a beggar-thy-neighbor world. Faced with staggering problems, the founders of Bretton Woods were inspired to seek cooperative solutions in the framework of a liberal international economic order. Out of that experience evolved an awareness that our economic and political destinies are inextricably linked.

Today, in the face of another set of problems, we must again shape policies which reflect the great stake each nation has in the growth and prosperity of others. Because I believe that interdependence is a reality—one that all must sooner or later come to recognize—I remain confident that we will work out our problems in a cooperative manner.

The course which the United States will follow is clear. Domestically we will manage our economy firmly and responsibly, resigning ourseves neither to the inequities of continued inflation nor to the wastefulness of recession. We will strengthen our productive base, we will develop our own energy resources, we will expand our agricultural output. We will give the American people grounds for confidence in their future.

Internationally, let there be no doubt as to our course. We will work with those who would work with us. We make no pretense that we can, or should, try to solve these problems alone, but neither will we abdicate our responsibility to contribute to their solution. Together, we can solve our problems. Let me reaffirm our desire, and total commitment, to work with all nations to coordinate our policies to assure the lasting prosperity of all of our peoples.

Exhibit 51.—Communique of the Interim Committee of the Board of Governors of the International Monetary Fund on the International Monetary System, October 3, 1974, released at the close of their inaugural meeting in Washington, D.C.

1. The Interim Committee of the Board of Governors on the International Monetary System held its inaugural meeting in Washington on October 3, 1974. The meeting was convened by Mr. Henri Konan Bédié, Chairman of the Board of Governors. Mr. John N. Turner, Minister of Finance of Canada, was selected as Chairman of the Committee for a period of 2 years. Mr. H. Johannes Witteveen, the Managing Director of the International Monetary Fund, participated in the meeting.

2. The members of the Committee had an exchange of views on the current situation and the prospects for the year ahead as it related to the business of the Committee.

3. The Committee reviewed the problem of recycling, and agreed to ask the Executive Directors to consider in this context, as a matter of urgency, the adequacy of existing private and official financing arrangements, and to report on the possible need for additional arrangements, including enlarged financing arrangements through the Fund, and to make proposals for dealing with the problem. The Committee also intends to discuss as a matter of priority the adjustment process, quotas in the Fund, and amendments of its Articles, including amendments on gold and the link, among other subjects.

4. The members of the Committee decided that their next meeting should take place on January 15–16, 1975, in Washington.

5. The terms of reference of the Committee are as follows:

"The Committee shall advise and report to the Board of Governors with respect to the functions of the Board of Governors in:

(i) supervising the management and adaptation of the international monetary system, including the continuing operation of the adjustment process, and in this connection reviewing developments in global liquidity and the transfer of real resources to developing countries;

(ii) considering proposals by the Executive Directors to amend the Articles of Agreement; and

(iii) dealing with sudden disturbances that might threaten the system.

In addition, the Committee shall advise and report to the Board of Governors on any other matters on which the Board of Governors may seek the advice of the Committee.

In performing its duties, the Committee shall take account of the work of other bodies having specialized responsibilities in related fields."

Exhibit 52.—Statement by President Ford, October 28, 1974, on the Foreign Investment Study Act of 1974

It gives me great pleasure to have signed S. 2840, the Foreign Investment Study Act of 1974.

A recent study by the executive branch concluded that the available information on the activities of foreign investors in the United States is inadequate. The bill I sign into law today will go a long way toward remedying that deficiency.

This bill provides for the Departments of Commerce and the Treasury to undertake comprehensive studies of foreign direct and portfolio investment in the United States. Under the authority provided by the bill, they will (1) conduct "benchmark" surveys of all existing foreign direct and portfolio investment in the United States; (2) analyze the effects of foreign investment on the U.S. economy; (3) review our existing reporting requirements that apply to foreign investors; and (4) make recommendations on means for us to keep our information and statistics on foreign investment current. These surveys will be conducted early next year and cover data for 1974; an interim report of the results will be submitted to the Congress 12 months after the date of enactment of this act and a full and complete report, together with appropriate recommendations, within 18 months of the date of enactment.

When this study is completed, we will be in a position to know better how to conduct ongoing monitoring of foreign investment activity in the United States. Earlier, this administration had opposed new reporting systems which would have lacked the benefits of the information which will be generated by the actions under S. 2840. We are not opposed to keeping a watch on foreign investment, but we do want to do it in the most efficient and helpful way, with the aid of the greatest possible amount of data.

As I sign this act, I reaffirm that it is intended to gather information only. It is not in any sense a sign of a change in America's traditional open-door policy toward foreign investment. We continue to believe that the operation of free market forces will direct worldwide investment flows in the most productive way. Therefore, my administration will oppose any new restriction on foreign investment in the United States except where absolutely necessary on national security grounds or to protect an essential national interest.

Exhibit 53.—Statement by Secretary Simon, December 3, 1974, before the Subcommittee on International Finance of the House Committee on Banking and Currency, on gold, the proposed solidarity agreement, and contributions to the Asian Development Bank and the Inter-American Development Bank

I am pleased to have this opportunity to testify before the Subcommittee on International Finance with respect to three subjects: gold, the proposed financial solidarity agreement among major oil-consuming countries, and negotiations concerning participation in the Asian Development Bank and the Inter-American Development Bank.

With respect to gold I shall attempt to respond to the questions which you put to me, Mr. Chairman, in your letter of November 26.

Your first question was whether I believe there should be a delay in the effective date for the required removal of existing regulations restricting private investment in gold in bullion form as contemplated in H.R. 17475 which you introduced. As you know, present law, Public Law 93–373, sets December 31 of this year as the date for repeal of these restrictions. You also know, Mr. Chairman, that I originally opposed the legislative proposals that would mandate the removal of these restrictions on a fixed date. I was fearful that the date might come at a time when the removal might serve to exacerbate disturbed conditions in domestic or international financial markets. For that reason, I have stated on a number of occasions that I would not hesitate to recommend congressional reconsideration of that date if I felt that market conditions or the state of international economic negotiations made such a change desirable.

Now that we have arrived in December 1974, however, I have attempted to review the outlook carefully. There are clearly important economic uncertainties present. Yet, when considering the overall situation, I do not see a basis in current market conditions or in ongoing international negotiations to propose a delay in removing the regulations. On the contrary, I am inclined to think that on balance there will be positive advantages in repealing the regulations to remove an element of uncertainty from our financial affairs and to take a practical step forward toward our objective of ending the official monetary role of gold so that it may ultimately be treated in all respects like any other commodity.

I have discussed these considerations with the President, and with his concurrence I would like to urge the Congress not to take the new restrictive action contemplated by H.R. 17475.

In my view, continuing restrictions on the individual freedom of U.S. citizens require clear-cut and compelling justification which I do not believe now exists in the case of gold.

The prohibitions on gold ownership were introduced in 1933 when President Roosevelt required all privately held gold to be turned in to the Federal Reserve banks. This gold was then acquired by the Federal Government under the Gold Reserve Act of January 1934 in return for the issuance of gold certificates to those banks. Up to that time, gold constituted a significant part of the Nation's money supply, and in periods of financial stress, hoarding and withdrawals of gold from the banks, as well as gold transfers overseas, had important and deflationary effects on the economy of the country. In fact, the measures taken by the Roosevelt administration with respect to gold were aimed at reversing a deflationary situation.

The Gold Reserve Act, and other actions taken in the early 1930's, began a trend toward a reduced monetary role for gold. Nevertheless, gold continued to play some role in our domestic monetary system and also was a major means of settling international accounts. It was in these circumstances that domestic gold ownership and use continued to be confined to industrial, artistic, and numismatic purposes.

Gold remained as partial backing for Federal Reserve notes until 1968 when Congress completely eliminated this requirement. As a result of this action, gold now has no function in our domestic monetary system. The removal of the ban on private gold ownership will not change this. As I will explain, the Federal banking regulatory agencies have adequate power to prevent any tendency for gold to develop a domestic monetary function in the future.

Mr. Chairman, I am not able to predict for you with any confidence exactly how much gold U.S. citizens will purchase next year in the form of bullion. Some have predicted sizable purchases by investors interested in an inflation hedge. That could happen. On the other hand, there are reasons why the total may not be large.

First of all, U.S. citizens can now—and long have been able to—invest in gold legally. They can not only buy gold in the form of jewelry, they can buy gold in coins, and at only a slight premium over its bullion value. Some coins have a rare numismatic value and sell at a high premium over their bullion value, but there are others in ample supply which can be bought at premiums of less than 10 percent above their bullion value. This premium is very close to that which will probably be charged in the future on small size bullion wafers and bars, so that the removal of the existing restrictions will not literally expand greatly the opportunities available to the investor.

Investors will also realize that the storage of gold is burdensome and expensive. that it earns no interest, and that it has no liquidity in the sense of an assured price when it must be sold. For the investor who can afford to take the chance, it is obvious that the price of gold purchased could go up before the need to sell arises; but it could also go down. In looking back recently, for example, over the history of Treasury operations in the silver market, I learned that, throughout the 2-year period after the Treasury made large auction sales of silver from its stocks from 1967 to 1970, the price of silver was below the average price at which the Treasury had sold.

Recent Japanese experience in this respect may also be instructive. Restrictions on investment in gold by private Japanese citizens were removed in 1973. Immediately thereafter there was a surge in private demand, but the interest quickly died down and now constitutes an extremely small factor in the investment activities of the Japanese.

I realize, of course, that some people have sort of a mystical feeling about gold, but that to me is no reason for our Government to adopt a similar approach. Rather, it is a reason to proceed with the dismantling of anachronistic Government measures seeming to confer some special status on this metal.

In my view, international considerations, as well as domestic considerations, make it desirable that we proceed with the scheduled removal of the remaining restrictions. For the past several years my predecessors and I have worked—with the full knowledge and support of the Congress—toward a reform of the international monetary system to make it more flexible and adaptive to changing economic circumstances. As a result, a wide measure of international agreement has been achieved. One important part of that agreement is that the international monetary role of gold should be reduced, that we should move toward the situation internationally in which gold is accorded a legal status no different from that of other commodities. It is consistent with that understanding that our Government no longer purchases or sells gold for monetary purposes. Yet if we were now to decide to prolong the restrictions on gold ownership because of international monetary considerations, we would seriously undermine the credibility of our position—and of our negotiators—in the continuing discussions with the Finance Ministers of the other nations. Conversely, if we proceed with the removal of the restrictions, indicating conviction on the desirability of further reducing the role of gold, we shall be in an improved position to negotiate further steps for improvement of international financial arrangements both among nations and within the International Monetary Fund.

All these considerations make it clear to me that the restriction on individual freedom which would result from continuation of the ban on private gold ownership no longer meets the test of clear-cut and compelling justification. With gold having no monetary function in our domestic economy, and with a reduced and declining role in the international sphere, the original reasons for this restriction on individual freedom seem to me to have disappeared. And I do not see an adequate new justification for the restriction. Domestic financial markets are not now in a state of high tension. Interest rates have eased, and internationally our exchange markets, operating on a lightly managed floating basis, are serving us well in a period of rapid economic change. Old-fashioned exchange rate crises have been avoided, and the governments of the major countries are clearly attempting to approach their common problems in a cooperative spirit. These are not circumstances which justify us in asking our citizens to accept continued restrictions on their freedom.

In your second question you have asked whether Public Law 93–373 precludes Government actions to prohibit questionable or dangerous trading techniques.

Most gold sales will probably take place through banks, brokerage houses, or other financial institutions which function under many forms of Government regulation. Consequently, there will undoubtedly be less of a problem of consumer relations than might otherwise be the case.

In any event, Federal and State regulatory agencies will be able with respect to gold to exercise their proper role in protecting investors. Public Law 93–373 does not allow a Government *prohibition* on purchasing, holding, or otherwise dealing in gold. Congress could not, however, have intended this language to limit the authority to apply to gold *regulations* applicable to all commodities. The regulatory agencies interpret Public Law 93–373 as allowing full authority to regulate dealings in gold under generally applicable regulatory statutes.

Proceeding on the basis of existing statutes, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, the

Federal Trade Commission, the Justice Department, the Postal Inspection Service, and the Securities and Exchange Commission fully intend, and are prepared, to enforce the laws and regulations which they administer and which are applicable to all commodities, including gold.

Banking in particular is a matter of special concern to this committee. The banking regulatory agencies have full authority, under the Financial Institutions Supervisory Act of 1966, to issue cease-and-desist orders to halt any unsafe or unsound banking practice with respect to gold. These agencies are now working on, and will issue, guidelines to their member banks on dealing in gold.

Mr. Chairman, you also wished me to comment on so-called naked options and other trading techniques. I understand a naked option to constitute a trading technique involving a contract, made with a small or no downpayment, to purchase a certain quantity of gold in the future; in other words, a form of call contract.

Simple purchases and sales of gold will in many cases not be subject to SEC regulation, but all trading techniques, including options, when they involve investment contracts, such as those for provision of investment advice and management services, will fall within the authority of the SEC. That agency, in cooperation with a number of other regulatory agencies, is preparing a general statement for guidance of investors.

Futures and transactions involving options, margin and leverage contracts in gold bullion and bulk gold coins on commodities exchanges will be regulated, effective April 21, 1975, by the new Commodity Futures Trading Commission. In the interim, commodities markets will continue under self-regulation. I understand that commodities markets which plan spot and future trading in gold will apply the same rules to gold as they apply to any other commodity. Thus, the rules for commodity market trading in gold will be the same as for any other commodity, and I see no reason to differentiate gold in this respect from other commodities.

Contracts payable alternatively in gold or in an amount of money measured thereby are both against public policy and unenforceable in our courts under the provisions of the Congressional Gold Clause Joint Resolution of 1933. This clause continues to apply after the lifting of restrictions on bullion ownership.

Thus Federal and State regulatory statutes will apply to purchases and sales of gold. Nevertheless, as in the case of investing in any other commodity, investors should "investigate before they buy." This rule should be observed with special care in the first few weeks after December 31 when there may well be temporary shortages of the various types and sizes of gold bullion that investors may wish to purchase.

Your third question, Mr. Chairman, asks what changes, if any, I would recommend in Public Law 93–373.

I would not recommend any changes in this law at this time. I have already pointed out that the administration believes that it has adequate authority to regulate gold as it does any other commodity.

If you believe that it would be useful to make the scope of Public Law 93–373 more explicit, this could appropriately be done at some later time rather than hastily in the few remaining days of this session of Congress. At the same time, the law could be amended to make clear that it allows the same standby authority for the Government to impose a prohibition on gold imports and exports as we have with respect to other commodities.

You also asked whether new legislation should be considered to allow contracts containing a multiple currency clause. This is a subject that is not directly related to private gold ownership. The Supreme Court, in the late 1930's, construed the Gold Clause Joint Resolution, which, as I have noted, continues in effect, to prohibit enforcement of multiple currency contracts in the United States. Today, such financing devices have become common in international financial markets. For example, bonds are issued and denominated in "Eurcos" which provide for payment in a number of European currencies in an amount measured by an index composed of these currencies. I see no reason why American businessmen should not be able to deal in this kind of instrument. Consideration of a change in the law at the next session of Congress would be desirable.

Your fourth question, Mr. Chairman, asked what general condition would cause me, as Secretary of the Treasury, to authorize the sale of Treasury-owned gold to private citizens. As you know, the law has for many years empowered the Secretary to make such sales from the Treasury holdings, which now amount to approximately 276 million ounces.

In deciding on this question an important consideration has been the fact that U.S. consumption of gold for industrial, artistic, and dental purposes is already far in excess of U.S. gold production. This year, even while investment in gold bullion has been prohibited to U.S. citizens, there has been an import demand for gold, on the order of $1 billion worth. While it is not possible to predict with any confidence how much additional demand will come forward in 1975 for investment purposes, it is clear that such additional demand would have to be met from additional imports if there were no sales from Treasury stocks. This additional import demand would tend to lower the value of the U.S. dollar relative to other currencies and would thus tend to increase the dollar prices of the goods we import and of the types of production we export. In other words, there would be a clearly adverse effect on our efforts to bring inflation under control.

To avoid this undesirable effect, it seems appropriate that the Treasury sell some small amounts from its large stocks. With the concurrence of the President, I have therefore asked the General Services Administration to act on behalf of the Treasury to prepare a public auction of 2 million ounces of gold in 400-ounce bars to be held on Monday, January 6. The GSA will issue the formal invitations to bid in about 10 days, using procedures comparable to those employed by the GSA in the past when selling silver on behalf of the Treasury.

Consideration will be given at a later date to the amounts and dates on which any additional further sales of gold would be appropriate after the initial sale. Presumably, however, later sales after the initial surge of interest would be for smaller amounts. Bars of the 400-ounce size are the only type available in the requisite amounts for the initial sale. At a later date it may be possible to arrange for sales of smaller-sized bars.

The amount being offered in the inital sale, the 2 million ounces, is not large in relation to our 276-million-ounce stockpile. The amount being sold could not in any way threaten the availability of gold needed for military and industrial purposes related to our national security. In fact, such uses are so small that they could be covered many times over by our annual domestic gold production without any reliance on our stockpile supplies.

The proceeds of our gold sales—over and above the amounts used to redeem at $42 an ounce the gold certificates now held by the Federal Reserve—will enable the Treasury to reduce its market borrowings, thus leaving more funds available for private investment in industry, housing, and other activities. The reduction in Treasury borrowing will also tend to offset any disintermediation which might take place through investors withdrawing funds from thrift accounts to make gold purchases. In fact, however, I would not expect much of such disintermediation since I believe most savers put their funds in thrift accounts to have assurance both on the value of their principal and on a reasonable interest income. Neither of these assurances will be available to those who invest in gold.

In planning a small gold sale the Treasury does not have any specific price objective in mind, and I feel strongly that our hands should not be tied to any specific formula determining the amounts to be sold. In my view, the Secretary of the Treasury should be expected to exercise responsible judgment, taking into account overall economic conditions and the need to avoid placing undue strains on the international value of the dollar. I hope I can have your support for this policy.

I realize that some have opposed any sale of gold by the Treasury from fear that we would be parting with our national patrimony, from fear that we shall need all the gold we have to support our future international payments position, and from fear that the sale of gold will signify some weakening in our resolve to fight inflation. I believe these fears are unfounded. First, I do not consider that it constitutes parting with national patrimony to transfer a commodity from the U.S. Government to U.S. citizens at a fair market-determined price. Second, we are proposing to sell some gold now exactly in order to prevent a weakening of our payments position, but the amount proposed to be sold is very small in relation to our total holdings. There is certainly no intent to throw a large portion of our gold on the market and to obtain in return only the small recompense such flooding of the market would bring.

Finally, I want to assure you that the sale of gold will not signify any weakening of our resolve to control inflation. In fact, an important reason why I support the sale is that it will make some contribution toward reducing inflation.

But while the gold sale will have some anti-inflationary impact, we must not lose sight of the fact that what is really important are the general governmental fiscal and monetary policies that are adopted here and abroad. We are now beginning to see some results of our past efforts. Inflation rates, both here and abroad, are now beginning to moderate. This is generally true in commodity markets, especially in the case of metals. As only one example, the world price of copper has dropped nearly 60 percent from a peak of $1.52 per pound early this year. This indicates to me that success in controlling inflation is both practical and feasible. If we have the foresight and wisdom to restrain our expenditures at home and to meet our international financial problems through effective cooperation—the kind of cooperation I will speak about next through the proposed financial solidarity agreement—we can and we will control inflation at home and abroad.

Mr. Chairman, I recognize that there are responsible men who have reached a different conclusion than I have about our proper course with respect to gold. And I realize that there are risks today—as there would be at any time—in removing longstanding restrictions. Yet after reflecting on the matter, I must conclude that with respect to gold today there would be greater risks in postponing actions which are clearly in the right direction for the U.S. Government to take.

Proposed Financial Solidarity Agreement

You have suggested that I also comment this morning on the U.S. proposals for a "solidarity fund" among the major industrial countries. Those proposals are described in detail in recent statements by Secretary Kissinger and by me, with which I am sure you are all familiar, and I will simply mention a few of the main points here. I would be happy to answer any questions you may have.

Our proposals for a financial safety net arose out of months of quiet negotiations with our major industrial partners. Our analysis of the forces underlying the energy markets has led us to the conclusion that the present level of oil prices is unjustifiable and that there can be no fundamental solution to the energy crisis without a reduction in the inflated price of oil. For this reason, we have not been attracted to purely financial "recycling" schemes, for these would treat only the symptoms and not the root of the problem itself.

Nevertheless, we see the need to provide financial backstopping until the goal of reduced oil prices can be achieved. We believe that the major consuming countries must join together in a creative response to the oil problem, a response which links cooperative energy policies to cooperative financial policies. In this way, we can provide the mutual insurance essential to protect the health of the world economic system, while at the same time we are increasing our energy independence and so laying the foundation for a fruitful dialog between producers and consumers on the oil price issue.

As you know, we have called for a major new mechanism, established by the major industrial countries in association with the OECD, to provide standby support to any participating country which finds itself in economic trouble after having taken reasonable measures to resolve its difficulties. As we have tried to stress, the facility is not intended to provide free, unlimited, or unconditional aid but to serve as a mutual insurance network for countries which might otherwise be compelled to take restrictive action or to reduce economic activity to lower-than-desirable levels—for their own well-being and the health of an increasingly interdependent world.

Several principles are fundamental to the kind of mechanism we envisage:

First, the financial arrangements would support a concerted energy program, and participation would be linked with a commitment to cooperate in reducing dependence on oil imports.

Second, participants would undertake to pursue responsible adjustment policies and avoid recourse to restrictive trade measures or any other beggar-thy-neighbor policies.

Third, the facility must be large enough to give confidence to the participants that emergency financing will be available. We have recommended a facility with total commitments by all members in the neighborhood of $25 billion in 1975, with provision for additional resources in subsequent years if and when the need arises.

Fourth, the facility is designed to supplement existing private and public channels of financing, not to replace them. This complex of existing mechanisms has worked well so far this year and we see no reason why it will not continue to do so. But we must allow for a situation in which individual countries find themselves in economic difficulty with needed credit either too scarce or too expensive to permit them to maintain open economies at appropriate levels of economic activity.

Fifth, decisions on the provision of financial support should be taken by a weighted vote of participants and should be based on the overall economic position of the borrower, not any single criterion such as oil import bills. Oil deficits have become increasingly indistinguishable from "nonoil deficits," and conventional balance of payments concepts have lost much of their meaning in today's world. Access to the facility should thus be determined on the basis of an informed judgment which considers not only a country's needs but also its resources—including alternative sources of finance—its internal and external economic policies, and the effort it is making to reduce its dependence on imported oil.

Finally, whenever support is provided by the facility, we believe it important that all members share the credit risk on the basis of their participation.

We have had initial discussions of this proposal with representatives of the major countries. While we have not sought commitments, others have indicated a strong interest in the proposals and voted unanimously to set up a working group under the Deputies of the Group of Ten. This working group will meet intensively, beginning later this week, to examine the U.S. proposal and a similar one by the Secretary-General of the OECD, with a view to reporting by mid-January.

We have considered that the Exchange Stabilization Fund would provide the best vehicle for U.S. participation in the new facility. We will be discussing this with the Congress intensively over the next few weeks and will seek congressional authorization for any U.S. participation.

Contributions to Multilateral Development Banks

Now, Mr. Chairman, in response to your request I would like to review briefly pending legislation and negotiations on future participation in multilateral lending institutions.

First, I would like to emphasize the administration's complete support for H.R. 11666, the Asian Development Bank bill, which was favorably reported by this committee and is now ready for floor action. It has the support of the U.S. business community here and abroad. The Senate passed identical legislation by unanimous consent last August.

This bill authorizes a $362 million subscription, the first since 1965, to the Bank's hard-loan facility. This subscription will restore U.S. voting power to 17 percent, on a parity with Japan, from the 7.5 percent to which it has fallen as a result of other countries going ahead with their planned subscriptions last year.

I must note that this subscription will be paid in three annual installments and over 80 percent, or $290 million, of these hard-loan funds are in the nature of a guarantee involving no budget outlay, and almost all of the remaining $72 million are in the form of non-interest-bearing letters of credit that will not be fully drawn down for many years.

A second part of the bill authorizes the final $50 million of a planned $150 million U.S. contribution to the concessional lending facilities of the Bank, of which $100 million was authorized in March 1972. The U.S. share of the total replenishment has been held down to under 20 percent of the total contributions by all donors, and no appropriations will be required until fiscal year 1976, with outlays stretched out over an additional period of time.

The burden-sharing and fiscal features of both parts of this bill are highly beneficial and fiscally responsible. I strongly hope this Congress will complete action on H.R. 11666 before final adjournment.

Second, I am happy to inform this committee that, after extended discussions, the Inter-American Development Bank and a group of 13 developed countries in Europe, plus Japan, have arrived at a basis for membership in the Inter-American Bank by those countries. This committee has long urged such membership, and, as I indicated in my recent letter to you, we expect their participation to be helpful in burden-sharing terms, without prejudicing the favorable position in the Bank that the United States now enjoys and will continue to enjoy.

The 13 countries involved will provide the Bank with $755 million of new resources. Their share of the Bank's voting power will be less than 8 percent, with a rule prohibiting a share in excess of this amount. These same rules will also prohibit our share from falling below 34.5 percent of the total voting power.

The prospective nonregional member countries expect to declare their intention to join the Bank on December 17 at a meeting in Madrid, after which they will go to their parliaments. Because a new class of stock is being created and extensive changes in the Bank's charter are necessary, we on our part require legislation as well. I want to point out that such legislation involves no money from us, but simply our agreement to the largely technical charter changes that are needed. I am transmitting to the committee for its examination documentation on the various aspects of the nonregional membership proposal. Treasury officials will be happy to work closely with you on it, in anticipation of the submission of draft legislation next year.

I should add that, quite apart from the nonregional membership question, there is an urgent need for us to reach agreement with the present members of the Bank on a new replenishment of resources. We have not discussed this issue yet with the other members, and before doing so we will consult with this committee and the other relevant committees of the Congress, as we promised to do on such matters and have been doing. I think it is important that consideration of a replenishment move forward on a timetable that would permit legislation on it and on nonregional membership to be considered as a package this coming spring.

Exhibit 54.—Press release, December 9, 1974, statement of the U.S. Treasury on consolidation of gold accounts administered by the Treasury

At the opening of business today there were three different gold accounts administered by the Treasury.

The general account of the Treasury held 271,430,657 ounces of gold, valued at $11,460 million at the par value of the dollar in terms of gold, against which gold certificates had been issued to Federal Reserve banks in exchange for dollar deposits for the account of the Treasury at those banks. The gold certificates represent a pledge by the Treasury of a corresponding amount of gold until such time as the certificates are repurchased for dollars by the Treasury.

The general account also held 2,518,006 ounces of gold, valued at $106 million at the par value, against which no gold certificates had been issued.

The Exchange Stabilization Fund, administered by the Treasury, held 2,019,751 ounces of gold, valued at $85 million, which had been acquired by the Fund prior to August 15, 1971, when the Fund engaged from time to time in gold transactions with foreign monetary authorities and with the market for the purpose of stabilizing the value of the dollar relative to gold.

In view of the likelihood that the Exchange Stabilization Fund will not be engaging in further transactions to stabilize the value of the dollar relative to gold, the gold held by the Fund was sold today to the Treasury at its par value.

Gold certificates were then issued by the Treasury to the Federal Reserve banks for all the ounces of gold held in the general account for which such certificates had not previously been issued, and the banks deposited $191 million to the accounts of the Treasury. The Treasury now holds gold in only one account, that is 275,968,414 ounces, valued at $11,652 million, against all of which gold certificates have been issued.

The transactions undertaken have had no direct effect on any individuals or institutions apart from the Treasury, the Exchange Stabilization Fund, and the Federal Reserve banks. The additional deposit balances of the Treasury in the Federal Reserve banks will be available for the use of the Treasury,

In the future, when sales of gold are to be made by the Treasury, the corresponding gold certificates will be redeemed by the Treasury prior to transfer of the gold to its purchasers.

Exhibit 55.—Communique of the Interim Committee of the Board of Governors of the International Monetary Fund on the International Monetary System, January 16, 1975, released at the close of their second meeting in Washington, D.C.

1. The Interim Committee of the International Monetary Fund held its second meeting, in Washington, D.C., on January 15 and 16, 1975. Mr. John N. Turner,

Minister of Finance of Canada, was in the chair. Mr. H. Johannes Witteveen, Managing Director of the International Monetary Fund, participated in the meeting. The following observers attended during the Committee's discussions of the matters referred to in paragraphs 2, 3, and 4 below: Mr. Henri Konan Bedié, Chairman, Bank-Fund Development Committee; Mr. Gamani Corea, Secretary General, UNCTAD; Mr. Wilhelm Haverkamp, Vice Precident, EC Commission; Mr. Mahjoob A. Hassanain, Chief, Economics Department, OPEC; Mr. René Larre, General Manager, BIS; Mr. Emile van Lennep, Secretary General, OECD; Mr. Olivier Long, Director General, GATT; Mr. Robert S. McNamara, President, IBRD.

2. The Committee discussed the world economic outlook and against this background the international adjustment process. Great concern was expressed about the depth and duration of the present recessionary conditions. It was urged that antirecessionary policies should be pursued while continuing to combat inflation, particularly by countries in a relatively strong balance of payments position. It was observed that very large disequilibria persist not only between major oil-exporting countries as a group and all other countries, but also among countries in the latter group, particularly between industrial and primary producing countries. Anxiety was also voiced that adequate financing might not become available to cover the very large aggregate current account deficits, of the order of US $30 billion, in prospect for the developing countries other than major oil exporters in 1975.

3. The Committee agreed that the Oil Facility should be continued for 1975 on an enlarged basis. They urged the Managing Director to undertake, as soon as possible, discussions with major oil-exporting members of the Fund, and with other members in strong reserve and payments positions on loans by them for the purpose of financing the Facility. The Committee agreed on a figure of SDR 5 billion as the total of loans to be sought for this purpose. It was also agreed that any unused portion of the loans negotiated in 1974 should be available in 1975. The Committee agreed that, in view of the uncertainties inherent in present world economic conditions, it was necessary to keep the operation of the Oil Facility under constant review so as to be able to take whatever further action might be necessary in the best interests of the international community. It was also understood that during the coming months it would be useful to review the policies, practices, and resources of the Fund since it would be appropriate to make increased use of the Fund's ordinary holdings of currency to meet the needs of members that were encountering difficulties.

4. The Committee emphasized the need for decisive action to help the most seriously affected developing countries. In connection with the Oil Facility, the Committee fully endorsed the recommendation of the Managing Director that a special account should be established with appropriate contributions by oil exporting and industrial countries, and possibly by other members capable of contributing, and that the Fund should administer this account in order to reduce for the most seriously affected members the burden of interest payable by them under the Oil Facility.

5. The Committee considered questions relating to the sixth general review of the quotas of members, which is now under way, and agreed, subject to satisfactory amendment of the Articles, that the total of present quotas should be increased by 32.5 percent and rounded up to SDR 39 billion. It was understood that the period for the next general review of quotas would be reduced from 5 years to 3 years. The Committee also agreed that the quotas of the major oil exporters should be substantially increased by doubling their share as a group in the enlarged Fund, and that the collective share of all other developing countries should not be allowed to fall below its present level. There was a consensus that because an important purpose of increases in quotas was strengthening the Fund's liquidity, arrangements should be made under which all the Fund's holdings of currency would be usable in accordance with its policies. The Committee invited the executive directors to examine quotas on the basis of the foregoing understandings, and to make specific recommendations as promptly as possible on increases in the quotas of individual member countries.

6. I. The Committee considered the question of amendment of the Articles of Agreement of the Fund. It was agreed that the executive directors should be

asked to continue their work on this subject and, as soon as possible, submit for consideration by the Committee draft amendments on the following subjects:

(*a*) The transformation of the Interim Committee into a permanent Council at an appropriate time, in which each member would be able to cast the votes of the countries in his constituency separately. The Council would have decision-making authority under powers delegated to it by the board of governors.

(*b*) Improvements in the general account, which would include (i) elimination of the obligation of member countries to use gold to make such payments to the Fund as quota subscriptions and repurchases and the determination of the media of payment, which the executive directors would study, and (ii) arrangements to insure that the Fund's holdings of all currencies would be usable in its operations under satisfactory safeguards for all members.

(*c*) Improvements in the characteristics of the SDR designed to promote the objective of making it the principal reserve asset of the international monetary system.

(*d*) Provision for stable but adjustable par values and the floating of currencies in particular situations, subject to appropriate rules and surveillance of the Fund, in accordance with the Outline of Reform.

II. The Committee also discussed a possible amendment that would establish a link betwen allocations of SDR's and development finance, but there continues to be a diversity of views on this matter. It was agreed to keep the matter under active study, but at the same time to consider other ways for increasing the transfer of real resources to developing countries.

7. The Committee also agreed that the executive directors should be asked to consider possible improvements in the Fund's facilities on the compensatory financing of export fluctuations and the stabilization of prices of primary products and to study the possibility of an amendment of the Articles of Agreement that would permit the Fund to provide assistance directly to international buffer stocks of primary products.

8. There was an intensive discussion of future arrangements for gold. The Committee reaffirmed that steps should be taken as soon as possible to give the special drawing right the central place in the international monetary system. It was generally agreed that the official price for gold should be abolished and obligatory payments of gold by member countries to the Fund should be eliminated. Much progress was made in moving toward a complete set of agreed amendments on gold, including the abolition of the official price and freedom for national monetary authorities to enter into gold transactions under certain specific arrangements, outside the Articles of the Fund, entered into between national monetary authorities in order to insure that the role of gold in the international monetary system would be gradually reduced. It is expected that after further study by the executive directors, in which the interests of all member countries would be taken into account, full agreement can be reached in the near future so that it would be possible to combine these amendments with the package of amendments as described in paragraphs 6 and 7 above.

9. The Committee agreed to meet again in the early part of June 1975 in Paris, France.

Exhibit 56.—Remarks by Under Secretary for Monetary Affairs Bennett, February 19, 1975, before the Sixteenth World Affairs Forum, sponsored by the World Affairs Council of Pittsburgh, Pa., entitled "Let's Get on With the Job, and Damn the Statistics"

Mr. Harper, ladies and gentlemen, I appreciate your kind welcome for me despite your undoubted disappointment in having to accept an unexciting substitute for Washington's most famous freedom-fighter. Unfortunately, Secretary Simon must testify today before a congressional committee. He asked me to express his sincere regrets. And, I would judge those regrets really are sincere. He derives real pleasure from getting away from Washington and talking to those in other parts of the country with a strong interest in the Government's policies. Moreover, probably no one has had, over the past 2 years, more personal experience than he with the duplicative process that the congressional hearings have so often become.

But I am glad to be here, and to have a chance to revisit this area, for I spent some wonderful years of my boyhood in the West Virginia hills south of here. Those were the worst years of the Great Depression; yet, what I remember are not the depression experiences but the wonders of wandering in those hills.

I do have some difficulty coming to the microphone after your expert speakers this morning. I feel particular trepidation in following my old colleague, Herb Stein. He is the only man I know whose sense of humor improved the longer he stayed in Washington. Herb was the author of a famous comment about a friend of ours whose difficult duty in Government was to announce and comment publicly each week, for a long time, on a series of disheartening economic statistics. Herb said our friend "had never met a statistic he didn't like."

This afternoon I'd like to give you a number of examples why I'd prefer to be known as a man closer to the opposite extreme, "a man who never met a statistic he did like."

Right today, for example, there appears to be a great national debate underway on whether the President's energy proposals will increase the Cost of Living Index by more than 2 percent. Here is a clear case in which attention to a statistic has totally replaced consideration of the underlying reality. The import fees, the excise taxes, and the removal of price controls which the President has proposed will increase the prices of petroleum products. And these increases will increase the published Cost of Living Index by some amount. The Treasury analysts say 2 percent, some others say more, others less. But that increase is only a small part of the story. All of the increased payments—and more—will be returned to the consumers through tax reductions and other means. As a result, the average citizen will have the wherewithal to buy the same amount of petroleum products as before, if he chooses to, without reducing his other purchases. But that reflow of funds to the consumer is not taken into account in the Cost of Living Index. That is why the whole debate seems so ridiculous.

Some are even arguing that we must adopt rationing to avoid the threatened increase in the Consumer Price Index. I am sure they are doing so without taking into account the probability that if the index could then be calculated correctly, the same restraint on consumption would be achieved by an even larger increase in the price index. Under rationing, absolute prices probably would not rise as much initially, but the quality of the total package of goods and services to be delivered to the consumer would probably be reduced by an even greater percentage. Since the price index should ideally take into account not only changes in price but also changes in quality, the percentage increase would be larger under rationing if account could be taken of the inconveniences, the reduction in associated services, and the possible tie-in purchases which would be inflicted on the consumer by a rationing system—quite apart from the extra taxes he would have to pay to cover the administrative apparatus and the lawsuits.

The efficiency of the President's proposals results from the fact that they rely on the decision each individual can make for himself as to which products to cut back his consumption of—and to what extent—in the light of the changed relative price of petroleum products and other products. In a real and historic sense, this has been the "American way." I hope it remains that way.

Higher prices can lead to more domestic production of energy. Rationing—to speak mildly—does not encourage production.

Of course, on average it is expected that consumers will choose to cut back their consumption of oil. By the fourth quarter of this year, it is estimated that the President's program would cut back imports by 1 million barrels a day below what they would otherwise have grown to. But the absolute year-to-year decline in consumption wouldn't be very much. Average U.S. consumption in 1975 would be only about 3 percent, around 500,000 barrels day, below the rate of consumption in 1974.

That consumption cutback would add a bit to the transitional difficulties our economy—particularly in Detroit—is having in adjusting to the world of higher cost energy. Yet the difficulties would be small compared to the difficulties which would be brought about by those who would not trust the consumers to choose for themselves how to cut their consumption but would force them intsead to take the cut all in gasoline use. It has been roughly estimated that an excise tax of 50 cents a gallon would be necessary if all the cutback were to be sought in that way, while manufacturers and consumers were given no incentive to mind their thermostats more carefully.

In any event, the slight economy-depressing effects of the energy conservation program can be—and have been—taken into account in considering the appropriate size of the stimulative tax reductions to go into effect—we hope—well before midyear. And the slight depressing effects of the energy program must be set beside the serious effects which could follow one day from another embargo if we have not restrained our consumption—and beside the continuing serious effects which there will be if we do so little that the Europeans and Japanese see no point in joining with us in cooperative programs to confront the various dangers created by the sudden fourfold increase in oil prices.

Sometimes I hear it said that we must "show" those OPEC oil producers. I can understand that sentiment, but so far, I'm afraid, some of the things we are "showing" them are not very helpful. We seem to be showing them that it is a national trauma for us to face the possibility of paying more than 60 cents a gallon for gasoline when Europeans are already paying $1.20 to $1.80 a gallon. We showed them in 1974 that we could cut back our oil consumption by 3 percent, while Germany relied on the price mechanism and cut 9 percent, while Belgium, the Netherlands, and Denmark cut 11 percent, and while Switzerland cut 13 percent.

Despite our relatively poor performance, the other major nations are cooperating with us today in the important energy-related areas. We have an agreement to share with each other in the event of a future oil embargo. We have an agreement, in principle, on a financial solidarity arrangement about which I'll say more in a moment. And we are hard at work now on arrangements to insure that there are adequate incentives to insure appropriate investments—by both producers and users of energy—to reduce our reliance on imported oil despite the possibility, which any prudent investor would take into account, that in coming years there may be some drastic declines in the import cost of oil. After all, marginal producing costs in the Persian Gulf are probably even now well under $1 a barrel.

In approaching this question of investment incentives, we have to take into account that, to some extent, we shall be able to provide for security of our energy supply in the future with emergency stockpiles and standby producing facilities. We recognize the need to pursue, simultaneously, our objective of avoiding undue dependence on insecure foreign sources of energy and our objective of reducing the real import cost of that oil which we—and other nations—do import. After considering those objectives, we conclude that some Government incentives to investment for reducing dependence on imports are necessary even though we know that those incentives, while tending to lower the import cost of oil, will tend to raise the immediate price to the consumer. In all probability, the most appropriate form of incentive will be some form of import fee or tariff. There are, of course, many kinds of tariffs. They vary from the tariff which grows rapidly smaller as the import price declines, to the ad valorem tariff, to the flat tariff, to the other extreme of the tariff which grows so rapidly as the import price declines as to create an effective price floor.

National—and international—discussion of these various techniques has not yet led to a consensus. It is a complex matter to balance, on the one hand, the desirability of retaining incentive for foreign producers to cut their price and of avoiding a riskless featherbed for our businessmen against, on the other hand, the necessity of avoiding undue dependence on foreign oil. The basic objective is, however, already largely agreed internationally. And a national objective is clear to us in Washington: we must not place our manufacturers and other producers at a competitive disadvantage. We remember the situation a few years ago when our petrochemical manufacturers were pushed toward the wall when they were faced with an effective oil-import ticket cost of $1.00 to $1.50 per barrel while their competitors were free to operate on cheap foreign oil.

Today, however, when I hear from my former colleagues in the U.S. oil business, I find they worry less about the impact on their new investments of a possible sharp decline in foreign oil prices than about the danger of continuation long into the future of domestic price controls, allocation schemes, and discriminatory "windfall" taxes.

While I am convinced that a decline in the import cost of oil is coming, I can understand why it is hard for others to focus on that possibility just after we have suffered an increase in our annual oil-import bill from about $8 billion to about $26 billion in just 1 year. But that brings me back to my theme for today—the danger of looking at a few statistics rather than at the real world. Just last

Friday, for example, the Department of Commerce published the first estimate of the U.S. balance of payments for the full year and for the fourth quarter of 1974. And on Saturday most newspapers stressed the fact that the official reserves transactions deficit increased from about $400 million in the third quarter to about $4 billion in the fourth quarter. The impression was given by most accounts that the international payments position of the United States had somehow significantly deteriorated. Yet, for those who looked behind that traditional statistic of the official deficit, it became clear that the U.S. trade deficit actually declined by a billion dollars from the third to the fourth quarter. In both quarters the bulk of the foreign official dollar purchases reflected in the reported overall deficit represented willing investments in U.S. Treasury obligations by foreign governments, including those in the major oil-producing states, rather than unwilling purchases by foreign monetary authorities trying to preserve particular exchange rate relationships.

I am not criticizing the Department of Commerce. Their full release explained the inadequacy of the traditional payments balances in today's circumstances. And they are working to revise the presentation with the help of an advisory committee which includes Pittsburgh's famous economist, Marina Whitman. But the reports from that advisory committee's meetings have been dismaying to me. Apparently, the business and trade association representatives have come asking, not for clearer presentation of the different facets of our payments position, but rather for some new single statistic which will purport to tell them all in one number.

Meanwhile, in Washington, another interagency committee is reviewing all aspects of our policies toward foreign investment in the United States. The outcome could be recommendations for limited changes here and there in our complex of laws and regulations affecting such investment. At the same time, I am confident that our basic policies will remain—with protection for security sensitive activities but with a continuing warm welcome for investment from abroad in most circumstances. In fact, I am hopeful the outcome will be an improvement in our appeal to investors by ending any uncertainty which may now exist, even if there are some changes recommended for specific types of investment.

Through much of last year, fears were being widely expressed that the foreign investments being accumulated by the OPEC oil producers would be heavily concentrated in the United States to the extent of threatening financial crises in other parts of the world. In fact, the OPEC-country funds were invested here directly in, roughly, the same proportion that the United States shared in their oil-export sales. Last year, the oil exporters appear to have accumulated about $60 billion in new investments abroad after spending an estimated $40 billion, 40 percent of their gross income, on rapidly increasing imports of goods and services. Of that $60 billion, the preliminary reports which the Treasury has received from our banks and other financial institutions suggest that only about $11 billion were invested directly in the United States. In time, we may find there have been some gaps in the reporting network, and there were probably some investments in the United States made indirectly through companies in other countries, but the overall picture is unlikely to change. The oil producers have been following responsible, conservative investment policies. They have been diversifying their investments widely around the world, and they have not been shuffling their funds around from market to market in a volatile fashion.

In 1974 the oil producers' investments were heavily concentrated in short-term Government obligations and bank deposits. We estimate that out of the approximately $11 billion in total invested directly in the United States, less than $1 billion went into real estate and corporate shares; and most of that latter invesment was on a widely dispersed portfolio basis. In recent months, these investors have begun to lengthen the term of the debt obligations they are willing to buy, and they are showing more interest in equity investments but rarely on a basis which would provide a significant element of management participation, for these countries have only limited managerial resources which they can spare these days from the great challenge of economic development within their own countries.

Many of them also realize that their investment funds, while still large, are probably already past their peak rate of accumulation. As a result of the rapid expansion of their imports and the gradual impact of the conservation efforts in the major consuming countries, the increase in the oil producers' investments abroad will probably be less this year than last. My own forecast is that the producing countries will have become net disinvestors before the end of this decade before their new investments have reached a total of $250 billion, perhaps before they reach $200 billion.

Yet these amounts are large. Their ownership is not widely dispersed. Conceivably they could be unduly concentrated in investment in just a few places, or even be manipulated for political purposes. For these reasons it has been recognized that powerful mechanisms of international financial cooperation should be available if needed. The main line of defense is the ready resources and procedures of the IMF, the International Monetary Fund. They are available in substantial volume for this year, and it has already been agreed that they will be increased by about a third for use next year and thereafter for assistance of any of the IMF's 126 members who may deserve external short-term assistance. In addition, the possibility of special supplementary help of a lower interest rate and possibly also longer term nature is being considered for a number of the poorest countries most severely affected by the drastic changes in the prices of oil and other commodities over the last several years.

At the same time the major industrial countries have agreed, separately from the IMF and within the broader framework of their cooperation on energy-related matters, to seek legislative approval of a financial solidarity arrangement which will at the outset provide national commitments totaling $25 billion to be used in extreme circumstances as a second line of defense, after the IMF, for the major nations upon whose financial operations the whole structure of international cooperation depends. This will be a standby arrangement, a form of mutual insurance policy. It may well never be used. But as in the case of other insurance policies which we hope will never be used, it is important that the coverage be there in case of need.

The U.S. administration proposed the safety net and has strongly supported it even though we recognize that the flexible private international banking system and flexible new direct international investing and borrowing arrangements of individual governments have been handling quite well the bulk of the expanded flow of international capital during the past year. We have supported the new intergovernmental arrangements even though we have observed that the prevailing system of unpegged international exchange rates has served us well in a trying period of rapid economic change, a period also of widely differing rates of inflation for the different currencies of the world.

Nevertheless, we have not been happy that formally the basic rules of the international monetary system, as embodied in the Articles of Agreement of the IMF, have not been brought into line with current reality. In fact today the U.S. Government and all other members of the IMF are, strictly speaking, in default of their solemn international obligations because they wisely are permitting their currencies to float in value vis-a-vis other currencies. This is a situation which hardly contributes to respect for international obligations. For this reason, we feel strongly that the finance officials of the world should get on promptly with the job of preparing a broad set of IMF amendments for legislative consideration.

Fortunately we seem in sight of consensus, not only on new rules to promote exchange market cooperation in lieu of the old rules for exchange rate pegging, but also on new provisions which complete the process of taking gold from the center of the international monetary system by abolishing the official price of gold and by abolishing all obligations to pay gold or accept it in payment.

Meanwhile, here in the United States we have been pleased to note that U.S. citizens reacted responsibly last month to their restored freedom to invest in gold bullion. We were pleased that there was no evidence of the mob psychology which some had expected to develop.

Last year U.S. citizens imported net about 7 million ounces of gold. Of that amount, about 4 million ounces were for industrial use, considerably less than the previous year—presumably because of the higher prices. This year, if the price of gold continues high, we would expect a further decline. The remaining 3 million ounces last year were in coin form. So far this year there has been a sharp drop in imports of this type. No one can be sure this year how much imports will be added for the newly permitted use in investment in bullion form. Experience so far could indicate that gold imports of all types this year will be less than last year. There was a surge in imports at the beginning of the year, but the flow has fallen rapidly since mid-January. The total so far appears to have been less than a million ounces, and in the most recent reporting week, through February 7, there appear to have been literally no gold imports at all.

Under the circumstances, no decisions have been made by the Treasury on the amounts or timing of future sales from our stockpile. An important factor we shall wish to watch is whether any resumption of imports threatens a new balance of payments outflow.

In recent weeks there have been many references in the press to a decline in the value of the dollar in the foreign exchange markets. And the dollar has declined over the past 6 months relative to the European currencies, most particularly relative to the Swiss franc. To me, however, those references to a dollar decline seem rather overblown in the light of the broader context. On a trade-weighted basis versus all the other currencies of the major industrial nations, the dollar is almost exactly where it was 1 year ago and much stronger than 1½ years ago. Relative to the currencies of our two main trading partners, Canada and Japan, the exchange value of the U.S. dollar has increased significantly over the past year. And the dollar's outlook for the future is strengthened by the fact that our inflation record—miserable though it is—is better than that of most other industrial countries apart from Germany.

From my talks with bankers and investors it is clear to me that the decline in the value of the dollar over the last 6 months relative to some of the European currencies has primarily resulted from the decline in U.S. interest rates—not just the size of the decline but also the fact that our rates have generally been leading the movement down. For the foreigner trying to decide where to place his next investment, the big question has now become whether the dollar has fallen to an extent that the interest earnings on an investment here are now likely to be supplemented over the coming months by added return in the form of appreciation of the dollar versus alternative investment currencies.

The answer to that question heavily depends, of course, on our ability to remember over the next few months as we fight recession that it was inflation which was primarily responsible for bringing us to the unhappy situation we are now in. That is a lesson we must remember in both our fiscal and monetary policies, but let me assure you that as a Treasury official I shall not comment on the substance of monetary policy. In this respect we live in Washington by an asymmetrical rule. The Governors of the Federal Reserve are expected to comment publicly on the fiscal and other policies of the executive branch, which was only established by the Constitution. But the Federal Reserve was provided its "independence" by the Congress, and it would not be appropriate for an official from the executive branch to become involved in a substantive public discussion of the Fed's "independent" monetary policies. However, in continuation of my vendetta today against overreliance on statistics, I do not wish to miss the chance to say how misguided seems to me the current drive by some in Congress to attempt to cure the recession by legislating an increase in the so-called M–1 statistic of the monetary stock in the Nation.

That drive seems misguided to me for several reasons. First, it should be obvious to everyone that our financial leaders are in agreement that what this country needs is more inflation, more inflation in the sense that no one in authority is advocating policies to eliminate inflation this week, this month, this quarter, or even this year. There is agreement that it is desirable to avoid the disruptions which would result from an attempted "cold turkey" cure. And second, I find it unsophisticated to think that the pace of our economy and of our inflation is only influenced by the figurative greenbacks we print and not at all by the number of liquid interest-bearing Treasury IOU's we print up and put in circulation.

You will recognize that I have a parochial interest here. And I confess that I am much preoccupied right now with trying to raise $28 billion in net new money for the Treasury in just this current half-year period—the time of year when traditionally the Treasury's needs have been about zero. If I were more foresighted, I might be even more worried about what's coming later in the year, for the Government alone is scheduled to borrow more in the securities market this calendar year than all borrowers put together, both public and private, borrowed in the securities market last year or in any previous year. In the fiscal year 1976 starting in June, the Treasury is scheduled to raise between $60 and $70 billion in net new money. And that's assuming the Congress doesn't add even more stimulus to the program of stimulus proposed by the President.

Some don't share my concern about this massive borrowing program. They point out, rightly, that recession tends to reduce business demands for credit when Government is trying to borrow more. They point that the Federal debt held by the public at the end of the next fiscal year will be a smaller proportion of GNP than it was in any postwar year prior to 1973. As an economist I can understand those arguments; as a bond-salesman I'm still worried. That GNP statistic is used for many purposes, but I doubt that it is very relevant here. What is relevant is that conditions in the debt market in this recession are not typical. Business has not withdrawn from the market. Many firms are attempting to rebuild their liquidity positions. They fear another inflationary surge may be just around the corner, and they don't want to be caught again. Corporate bond issues this quarter are therefore at a record level, even though the total of business borrowing from banks and the commercial paper market is down.

It is a worrisome situation. Fortunately, the Treasury has the counsel of some outstanding advisers on the functioning of the securities market. Among them, I'm glad to say, is Ed Yeo from here in Pittsburgh. With their help I think we'll get by without a credit crunch—if the Congress doesn't override too many vetoes. Still, an awful lot of bonds are going to have to be sold. And, Mr. Chairman, I have my order book right here with me if anybody's ready to sign up right now.

Exhibit 57.—Statement by Assistant Secretary Cooper, February 20, 1975, before the Subcommittee on Multinational Corporations of the Senate Foreign Relations Committee, regarding the financial solidarity fund

Mr. Chairman, you asked that I appear before you to discuss the financial solidarity fund, first proposed by Secretary Kissinger and Secretary Simon last November, and I am pleased to respond to your request. I am sure you are all familiar with most of the general features of the fund. I would like to focus my remarks briefly on three main areas: a definition of U.S. interests in establishment of the fund; a description of what I consider to be the essential characteristics of the fund; and legislative and budgetary aspects of U.S. participation in the fund.

U.S. interests in the solidarity fund

The President's decision to put forward proposals for establishment of a financial solidarity fund reflected the strong conviction that the world's major oil-importing countries must join together in a creative and coordinated response to their common energy and economic problems. Cooperation in finance is an essential complement to the substantial progress already made in the recently created International Energy Agency, toward arrangements for oil stockpiling and emergency oil sharing and toward joint action programs in the areas of energy conservation and production. These IEA programs will provide protection against the threat of a new embargo and, for the longer term, lay the basis for reducing dependence on imported oil. But programs in the energy area alone cannot deal with the broad range of economic and financial problems that confront the world as an immediate consequence of the oil price increases. Cooperation among the major oil-importing countries is also needed in domestic economic policies, in trade policies, and in balance of payments policies. The proposed solidarity fund, with properly designed aims, terms, and policy conditions, will provide the financial cement for effective consumer cooperation across the full scope of economic policy issues.

The U.S. interest in preservation of a cooperative and smoothly operating world economy is unmistakable. That interest, reflected in the extensive framework of international cooperative arrangements developed in the postwar period, has been underscored with a vengeance by the events of the past 2 years or so. If there were ever any doubt that the United States is not immune to economic developments and decisions taken elsewhere, the oil embargo and the parallel swings in economic activity and inflation throughout the industrial world should testify to the fact that we are an integral part of an interdependent world economy. We may be better able than many to weather external economic influences because of the size of our own economy, our tremendous domestic productive potential, or our relatively high income level. But we ignore external developments only at a price—and that price is in terms of the economic prosperity of the American people.

I suspect that most members of this committee would agree that U.S. interests in the energy area are well served by cooperative energy policies by the major oil-consuming countries. It is equally true that our economic well-being depends on avoiding a destructive and ultimately self-defeating round of restrictions on trade and other protective actions. Yet we could face that prospect if oil-importing countries are driven to such policies in an attempt to sustain their external positions by the absence of adequate financing.

The transitional nature of the potential financing problem means that with a restoration of the energy balance this particular source of danger will disappear. The real problems will not—for the impact on our standards of living will be measured by real transfers of goods and services we will have to make and the real costs involved in creating and using more expensive energy; and our vulnerability to supply interruptions is a problem we must address in other ways.

The financial problem, then, is to assure that in the interim, OECD countries have the assurance that necessary financing will be available to avoid recourse to inappropriate and disruptive economic policies. No single arrangement can ensure this result, for it depends in the final analysis not only on countries' ability to cooperate but also on their willingness to do so. But I believe that the basic willingness is there, and that the facility can provide participants with confidence they need to support constructive and effective economic policies.

It is important to an understanding of the purposes of the facility to recognize that it is not just another "recycling" mechanism. We don't need another "recycling" mechanism, and, in fact, the term has become very misleading. It means different things to different people, and this can't help but raise the level of misunderstanding about the nature of the problems we face. The term "recycling" generally is used to represent the process of channeling the financial surpluses of the oil-exporting countries into the economic and financial systems of the oil-importing countries. Viewed in these terms, there is no recycling problem in the aggregate. The financial surpluses of the oil-exporting countries must, as a certainty, be invested in the oil-importing countries as a group.

The immediate economic and financial problem is posed by the huge shifts in countries' external payments positions caused by the increases in the price of oil. The world is faced with a novel situation in which large financial surpluses are concentrated outside the industrial countries; in countries which do not have large capital markets of their own and whose capacity to spend those surpluses on real goods and services is, at least temporarily, restricted; and very substantially in the hands of governments.

While this financial situation is unprecedented, it is also temporary and transitional. Many of the earliest guesses at the magnitude of the financing problem, made in the immediate wake of the oil price increases, raised the prospect of extreme imbalances lasting for an indefinite period. More recent forecasts, taking into account revised estimates of the oil exporters' ability to increase their imports of goods and services, have considerably shortened this horizon. My own guess is that the "oil deficits" will have disappeared by the end of this decade, that the countries presently facing large collective current account deficits will by then be running current account surpluses—in effect, paying in real terms for their past imports of oil—and that the new investments of the oil producers will begin to dwindle before they reach a cumulative total of no more than $200 to $250 billion.

The distribution of oil-related financial flows among the oil-importing countries depends only in the first instance on the form and direction of investments by the oil producers. The complex of existing private and official financing arrangements has worked well to date in channeling funds on reasonable terms to individual countries. These arrangements have successfully handled some $60 billion in new oil producer investments in 1974, and probably many billions more induced by energy developments, with only moderate strain. We expect that these mechanisms will continue to work well in the future. I do not refer here to just the commercial banking systems, because we have already seen, and I believe will continue to see, new techniques developed by governments and private institutions to handle the increased volumes of capital now flowing.

Nevertheless, there is no certainty that each individual oil-importing country will be able to obtain on reasonable terms the financing it needs in order to maintain reasonable economic growth; to resist protectionist policies designed to sustain its external position; to undertake longer term policies to achieve energy independence; and to carry through the major changes of economic structure that the new energy situation will demand. It is this potential for financing problems in individual countries that gives cause for concern, not the ability of the oil-importing world as a whole to finance its position.

Primary reliance for the world's multilateral official financing needs will continue to be placed on the International Monetary Fund. While it is impossible to predict what amount of credit the IMF might have to be prepared to extend in 1975 and beyond, we have agreed to arrangements for a significant expansion in IMF lending capacity in 1975—through improved utilization of its regular resources and through a $6 billion expansion of its special oil facility—and have agreed in principle to a major enlargement of IMF quotas to augment its resources over the longer term.

The new financing facility is designed not to replace but to supplement the IMF and other sources of financing, to assure each participating country that needed financing will be available if it is not forthcoming from other sources on reasonable terms. The novelty of the situation, the unprecedented scale of the oil-related financial flows, and uncertainty over the nature and direction of future oil producer investments make it essential that such an insurance mechanism be in place to assure that, at the margin, funds do flow in particular directions if the need arises.

I should note that some concern has been levied that the new facility will serve as a guarantee of oil exporters' investments. It is true that the existence of the facility will strengthen the operations of the markets and improve participants' ability to obtain financing from other sources, and the benefit will accrue to the oil exporters as well as oil importers. But the pros and cons of having such a facility can only be weighed against the alternatives. No one has yet come forward with a formula which would require the oil exporters to assume high risk investments—their investment policies have been generally conservative to date. But even if one did devise a means of having OPEC countries lend to OECD countries in serious need, the benefits of shifting the risk would have to be weighed against the costs of placing OPEC countries in such a strategic position. Here the facility—whose financing and operations are independent of decisions by or agreements with the oil exporters—can provide a reasonable alternative to financing which might otherwise be unnecessarily expensive, or with inappropriate policy conditions either implicit or explicit.

Similarly, the facility is not a device for perpetuating high oil prices. To the contrary, it is an integral part of a cooperative effort to reduce dependence on imported oil and restore the energy balance. Certainly the facility may help to prevent financial disruption of the oil-importing world while longer term corrective measures are put in place, but I know no one who advocates this course as the preferred means of getting oil prices down.

The essential characteristics of the solidarity fund

The nature and purpose of the proposed facility—a mutual insurance arrangement designed to promote economic cooperation among OECD countries—have determined its most important characteristics more or less automatically.

Safety net.—The facility is designed as a safety net—a backstop to other sources of financing available to participants. It is not envisaged as a regular, operating cog in the world's financial machinery. Before turning to the facility, countries would be expected to make the fullest appropriate use of other sources of finance—the private capital markets, their reserves, their ability to borrow from other governments and regional organizations, credit from the IMF—and borrowers would have to accept economic and energy policy conditions set forth by a Governing Committee. Credit will be provided only on market-related terms, to insure that countries not be induced to request loans from the facility in lieu of other financing available on reasonable terms, or view it as a foreign aid device.

These provisions all tend to ensure that extensive recourse to the facility will not be sought. Yet at the same time, the facility will provide the basic assurance that in the final analysis financing is available if needed, and by doing so will make a major contribution to the operations of the world economic system: on the one hand, by providing governments the confidence in their financial positions they must have to maintain sound and cooperative economic policies; on the other hand, by strengthening the confidence of private lenders and investors in the integrity of the system as a whole and in the ultimate strength of individual countries' positions.

Risk sharing.—We are confident that all loans made through the facility to participants will be repaid according to the provisions established at the time the loan is arranged. No loan will be made in the expectation that payment might be delayed or deferred. Nevertheless, we must recognize that we do not live in a riskless world. Accordingly, the fundamental principle on which this facility will operate is that all participants will share in the risks of the facility's operations in proportion to agreed quotas. This risk-sharing will operate regardless of the specific financing techniques used or the ultimate distribution of loans to and borrowing from the facility. In concrete terms, this means that maximum U.S. exposure would be only our proportionate share of any defaults. If our share is 25 to 30 percent of a default, other countries will pick up 70 to 75 percent of the burden.

The facility is thus not a U.S. "bailout" of other OECD countries. However loans through the facility are financed, and whoever the borrowers may be, the risk will be shared.

Quotas.—Country quotas will determine both participants' quantitative obligations to provide support to the facility and their potential rights to borrow from the facility. In this connection, the $25 billion figure for total quotas may be somewhat confusing if it conveys the idea that this is the amount of lending the facility can provide. The amount that would actually be available will depend on the pattern of financing needs among participants. At one unlikely extreme, for example, only one country with a small quota might be in a position to provide financing, with all others needing to borrow. In this case, the facility's financing capacity would be close to nil. At the other extreme, also highly unlikely, only one country might need to borrow, with all others in a position to lend. In this case, it is theoretically possible that the facility's lending capacity could approach the limit of $25 billion. As a practical matter, if use of the facility is required, its lending capacity will fall between these extremes.

The temporary nature of the facility.—The solidarity fund will not become a permanent piece of international financial machinery. There is agreement that its authority to make new loans will automatically lapse 2 years after it comes into operation, unless extended by mutual agreement.

No new international staff will be recruited by the facility. It will rely on the OECD for any required secretariat.

Financing.—A number of technical difficulties remain to be resolved. Three general techniques for financing of loans are under consideration: direct loans by participants to the facility; provision of individual countries' guarantees of borrowings by the facility; and joint guarantees by all participants. Each of these techniques has some support. The United States has felt from the outset that the ideal course would be to leave financing technique to the decision of individual participants, and we may well reach agreement on an "open" approach that allows for use of all of these techniques. This approach does involve considerable technical difficulties, however, and the group may ultimately have to decide to limit the financing alternatives in the interests of assuring a workable system. However the technical issues are resolved, it is agreed that the facility will not borrow directly from oil producers.

Legislative and budgetary aspects of U.S. participation

The principal characteristics I just described—and a number of more technical but nevertheless important operational details—are basically agreed. The agreement in principle, reached by the major oil-importing nations last month at meetings here in Washington, is set out briefly in the communique attached to the text of my remarks today. A working party was subsequently established in the OECD which has confirmed that these principles are appropriate and is now working to prepare a full draft agreement for approval by governments. This draft agreement might be available by the end of this month but may not be completed until sometime in March after which signatories would seek required domestic authority for their participation.

With that schedule in view, let me turn now to the legislative and budgetary aspects of U.S. participation in the facility. U.S. participation in the facility will require the approval of the Congress and has been provided for in the budget submitted by the President earlier this month. The budget proposed for fiscal year 1976 recommends budget authority for up to $7 billion for the facility and provides for estimated outlays of up to $1 billion that year.

It is not possible to be more precise at this point on the amount of U.S. participation or the exact form our participation will take. While it is generally agreed that all participants' quotas will total about $25 billion, individual country quotas and certain important features of the facility's operations are still under negotiation. The answers to these open questions—which we should have very shortly—and the advice we receive in the course of our consultations with the Congress, will be key determinants of the specific legislative proposals the administration eventually puts forward.

The United States has indicated in the course of the negotiations on the facility that it would consider its appropriate share to be in the range of 25 to 30 percent of the total, based on various relevant economic criteria such as GNP, trade, and oil imports. This range is generally regarded as appropriate for the United States by other participants in the OECD working party I mentioned earlier. Judging from the discussions at the meeting of the working party I attended last week, I would guess that we will wind up in that range—near the $7 billion mentioned in the budget—with other countries' quotas also set on the basis of appropriate economic criteria.

The estimate for outlays contained in the budget is notional. As I explained earlier, we view the facility as an insurance mechanism to be called upon only if financing is not available from other sources on reasonable terms and only in connection with cooperative economic and energy policies. Existing financing arrangements have worked and adapted well to date. We hope this new facility will never be needed, and we believe that hope has a strong probability of being realized; but we also believe it is important to have the facility in place if the need does arise.

As I mentioned, there is not yet full agreement in the working party on certain operational characteristics of the new arrangement. How the technical issues related to the various financing techniques are resolved will, of course, have an important bearing, to the extent financing is actually required, on the form of U.S. participation in the facility and on the form of legislation needed to support U.S. participation. We will be considering various techniques in consultation with the Congress, and hope to proceed quickly once the shape of the facility is clear.

Conclusions

Mr. Chairman, the proposed solidarity fund is an essential element in the efforts of the oil-importing nations to develop a cooperative response to the energy situation and to maintain a strong and open world economic order. The facility is designed to promote maximum reliance on the existing financial mechanisms that have served us well to date while providing insurance should those arrangements be inadequate. It is based on the principles of mutual support and equitable sharing of common risks. We would hope to complete necessary consultations with the Congress in time to forward a comprehensive legislative proposal by late March or early April. That proposal will embody a key element of U.S. foreign economic policy, and I hope it will receive your strong support.

Communique of the Ministerial Meetings of the Group of Ten, January 14 and 16, 1975, Washington, D.C.

1. The Ministers and Central Bank Governors of the 10 countries participating in the General Arrangements to Borrow met in Washington on the 14th and 16th of January 1975, under the chairmanship of Mr. Masayoshi Ohira, Minister of Finance of Japan.

The Managing Director of the International Monetary Fund, Mr. H. J. Witteveen, took part in the meetings, which were also attended by the President of the Swiss National Bank, Mr. F. Leutwiler, the Secretary-General of the OECD, Mr. E. van Lennep, the General Manager of the Bank for International Settlements, Mr. R. Larre, and the Vice-President of the Commission of the EEC, Mr. W. Haferkamp.

2. After hearing a report from the Chairman of their Deputies, Mr. Rinaldo Ossola, the Ministers and Governors agreed that a solidarity fund, a new financial support arrangement, open to all members of the OECD, should be established at the earliest possible date, to be available for a period of 2 years. Each participant will have a quota which will serve to determine its obligations and borrowing rights and its relative weight for voting purposes. The distribution of quotas will be based mainly on GNP and foreign trade. The total of all participants' quotas will be approximately $25 billion.

3. The aim of this arrangement is to support the determination of participating countries to pursue appropriate domestic and international economic policies, including cooperative policies to encourage the increased production and conservation of energy. It was agreed that this arrangement will be a safety net, to be used as a last resort. Participants requesting loans under the new arrangement will be required to show that they are encountering serious balance-of-payments difficulties and are making the fullest appropriate use of their own reserves and of resources available to them through other channels. All loans made through this arrangement will be subject to appropriate economic policy conditions. It was also agreed that all participants will jointly share the default risks on loans under the arrangement in proportion to, and up to the limits of, their quotas.

4. In response to a request by a participant for a loan, the other participants will take a decision, by a two-thirds majority, on the granting of the loan and its terms and conditions, in the case of loans up to the quota, and as to whether, for balance-of-payments reasons, any country should not be required to make a direct contribution in the case of any loan. The granting of a loan in excess of the quota and up to 200 percent of the quota will require a very strong majority and beyond that will require a unanimous decision. If one or more participants are not required to contribute to the financing of a loan, the requirements for approval of the loan must also be met with respect to the contributing participants.

5. Further work is needed to determine financing methods. These might include direct contributions and/or joint borrowing in capital markets. Until the full establishment of the new arrangement, there might also be temporary financing through credit arrangements between central banks.

6. Ministers and Governors agreed to recommend the immediate establishment of an ad hoc OECD Working Group, with representatives from all interested OECD countries, to prepare a draft agreement in line with the above principles. In their view this work should be concluded in time to permit approval by the OECD Council by the end of February 1975.

Exhibit 58.—Statement by Under Secretary for Monetary Affairs Bennett, March 4, 1975, before the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs, on foreign investment in the United States

Mr. Chairman, I appreciate this opportunity to present to your committee the administration's views on foreign investment in the United States.

Within the executive branch we have been engaged in an extensive interagency review of governmental policy toward such investment. We felt that such a review was appropriate in the light of the pace of change in international economic affairs, including in particular the rapid growth in the hands of a few governments of funds available for investment abroad.

In summary, the basic conclusion of our review was to reaffirm the traditional policy of our Government as stated, for example, by the President in October when he signed the Foreign Investment Study Act of 1974. He said, "We continue to believe that the operation of free market forces will direct worldwide investment flows in the most productive way. Therefore my administration will oppose any new restriction on foreign investment in the United States except where absolutely necessary on national security grounds or to protect an essential national interest." An important underlying reason for the reaffirmation of that policy was our recognition that we shall need all the investment we can appropriately attract to assist in restoring the productivity growth of our economy.

Our review confirmed that existing laws, regulations, and practices provide extensive information with respect to foreign investments as well as safeguards to deal with particular investments. We concluded, however, that, in addition to enforcing rigorously the existing laws and regulations which control the activities of foreign investors, we should take administrative action to supplement present arrangements—

By establishing a new, continuing high-level interagency committee to report to the President's Economic Policy Board and to serve as the focal point within the executive branch for insuring that foreign investments in the United States are consistent with our national interest;

By creating a new office to serve that committee and all other parts of our Government by monitoring foreign investment and producing analyses both of developing trends in various categories of investment and of the prospective impact of significant individual investment proposals;

By using the new office to centralize and improve the gathering of information on foreign investment and its dissemination to appropriate parts of the Government; and

By negotiating procedures with the principal foreign governmental investors for advance consultation with the U.S. Government on prospective major direct investments in the United States.

It is our belief that the policy and arrangements we are proposing will simultaneously safeguard our national interest and, by clarifying the situation, actually enhance the attractiveness of the United States for foreign investors.

We do not believe that there is at this time a need for any new legislation, apart from the possible desirability of legislation now being studied by the SEC to impose more effective requirements, on both domestic and foreign investors, to reveal the beneficial owners standing behind investments held in nominee names.

At the outset of the administration review just completed, we took a look at trends in foreign investment over the last several years. Although the term "investment" sometimes covers all types of financial claims, in this particular study we concentrated on investments in relatively long-term assets such as stocks and bonds rather than short-term assets such as bank deposits and Treasury bills. We distinguished between direct investment and portfolio investment. Until recently foreign equity holdings of 25 percent or more were classified in our statistics as direct investment. Starting in January we now include any holdings of 10 percent or more in the direct investment category.

These data are available since under existing law the U.S. Government collects a substantial amount of data on foreign investment in this country. The Treasury Department requires monthly reports from brokers, banks, and other firms in the United States participating in long-term securities transactions with foreigners. The Commerce Department collects and publishes data, on a quarterly basis, on foreign direct investment in U.S. firms where the foreign participation has a book value of over $2 million in the equity and debt accounts. In addition to these ongoing reporting programs, the Commerce and Treasury Departments are, pursuant to the Foreign Investment Study Act of 1974, undertaking a one-time detailed benchmark survey of foreign investment in the United States outstanding as of end-1974. The data from this survey will show foreign investment in every U.S. company of significant size broken down by type of investment, kind of investor, and by country of residence. A preliminary report on this benchmark survey will be sent to the Congress in the fall of this year.

The data we now have show that foreign long-term investment in the U.S. private sector at the end of 1973 had a book value totaling $55 billion, consisting of $18 billion in direct investment plus $37 billion in portfolio investment. These numbers are not large relative to our U.S. private sector's long-term investment abroad, which had a reported book value at the end of 1973 totaling $132 billion, consisting of $107 billion in direct investment and $25 billion in portfolio.

In 1973 the inflows reported in our balance of payments from all foreign investors were $6.6 billion. In the first three quarters of 1974, the rate of flow fell. It was only $4.2 billion. Of this amount in 1974, $2.9 billion was direct investment and $1.3 billion was portfolio.

We do not yet have an estimate of foreign direct investment in the United States during the fourth quarter, but we do know that foreign portfolio flows into U.S. private securities declined quarter-by-quarter last year and actually turned into a net outflow in the fourth quarter. Foreign investors apparently did not take advantage to any substantial extent of the bargains which were available in our securities markets last year.

During the year 1974, governmental and private investors from the OPEC countries did appear in our market in larger volume than before, but their aggregate long-term investment was quite small. Out of the approximately $60 billion in short- and long-term investment abroad which they accumulated during the year, less than $1 billion was placed in long-term private investments in the United States, and the bulk of that investment was made in portfolios of securities chosen and managed for the investors by U.S. financial institutions. One billion dollars of investment represents less than one-tenth of 1 percent of the current market value of outstanding U.S. securities even when leaving out of account the value of the real estate and housing area, in which the OPEC investors are placing some of their investments. During the year there was only one large direct investment by an OPEC country in a U.S. corporation, and that investment was in a U.S. company whose productive assets were largely in the country from which the investment came.

It is, of course, not easy to predict precisely what will be the course of foreign investment in our economy in 1975 and beyond. We hope that investors from many areas will come here, and specifically we hope that investors from the OPEC countries will make substantial investments here. In view of the buildup in their liquid assets last year, we particularly hope they will be making a larger proportion of longer term investments. Yet we must take into account that their total funds available for investment this year will probably be significantly less than last year's $60 billion. And the next year's total will be smaller again. In fact, it is quite possible that the OPEC countries will become net disinvestors in total well before the end of this decade, and that some important investors last year, for example, Iran, will become disinvestors much sooner. At its peak, the foreign investment accumulation of the OPEC nations may not exceed $200 or $250 billion. Of this amount, much will continue to be held in short-term form; some has already been committed in loans to foreign governments and agencies, including the International Monetary Fund and the World Bank. Moreover, the OPEC investors are following conservative investment policies which rely heavily on geographic diversification in their investments. Taking these factors into account, I would be extremely surprised if we were able to attract as much as $5 billion of OPEC funds into long-term investment in the U.S. private sector in 1975.

It is clear that major OPEC investors now realize that we do not wish foreign investors—from any area abroad—to gain control of industry sectors or corporations in our economy vital to our security, to our national interest, or to public communication. A number of major potential investors have indicated a willingness to discuss with us in advance their plans to invest in U.S. productive ventures. The consultations with the Iranian Government on a loan to Pan American World Airways provide one illustration. The recently established joint economic commissions between the United States and a number of other countries, including some of the countries with the largest volume of funds available for investment, provide a convenient framework for such consultations. Informal consultations can be flexible and tailored to the circumstances of each proposed investment. Because there will be continuing informal contact, we shall obtain information on proposed major investments at an early stage. You will have noticed that the communique issued last week at the conclusion of the meeting of the United States-Saudi Commission specifically notes that the two governments recognize that participation in productive ventures in each other's economies requires close consultation to assure consistency with their national policies and objectives. It was agreed that each government will consult with the other regarding significant undertakings of this type.

Our interest in fuller information on foreign investment in this country represents in no sense a departure from our conviction that free market forces are the best means for directing worldwide investment flows into the most efficient uses. It is a basic U.S. policy objective to achieve an environment for international investment in which capital flows are responsive to market forces and Government policies neither encourage nor discourage investment flows. We offer foreign investors in this country no special incentives to attract them to the United States and, with a few internationally recognized exceptions, impose no special barriers to their entry. This policy is consistent with our overall dedication to the freest possible economic relations amongst countries and is also consistent with our various international obligations.

The President, in a statement last week, made clear that foreign businessmen and investors are welcome in the United States when they are willing to conform to the principles of our society. We feel strongly that foreign firms which come to this country should not attempt to use economic pressure to force U.S. firms to take actions on matters unrelated to their business relationships. We are not aware of any occasions in which a U.S. firm has succumbed to such pressure. We do not believe any responsible U.S. firm will do so. As the President said, "discrimination is totally contrary to American tradition and repugnant to American principles."

Apart from the new consultation procedures, we shall make full use of the existing laws and regulations giving us information and powers to protect the national interest.

In addition to the information collected by the Treasury and the Commerce Departments for statistical purposes, we have available a vast amount of information collected for regulatory purposes. As the committee is aware, the Securities and Exchange Commission and other Federal regulatory commissions require reports on ownership in connection with various applications and thereafter; these reports are also open for public inspection. In many cases, these agencies also require reports on the indebtedness of U.S. companies, including the identity of individual creditors. The Department of Defense requires each contractor to submit a certificate pertaining to foreign affiliation to meet its industrial security regulations. If the total foreign ownership is above 6 percent, the firm must identify the individual owners. The Council on International Economic Policy and the Office of Management and Budget have already completed a comprehensive review of these data-collecting programs, and Mr. Niehuss will submit their report to the committee tomorrow.

We shall also act in full awareness that existing law provides a formidable array of safeguards against unwanted foreign investment or undesirable activity by foreign investors. Federal restrictions which limit the amount of foreign investment apply in the fields of atomic energy, radio and telegraph communications, domestic air transport, acquisition or exploitation of Federal mineral lands and hydroelectric power, and shipping. These restrictions are generally accepted internationally and are incorporated into most of our bilateral treaties. Additionally, the Department of Defense Industrial Security Regulations make it a practical impossibility for a foreign-controlled firm to obtain the security clearance necessary to perform classified work. Restrictions applicable to foreign investment, particularly in banking, insurance, and land ownership, are also imposed by many States.

Finally, and perhaps most importantly, there are two other significant sources of protection. First, the actions of foreign investors are fully subject to all of our business regulation laws—for example, the antitrust and securities laws—as well as to our export controls. Moreover, under the Trading with the Enemy Act, in time of war or national emergency the President has broad authority to regulate or prohibit undesirable activities of foreign-owned enterprises in the United States.

We recognize that the responsibilities for the gathering of statistics on foreign investment in the United States and for surveillance of particular types of investment activity are widely dispersed within the administration to agencies with various kinds of specialized knowledge. To insure that the information available in the various parts of the Government is brought togetheer in a coordinated fashion both for the review of overall trends and for the consideration of specific important investments, we have decided to estabilsh the new centralized office within the executive branch and the new high-level interagency committee. These organizations are not intended to replace the existing specialized authorities but to insure that a comprehensive view can be taken. The new organizations will be asked to publish periodic reports on foreign investment activity. They will be charged with reporting any need which may develop for new legislation to enhance our powers in the foreign investment area.

In our recent interagency review, we did consider carefully the legislative proposals which have been made to the Congress, including your bill, S. 425. Mr. Chairman. Our conclusion was that, as compared to the approach we have adopted of more active administrative monitoring of foreign investment here, new legislation directed to foreign investment reporting and control would not provide any significant additional safeguards but would in practice be likely to deter a substantial amount of beneficial investment in the United States.

Insofar as S. 425 addresses itself to the objective of more thorough disclosure of the beneficial ownership behind nominee shareholdings in U.S. corporations, we have—as I indicated earlier—considerable sympathy for the objective. We feel, however, that this subject should not be addressed in a bill primarily related to foreign investment. As you recognize, the U.S. investing public should be equally entitled to this knowledge, whether the beneficiary is an American or foreign investor. We do not feel that any change in our law in this respect should be undertaken in a context discriminating against the foreign investor. In our negotiations with foreign governments, we rightly ask that U.S. firms operating in their countries be accorded equal treatment with their investors. If the United States should now introduce general discriminatory provisions, we could expect that we would encourage the growth of retaliatory and discriminatory restrictions on U.S. investment operating in foreign countries. Moreover, the provisons of S. 425 which would require foreigners to provide advance notice of proposed acquisitions of equity in U.S. companies and would authorize the President to prohibit any such acquisitions would, if broadly implemented, violate a number of existing treaties of friendship, commerce, and navigation and other international agreements.

I can assue you that, without this legislation, the administration will carefully monitor foreign investment in the United States and will take prompt action, in consultation with the Congress, when necessary to protect the U.S. national interest. Meanwhile, we feel it is crucial that we recognize that foreign investment in the United States is contributing to the dynamism of the American economy by stimulating competition in seeking out new investment opportunities. It is bringing much-needed new resources to our economy.

In conclusion, I urge that we observe foreign investment in our economy carefully, but let us not make the surveillance so oppressive as to drive it away. We need it.

Exhibit 59.—Statement by Secretary Simon, March 24, 1975, before the Subcommittee on International Economics of the Joint Economic Committee, on the international monetary situation and the position of the dollar

Mr. Chairman, there is a great deal of discussion these days about the international monetary situation and the position of the dollar, and many suggestions about what policies the United States should follow in present circumstances. I am pleased to have this opportunity to give you my views on this subject, and to outline the status of international discussions of amendments to the IMF Articles that have important implications for the future evolution of the monetary system.

Recent exchange market developments and prospects for the future

I am sure the subcommittee is aware that in recent months the price of the dollar decreased in terms of several European currencies. I am sure you have also heard the views of some who argue that this movement should be countered by large-scale intervention to peg the dollar at a particular rate or zone, or by an offer by the United States and the IMF to replace foreign dollar holdings with newly created SDR's, or by other direct measures.

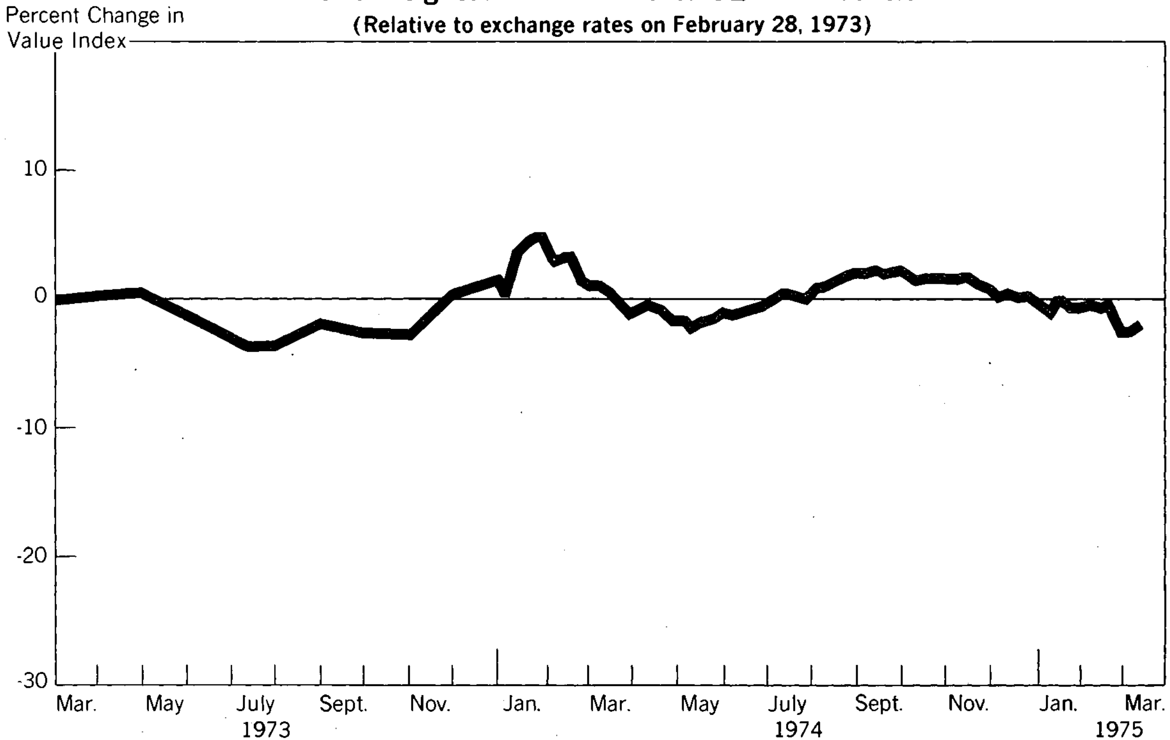
I disagree with these proposals, and I disagree with the assessments on which they are based. Let me try to place recent exchange rate movements in their proper perspective.

While there have been changes in terms of a number of European currencies, the particular exchange rate movements that have attracted the greatest attention are two—the changes of the Swiss franc and the German mark relative to the dollar. Since last September the change in the dollar exchange rate for these two currencies has indeed been large: almost 23 percent for the Swiss franc and almost 16 percent for the German mark.

Chart 1

Changes in Value of U.S. Dollar
Trade Weighted Vis-A-Vis Other OECD Currencies

(Relative to exchange rates on February 28, 1973)



Data are monthly for 1973, weekly for 1974 and 1975
Source: Department of the Treasury

But three points should be borne in mind. First, looking at present rates just in relation to rates prevailing last September exaggerates the movements that have occurred. Present dollar rates for these two currencies are much closer to previous highs than this comparison suggests: The Swiss franc is only 10 percent above its previous high relative to the dollar; the German mark remains slightly below its earlier high point in terms of the dollar. Second, while these two currencies have been strengthening relative to the dollar, and the Swiss and German monetary authorities have been buying dollars, the dollar has also been rising relative to certain other currencies, and their authorities have been selling dollars. In some cases, they have been borrowing dollars to sell in the market to support the rate. Thus, there has been market intervention by foreign governments on both sides of the market—and, in effect, many of the dollars bought by the Swiss and German authorities have been sold by other foreign governments whose exchange rates have been under downward pressure. Third, the Swiss and German currencies have also increased significantly in value against other major currencies as well as the dollar, and it is legitimate to ask to what extent the changes vis-a-vis the dollar reflect a weakening of the dollar or a general strengthening of these two other currencies.

Movements of the dollar or any currency must be looked at against a broad background: They must be examined over a longer period than just a few months, and measured against the full range of other major currencies rather than just one or two—for example, by measuring changes on an average basis against a number of currencies.

Looked at in that broader context, the dollar does not show a large or continuous depreciation, nor great instability. Several tables and charts attached to my statement illustrate this point. These show that:

On a trade-weighted average basis against *all* OECD currencies as a group, the dollar stands approximately where it was 2 years ago when generalized floating began. Moreover, the dollar has been one of the most stable of the major currencies during this period.

On the same basis, while the dollar declined from last September to mid-February, that decline followed an equally large increase in the dollar's value in the preceding few months, so that there has been no significant net change since last spring.

It is of importance to recognize and understand what factors influenced the exchange rate moves during the September to mid-February period of dollar decline. There are a number of factors, neither mysterious nor alarming, which tended toward a weakening of the dollar in that period:

First, as is also shown in one of the attached tables, there have been substantial changes in relative interest rates as between the United States and other financial centers. Interest rate reductions here have been in advance of reductions elsewhere, and, given the depth of the recession in the United States, the yield on short-term instruments declined much more sharply in the United States than in most other countries in the period from September through January. Such cyclical differences in interest rates can have an important influence on capital flows.

Second, since mid-1974 there has been a natural and healthy correction of earlier expectations that the United States would receive a greatly disproportionate share of the investments made by oil exporters. Such expectations probably pushed the dollar up last summer, and a readjustment based on a more reasonable assessment has taken place more recently.

Third, some elements of the U.S. current account balance of payments were not as strong in the latter part of 1974 and in the early months of 1975 as they were earlier. With lower world commodity prices and slack economic conditions abroad, for example, some moderation of our agricultural and raw materials exports was to be expected. As a footnote to this point, however, I would urge that a great deal more caution be exercised in interpreting balance of payments statistics. Just last week, the press highlighted a figure in a Government press release which indicated that the deficit in our balance on current and long-term capital transactions had risen to $10.6 billion in 1974 from a $1 billion deficit in 1973. This was a highly misleading interpretation of our balance of payments situation. This particular balance is constructed in such a way that it excludes most of the identified investments in the United States by the oil-exporting countries—investments which totaled about $11 billion in 1974. Adding in these investments would eliminate the whole deficit. Careful judgment must be exercised in interpreting these statistics, and revisions to provide for a more meaningful presentation of balance of payments numbers are under study.

TABLE 1.—*Trade-weighted exchange rate changes for selected currencies during the period of widespread floating—March 1973–March 1975**

[Percent changes relative to rates prevailing at end of February 1973]

As of end of month or date shown	U.S. dollar	German mark	U.K. pound	Japanese yen	Swiss franc	French franc	Italian lira	Canadian dollar
July 6, 1973 [1]	−4.4	13.3	−3.4	−0.8	2.5	3.6	−14.4	−1.8
September 1973	−2.6	11.7	−7.2	−.3	−3.2	−.6	−7.4	−1.8
Jan. 24, 1974 [2]	5.1	8.4	−6.8	−9.2	−.5	−8.0	−12.0	2.2
March 1974	−1.1	12.2	−4.7	−2.5	−2.8	−7.7	−12.4	2.1
September 1974	2.2	8.6	−5.2	−9.1	6.9	−4.6	−16.9	1.8
Mar. 19, 1975	−2.2	13.4	−9.2	−8.6	15.7	−1.7	−22.2	−1.1

*Trade-weighted average appreciation (+) or depreciation (−) of each currency vis-a-vis all other OECD currencies.

[1] Low point for dollar during period.

[2] High point for dollar during period.

TABLE 2.—*Maximum variation in trade-weighted exchange rate indexes during period of widespread floating**

Trade-weighted index for—	Percentage variation
Italian lira	27.1
Swiss franc	24.4
New Zealand dollar	18.7
French franc	17.9
Australian dollar	17.7
Spanish peseta	16.4
Japanese yen	16.3
Pound sterling	13.3
German mark	12.6
Austrian schilling	12.6
Netherlands guilder	10.6
Norwegian krone	10.5
U.S. dollar	10.0
Swedish krona	7.5
Belgian franc	6.9
Danish krone	6.7
Canadian dollar	5.6

*Measured as the percentage by which the highest trade-weighted value of each of the listed currencies vis-a-vis all other OECD currencies exceeded the lowest trade-weighted value for that currency during the period Feb. 28, 1973–Mar. 19, 1975. Values are relative to base rates as of Feb. 28, 1973. Data are for the end of each month prior to Apr. 18, 1974, and both weekly and end-of-month thereafter.

TABLE 3.—*Differences between short-term interest rates in selected foreign financial markets and the United States*

[End of period; percent per annum]

	September 1974	January 1975	March 1975	Latest date
Germany	−1.47	0.05	−0.25	3/17
France	2.21	3.30	3.50	3/17
Switzerland	−4.17	[1] −.45	[1] −1.25	3/7
Japan	1.83	5.55	7.25	3/8
Canada	.21	−.45	.75	3/17
Italy	6.58	6.68	6.50	3/17
Belgium	.83	2.55	2.75	3/4
Netherlands	−3.79	−.89	.81	2/28
United Kingdom	.83	4.67	5.19	3/11
United States (actual rates)	11.17	7.45	5.75	3/19

[1] Switzerland imposed a negative interest rate of 40 percent on foreign deposits.

NOTE.—Positive numbers indicate foreign interest rate higher than U.S. interest rate.

Short-term rates: United Kingdom—90-day local authority deposits; Germany—3-month interbank loan rate; France—call money rate against private paper; Italy—3-month interbank rate; Belgium—rate on 4-month Treasury bills at midmonth; Switzerland—3-month deposit rate; Japan—call money rate, unconditional; Canada—Canadian finance company paper; United States—60-89 day prime bank CD rate.

Fourth, there has undoubtedly been some fear that expansionary policies in the United States might lead to a resurgence of inflation, and a recognition in exchange markets that our performance has not in the past been as good as that of Germany and Switzerland. Prospective massive Treasury borrowings this year, and the possibility of excessive tax reductions and expenditure increases, call into question our dedication to the struggle against inflation, and raise the possibility that a new round of inflation will halt the process of economic recovery.

In addition to these primary influences, Middle East political developments may well have had some impact. And several other factors have probably had a minor, shortrun influence—for example, talk of oil price indexation; and actions taken by Iran, Saudi Arabia, and a few other countries to "peg" their currencies to the SDR rather than the dollar, even though these moves were designed to moderate the effect of exchange rate fluctuations on domestic prices in those countries, and have no direct implication for exchange rates for the dollar.

What of the future? The dollar has strengthened slightly in the last few weeks and, looking ahead, there are a number of factors which suggest that the prospects for the dollar are reasonably strong:

First, the U.S. lead in reducing interest rates may be ending, as is suggested by some of the most recent figures in the attached table. As recession bottoms out and our domestic demand strengthens in the months ahead, incentives for interest-sensitive flows could be reversed by a further change in international interest rate differentials.

Second, while the oil producers have been diversifying their investments geographically, which is a healthy and natural contribution to "recycling," the United States is likely to continue to receive a significant share of these investments directly and indirectly—perhaps a higher share in coming months than we have received in the last few months.

Third, our competitive position is strong. There are probably still some residual effects of the 1971 and 1973 devaluations that have not fully worked through the system. More importantly, the U.S. performance on inflation, bad as it has been, is nonetheless better than that of most other countries. If the Congress will cooperate with the administration in holding the line on tax reductions and expenditure increases, we can continue to do better in the future. This is of fundamental importance.

U.S. exchange rate policies

Against the background of these developments and in light of our domestic requirements and international objectives, what policies should the United States adopt with respect to exchange rates?

My views can be stated simply. I believe that for a sound dollar, the main imperative is to concentrate not on exchange markets and exchange rates—which are a product of our economic policies and performance—but on assuring the strength of the U.S. economy. In a very basic sense, the United States does have a serious exchange rate problem—and that is the continuous decline of the dollar, not in terms of foreign currency, but in terms of its purchasing power, or its exchange rate against goods and services in general. We have not done well in maintaining that particular exchange rate. Our inflation record is not one to be proud of. We have not done a good job of defending the dollar against the devaluation and depreciation in purchasing power which inflation brings. Undoubtedly, the prestige of the dollar has suffered.

The way to achieve greater stability in the dollar's value is *not* through governmental intervention or controls to maintain a particular rate or pattern of rates in the foreign exchange markets. Such measures in a sense are like price controls over one sector of our economy—the international sector—which would introduce rigidities into the system and would be positively damaging. They would exacerbate our longer term problems and would be of doubtful value even in terms of shorter run exchange market objectives.

We must bring our inflation under control and do a better job of reducing the depreciation of the dollar in terms of the goods and services it can buy. This is true "defense of the dollar," and improving the strength and stability of the U.S. domestic economy is the single most important contribution we can make to a strong international economy, as well as to our own economic health and well-being.

Accordingly, I regard policies which look toward the establishment of foreign exchange rate pegs, targets, or zones for the dollar as unwise. Such policies focus on the symptoms rather than the sources of our troubles—on effects rather than causes. The world moved to the present arrangements of "managed floating" for very good reasons—we needed greater flexibility and greater reliance on market forces at a time of great uncertainty in the world economy. Those conditions still exist, and monetary arrangements which allow considerable scope for market forces are particularly well suited to present circumstances. These arrangements have served us well in enabling the world economy to absorb some rather severe shocks in the past 2 years without the periodic crises of earlier years.

There are some economists who take the view that the foreign exchange rate "doesn't matter" as far as a nation's balance of payments is concerned. While everyone acknowledges that exchange rate movements have some effect on domestic prices, this group contends that any exchange rate change stimulates prompt and fully offsetting adjustments in domestic price levels, and thus has no lasting impact on international payments.

I do not accept that extreme view. The exchange rate is a major economic variable which does facilitate balance of payments adjustment among countries and contributes to a smooth functioning of the international economy. When I express doubts about exchange rate pegs or zones, this does not indicate a policy of "benign neglect" or a belief that exchange rates have no effect. Rather, it reflects a conviction that those techniques do not best serve the need for balance of payments adjustment and a smoothly functioning international economy.

With widespread floating, international cooperation on exchange practices remains essential, although the form of cooperation may differ from that in a par value world. Our attention, and that of the rest of the world community, should not be concentrated on specific exchange *rates* of individual currencies, but rather on assuring that the exchange *system* is not disrupted and disorderly. This calls for a code of good behavior, to assure that all countries—those floating as well as those attempting to maintain established pegs or zones for their currencies—avoid beggar-thy-neighbor practices. And it may call for cooperative approaches on intervention to maintain orderly markets.

The United States has joined with others in stating its willingness to cooperate in intervention in particular situations where such intervention is useful and appropriate for maintaining orderly markets. There has, indeed, been a significant amount of such market intervention in recent months—since last September total market intervention by the United States has amounted to slightly more than $1 billion.

Another element of U.S. policy which has a major influence on the strength of the dollar is our policy toward foreign investment. I mentioned earlier that there has been somewhat greater diversification in oil exporter investments than was apparent or widely expected earlier last year. Such a shift in the flows and in public anticipation was to be expected, and this is both natural and healthy. It can facilitate resolution of the world's oil-related financing problems and need not have adverse implications for the dollar. I do not subscribe to the view which has been put forward that there has been a major shift in portfolio preference on the part of the oil producers which would place continuing downward pressure on the dollar.

In the immediate wake of the oil price increases, initial investments were placed heavily in dollar instruments, and heavily at short term. As accumulations and experience grew, greater diversification occurred—in currencies, maturities, and types of investment—spurred on undoubtedly by interest rate changes in the United States and abroad. This diversification enhances the ability of other countries to obtain needed financing directly and reduces the need for the U.S. banking system to play an intermediary role.

At the same time, a very high proportion of the investments by oil exporters remains denominated in dollars. The United States has received a reasonable share of these investments. We welcome these investments. We have a large, efficient, and very attractive capital market, and we want to keep it that way.

I have made clear that the administration has no intention of imposing capital controls—on inward or outward flows. We have testified that we are confident that the Government already possesses adequate safeguards to protect the national interest against problems that might arise from foreign investment. Also, we have decided to establish a new office to consolidate information on investment flows, and in particular cases to examine the prospective impact of proposed investments. Under these arrangements, we can expect to benefit from continued substantial flows of investment into the United States—again, if we can run a strong and inflation-free economy.

One view that I am sure has come to the attention of the subcommittee asserts that a substantial volume of foreign investments in dollars is, in effect, held involuntarily. According to this view there is a massive "overhang" of some $100–$200 billion of foreign official holdings of dollars, placing constant downward pressure on the dollar's value in the exchange markets, which must be converted into a different asset—presumably SDR's. This use of the term "overhang" is incorrect and misleading in present circumstances. I believe there was a genuine overhang several years ago, in the sense that some foreign countries had acquired dollars in excess of amounts they really wished to hold at the time. This is no longer the case. Dollars acquired by foreign official agencies, and invested here and in the Eurodollar markets, are acquired by choice, without the pressures arising out of a concern to preserve the monetary system.

The United States and other countries are taking important steps to strengthen the international monetary structure at a time when there might be severe pressure that could otherwise disrupt exchange markets. The technical details of a draft agreement establishing the $25 billion Financial Support Agreement in the OECD have just been completed by the OECD working party assigned to this task in January. I plan to join with other OECD ministers in signing the agreement in Paris on April 9, and we expect to propose legislation authorizing U.S. participation shortly thereafter. This new supplementary facility will be an important element of our efforts to develop a cooperative response on the part of the major countries to the world energy situation; it will also provide an important financial insurance mechanism to backstop cooperative economic and international monetary policies. Signature of this agreement will bear witness to the importance that all OECD governments attach to this historic step toward financial solidarity among all consuming nations.

Possible changes in rules on the international monetary system

The IMF will, of course, continue to play the central role in meeting the world's official multilateral financing needs. The broad outlines of a major increase in IMF quotas which would enhance its capacity to perform this role have been tentatively agreed upon. The increase will be approved by the Interim Committee in June for submission to legislatures, if final agreement can be reached on the distribution of the new quotas and on a series of amendments to the IMF Articles of Agreement being developed in conjunction with the quota review.

I do not believe it would make sense to try to introduce abruptly a new, highly structured reform of the monetary system. That was essentially the judgment of the Committee of Twenty last June, and that judgment remains valid today. But the C–20 did envisage a number of important amendments of the IMF Articles to set the stage for a more evolutionary process of reform as circumstances warrant, and to help preserve the IMF's authority in dealing with current monetary problems.

The IMF Executive Directors are working intensively to reach technical agreement on amendments designed to eliminate certain rigidities and anachronisms in the system, for consideration by the IMF's Interim Committee at its June meeting. Three of these amendments—dealing with floating exchange rates, gold, and use of IMF currency resources—are particularly important.

The United States strongly supports an amendment to bring floating exchange rates within the legal framework of the IMF Articles. We are not comfortable with a situation in which we and all other countries—despite agreement that floating is the only desirable and practical course—are in technical violation of the Articles because our currencies are floating. And continuation of this situation would tend to erode the Fund's authority as a "keeper of the rules." As we have discussed in the past, Mr. Chairman, we need rules that would not require specific Fund approval for countries to refrain from attempts to maintain their exchange rates within narrow margins around par values. The basic exchange rate obligations of member countries are to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations. But countries should be free to meet these obligations in ways of their own choosing, so long as they adhere to internationally agreed standards of conduct.

I must report that this U.S. concept is not shared by many of the IMF members. A number of countries are prepared to retain the present rules, recognizing that all of the Fund's membership is presently in violation of these rules and will be in violation for the foreseeable future. Some are willing to provide a basis for floating in the Fund's legal framework, but would constrain countries' ability to float more tightly than would the United States. We shall continue to press for provisions that do not require specific IMF approval for a country which does not choose to maintain a par value. I remain hopeful that the differences on this question can be resolved satisfactorily.

We have made more progress toward a convergence of views on gold. It is agreed that the monetary role of gold should be reduced. It is also agreed that the concept of an official international monetary price for gold should be abolished and that obligations on members to use gold in transactions with the IMF, as well as obligations on the IMF to accept gold from members, should be eliminated. And it is agreed that the various restrictions that distinguish gold from other commodities and give it special status should be eliminated, subject to special transitional arrangements designed to insure that gold's role in the system is, in fact, reduced.

The key remaining questions are what these transitional arrangements should be and what disposal should be made of the Fund's own gold holdings. We think it is important to have arrangements that would effectively prevent the reemergence of a de facto official or officially managed gold price, and which would sharply limit official purchases during a transitional period. We also believe the Fund should be enabled to dispose of its gold in an orderly manner, and possible arrangements to accomplish this are under discussion. We will continue to work on these questions in the months ahead, and I will keep this committee and the Congress advised of our progress.

Finally, we are seeking amendments that would assure that all countries' currency subscriptions to the IMF are usable by the Fund under uniformly applicable rules, conditions, and criteria. This is not the case at present, in that countries may effectively block the use of their currencies by the Fund, even though they may be in a strong payments position. We feel that such changes are essential to the rationale and justification for a quota increase, will make the Fund a more truly cooperative institution, and will enhance its lending capacity. This point is generally accepted in principle, and I am hopeful that agreement on technical details can be reached shortly.

If these questions, and that of the distribution of new quotas, can be settled in the coming weeks, the Interim Committee will be able to reach agreement in June on a comprehensive package of quotas and amendments. If that tentative schedule can be met, we would expect to be submitting the necessary legislative proposals to the Congress later this year.

Mr. Chairman, this statement has covered a lot of ground. Let me conclude by emphasizing the following points:

First, the value of the dollar against the generality of major world currencies is today very close to its value in 1973, just after the widespread move to floating rates. The dollar has been among the most stable of major currencies.

Second, financial officials in almost every country agree that it would be undesirable to try to peg exchange rates today, but that they will cooperate to maintain orderly conditions in the foreign exchange markets.

Lastly, in our efforts to maintain the dollar's value, we will concentrate on strengthening our domestic economy through responsible monetary and fiscal policies at home. Let us always remember that the one fundamental condition for a sound dollar is a strong, inflation-proof U.S. economy.

Exhibit 60.—Remarks by Assistant Secretary Cooper, April 7, 1975, before the Bankers Association for Foreign Trade Convention at the Greenbrier, White Sulphur Springs, W. Va., on a perspective on current international financial problems

I am very pleased to have this opportunity to offer some observations on current international financial problems before such a distinguished audience. We have seen remarkable changes recently in international monetary relationships, and this convention provides a welcome occasion for a useful exchange of views between those who view these relationships from a private perspective and those who see them from a public perspective. I am sure that in such an exchange bankers and government officials alike will learn more about the nature of the world—in the old fable, adding to the number of blind men examining the elephant did make a contribution to human knowledge even though the disagreements were passionate.

The experience of the past year gives us basis for confidence that our financial problems are manageable. There has been a notably successful adjustment to a radically altered situation due in no small measure to the flexibility and creativity shown by private financial institutions. But our mutual challenges remain demanding.

All of us who are players in the arena of international finance realize how essential it is that we continue to respond effectively to the problems arising from the enormous increase in world petroleum prices. These price increases have occasioned abrupt and massive shifts in the pattern of international trade and payments. They have placed industrial countries long accustomed to current account surpluses in the unfamiliar position of running large current account deficits. They have concentrated enormous wealth in the hands of a small group of countries, creating problems of financial management on a heretofore unprecedented scale.

The financial dimensions of the change in relationships between the oil-producing countries of the Organization of Petroleum Exporting Countries and the rest of the world are now familiar. Last year, with their quintupling of oil prices, the OPEC countries saw their current account surplus surge to some $60 billion, from one of approximately $5 billion in 1973. The oil-consuming countries ran a collective current account deficit of that magnitude, and the OPEC countries had funds of the same amount available for new foreign investments.

While this financial imbalance is unprecedented, it is also temporary. Recent forecasts, taking into account the demonstrated ability of the oil exporters to increase their foreign purchases of goods and services and a reduction in demand for oil in the importing countries, suggest that the cumulative OPEC surplus will peak and begin to decline sooner than indicated by earlier projections. By the end of the decade, were the cartel to hold together, OPEC's financial accumulations might total between $200 and $250 billion, measured in constant dollars.

In general, the initial response of the international community to the problems posed by these massive shifts in payments patterns has been constructive. From the earliest stages, there has been widespread recognition of the need to avoid recourse to self-defeating measures to restrict other imports or subsidize exports in order to pay swollen oil bills. The complex of international financial institutions, both official and private, has adapted well to the challenges of handling immense capital flows moving in new patterns. As a product of sustained effort, the oil-consuming countries have developed innovative forms of cooperation in energy policy to protect themselves against the dangers of overdependence on unreliable foreign suppliers.

Novel situations tend to call forth a wide variety of allegedly innovative and imaginative solutions. My own bias is somewhat different. I confess to applying to the game of international finance the lesson that John Wooden has convincingly imparted to basketball—that while there is a need to be adaptable, what really pays off is close attention to fundamentals. During a period of strain, it is particularly important not to divert our energies from the practical and essential to the impractical and inadequate.

From this viewpoint, I am skeptical about some of the suggestions for innovation which have been made.

One set of proposals would establish new institutions in the form of investment trusts jointly managed by OPEC governments and investment advisers from the oil-consuming countries to channel OPEC funds into long-term investments in consuming nations. It is asserted that such arrangements would, among other things, serve to reduce the concentration of OPEC investments in volatile short-term placements and allay fears in oil-consuming nations about OPEC domination of key industrial sectors or investments in key firms.

While these proposals reflect laudable aims, they seem to me to have only limited relevance to the issues at hand. It is inconceivable that such arrangements could handle more than a relatively small percentage of prospective OPEC surpluses, and I doubt whether their establishment would significantly affect either the volume of OPEC direct investments or their distribution. Moreover, unless special incentives are provided, which would seem to be highly inappropriate, I fail to see why any new institutions of this sort could be expected to out-compete the wide variety of diversified portfolio management services which can be expected to be available through normal private channels.

Another approach is embodied in the IMF's special oil facility. This facility was a serviceable first response to the sudden shift in payments positions that confronted the oil-importing world last year. But the oil facility approach does not provide a useful continuing response, basically for three reasons. First, its operations are tied to an arbitrary—and, as time goes on, increasingly inappropriate—"oil deficit" formula. Second, its basic presumption is that no attempt should be made to begin to adjust the imbalances between oil importing and exporting countries, or among oil-importing countries. Access to the facility's resources has been therefore virtually automatic. But this presumption is not a valid longer term response; adjustments are necessary and must begin. Finally, the oil facility borrows in effect on a guaranteed basis from the oil exporters and others, and in doing so tends to encumber the Fund's regular lending resources. This problem is further exacerbated by the facts that the oil facility pays a higher interest rate on these guaranteed borrowings than the IMF pays on the use of its regular currency subscriptions, and that a number of major oil facility lenders currently refuse to allow their regular subscriptions to be used by the Fund.

Happily, these shortcomings are now generally recognized. It has been agreed that the oil facility's operations will be improved somewhat this year and that its transitional role will be completed by the end of 1975, by which time it will be phased out.

Yet another imaginative idea sometimes put forward is that the oil-consuming countries should seek to reach agreement on their current account objectives in general and on sharing the "oil deficit" in particular. The idea appears to be that industrial countries should devise a formula that would distribute these deficits in an acceptable and equitable fashion. It is argued that without such agreement some countries may not accept the self-discipline necessary to prevent runaway inflation while others may move so rapidly and insistently to reduce their deficits that they create intolerable adjustment problems for their trading partners. Since the latter would be likely to react in kind, so the argument goes, the world could be plunged into a spiral of escalating trade restrictions and artificial subsidies to exports.

This sort of proposal is intellectually seductive—but is it really intellectually sound? One difficulty in such approaches is the technical but inescapable problem of defining both the current account position and the oil deficit to be shared. In seeking to measure current account positions, it is difficult to isolate the influence of transitory factors such as differences in cyclical situations among countries in order to determine the underlying position. Measuring the oil deficit raises other questions: Should the oil deficit be regarded as simply the increase in a country's oil bill, or should it include related new exports to the oil producers, the investments of the oil producers, the interest payments thereon, and so forth?

More fundamentally, this focus on sharing current account deficits as a policy objective ignores the fact that many different balance of payments structures are consistent with a satisfactory adaptation to the oil price increases. For example, a relatively strong current account position in an oil-importing country need not raise consistency problems so long as that country is willing to provide financing for the consequently enlarged deficits of other consuming countries. Given the range of policy alternatives to achieve consistency, the emphasis inevitably must be on whether countries' policies as a whole are appropriate, rather than on some concept of what countries' positions should be, arrived at by mechanistic formulas.

It also must be recognized that to be meaningful, an international agreement on an appropriate sharing of current account and oil deficits would also have to embody agreement on a program of action to correct imbalances. The acknowledged limits on the willingness of countries to adapt fiscal and monetary policies to achieve external objectives, combined with the unacceptability of extensive recourse to direct measures affecting external transactions, would inevitably imply actions by countries to influence artificially the underlying trend of their exchange rates. It seems to me highly unrealistic to suppose that a world which suspended attempts to fix exchange rates even before the onslaught of the oil crisis is now ready to undertake the effort again.

Ideas of the kind I have just been discussing all reflect a concern that something more must be done. Other commentators, however, seek to minimize the problem itself. Their argument is that it is easily within the capability of the industrial countries, if they resume historical rates of economic growth, to transfer real resources, in the form of exports of goods and services, to the OPEC countries to liquidate oil bills. The transfers to be made to OPEC—estimated at some 2 percent of the industrial countries' GNP—are said to be relatively no greater than those that would have been required had Marshall plan aid to Europe been all in the form of loans. On the basis of this reasoning, it is concluded that the consuming countries should accept high oil prices, minimize the structural adjustments implied by these prices, borrow to finance current oil bills, and pay later in real resources.

One pitfall in this approach is that it does not take into account the problems which arise from differences in countries' willingness and ability to borrow. Some countries will be able to borrow but reluctant to do so, while others will be anxious to borrow but unable to do so. In the real world, these differences cannot be eliminated by assertions as to what countries ought to do.

But the major shortcoming of this line of reasoning is that it seriously underestimates the economic costs which the oil price increases levy on the rest of the world. It ignores the inflation and unemployment costs imposed on oil-importing countries as they adjust their industrial structures to a major change in the relative price of their inputs. The losses incurred in the process of an abrupt, forced structural adjustment of the entire industrial world should not be minimized. Anyone in Detroit can testify to what high oil prices mean for employment on an auto assembly line. Even when the shortrun effects are dissipated, levels of real income in the oil-importing nations at any point in time will be substantially lower, not only because of the continuing costs of high oil prices, but also because of the reduced capital stock caused by the transitional adjustment to the high oil prices. Moreover, the potential diversion of real output from domestic consumption to foreign markets can by no means be termed minimal—last year alone increased oil payments were on the order of 15 percent of world trade.

It is thus important to guard against thinking of costs of 2 percent of GNP as small. If the oil price increases were to be maintainable for a number of years, the result would be the greatest economic misallocation of resources that the world has ever seen. Locking up one of the world's cheapest forms of energy inevitably imposes a worldwide burden of massive dimensions.

While it is important in this troubled period not to chase down blind alleys, it is even more important to take decisive actions to meet real problems.

In the international financial sphere, additional safeguards against the continuing uncertainties inherent in the present dramatically changed situation are desirable. While OPEC's surplus funds can't leave the system in the aggregate, there is some danger that individual oil-importing countries might be unable, or fear they will be unable, to obtain on reasonable terms the financing they need even when their own policies are prudent and appropriate. Insurance against such a risk would help to ensure that national and international policies will be based on confidence, not on fear.

Tonight I will be leaving with Secretary Simon for Paris, where on Wednesday he and other Ministers of the Organization for Economic Cooperation and Development will initial an agreement which, when approved by the Congress and other legislatures, will establish a financial safety net to provide such insurance. That is the $25 billion mutual Support Fund, proposed by the United States last November, agreed to in principle at high-level monetary meetings in January, and subsequently worked out in detail.

This agreement constitutes a key element in the evolution of governmental strategy to protect against the uncertainties now generated by the oil crisis. Having participated in the negotiation of this agreement, I know there is a feeling among prospective adherents that it represents a significant achievement in cooperative international financial arrangements. It is also an important complement to the cooperation in energy policy which is central to resolution of the fundamental problems resulting from the changed energy balance. For countries committed to cooperation in energy, it will provide assurances that financing will be available in case of need. And, by strengthening the confidence of private lenders and investors in the integrity of the system as a whole and in the ultimate strength of individual countries' positions, the fund will make a major contribution to the operation of the world economic system.

We hope that the safety net will not have to be used. If that turns out to be the case, it will have been a costless precaution. If it is utilized, the contribution to world financial stability will be well worth the cost.

Whatever new intergovernmental arrangements are developed, the private financial system will inevitably be called upon to play the major role in channeling OPEC monies to their ultimate employment. To do so will require more of the flexibility and innovation on the part of private institutions which they demonstrated not only last year, but earlier. For example, liabilities management, which changed so greatly in the 1960's with the growth of the Eurodollar market and the rapid expansion of new forms of debt instruments, must continue to be adapted to new realities. Asset management also must be adapted to importantly altered circumstances. This is perhaps the more difficult challenge because some of the familiar yardsticks are no longer applicable. In particular, analysis of country risk has become almost a new ball game.

Traditional risk analysis has related a country's repayment ability to balance of payments trends, external debt, and reserve levels. If these traditional yardsticks were rigidly applied, without due regard to the consequences of the existence of a new group or surplus countries, it would be difficult to justify anything beyond a bare minimum of foreign lending. With the increase in oil prices, the trade and current account positions of oil-importing countries as a group have turned sharply adverse. Until the time when the OPEC countries are able to absorb imports from consuming countries at the same rate they themselves export, there will inevitably be an increase in the external indebtedness of the oil-consuming countries as a group. What must be cranked into credit analysis in these circumstances is that the creditors—the OPEC countries in the final analysis—can only call their loans from the oil-importing countries as a group by accepting goods and services in payment. The very demand for payment creates the conditions that allow payment to be made. Certainly, they can shift funds from one oil-importing country to another—if it were in their interest to do so—but this need not cause intolerable strains so long as financing arrangements among the oil-importing countries are adequate.

Widespread floating of exchange rates introduces still other variables into the analysis of the risks of foreign lending. Heretofore, the level of a country's reserves, often measured in relation to imports or other such norms, was an important guide to a country's debt service capacity. Individual countries now, however, have the choice of taking the consequences of a deteriorating position "on the rate," rather than by drawing down reserves. There are no "pat" answers as to what any given country will do, and net borrowing by the oil-consuming countries as a group remains inevitable, but it is clear that every country has available and usable an additional policy alternative. This greater flexibility means that neither the level of a country's reserves nor changes in that level provide the same guide to a country's creditworthiness that they once did.

The diminished relevance of these traditional criteria makes it more important than ever to take a fresh look at the risks of international lending.

Of course, commercial risk is always present when lending to business firms or banks. Such normal risks are certainly present in the current difficult situation. The oil embargo, high oil prices, and uncertainty about future energy sources have contributed importantly to the downturn in economic activity and to the pace of structural changes in national economies. In this climate, certain sectors will experience greater difficulties, while others will profit.

None of this, however, has anything particular to do with the overall external position of a country. It is both interesting and relevant that three of the most highly publicized bank collapses which have occured in the past year were in Germany, Switzerland, and the United States—countries which could hardly be regarded as devastated by the oil-related events. This merely reinforces the point that bankers, like governments, must pay attention to the fundamentals.

There is a natural resistance to the rather major revisions in our thinking and our practices which are required by the marked changes we have witnessed in our economic order. There is a certain comfort in familiar doctrines and habits no matter how circumstances may have been altered. But I am confident that we can and will make the necessary adjustments, for they are really imposed by external developments.

Governments have had their own problems in adjusting—most notably to floating exchange rates. You are all aware of the concern that was being expressed recently in Europe about what is described as weakness of the dollar. The dollar, not surprisingly, has significantly strengthened in recent weeks. Despite a good deal of educational effort, far too many still have apparently not yet recognized that there are two sides to every exchange rate and that what is called a weakening of the dollar may more aptly be described as a strengthening of the German mark or the Swiss franc. Even the widespread use of trade-weighted exchange rate computations does not seem to have enabled some observers to broaden their vistas from bilateral rates to more representative measures.

Let me conclude my remarks today by briefly rounding out the long agenda of actions needed to cope with the multiple challenges ahead.

The basic challenge is as much domestic as international. Nothing is more fundamental to future domestic prosperity and the stability of international financial relations than bringing the major world economies out of recession without exacerbating a still dangerous inflationary situation. We will find it infinitely more difficult to solve the present complex of economic problems in the context of high unemployment and negative growth. Yet if we can restore growth only at the cost of another inflationary spiral, we will have but substituted one set of problems for another, and find in the end we have choked off the economic recovery we seek.

For developing countries, the challenge is similar. Effective assistance to developing countries hard-hit by the increase in oil prices require a solid foundation. The answer will not be found in oratory about a New Economic Order. The basic requirement remains unchanged: sound domestic economic policies on the part of these countries themselves, to adjust to changed economic conditions, and to promote investment and the increased productivity essential to the realization of their aspirations. But others also must recognize their responsibilities. For the OPEC countries, this means accepting the full implications of their new role. For the world's former creditor countries this means we must not, whatever our own problems, turn inward and backward. We have established a new Development Committee under the aegis of the International Monetary Fund and the World Bank as a major new forum for organizing the needed response. We have high hopes that the work of this new Committee will be effective and practical. More action and less rhetoric is the order of the day. We must find concrete solutions to concrete problems.

Finally, we must continue our efforts to conform our international financial system to the realities of the present. The OECD Financial Support Agreement will not replace the International Monetary Fund at the center of our financial system; indeed the job of that institution has never been more demanding or more important. We are seeking to move ahead to reach full agreement on expansion of its resources through a major quota increase. Such an expansion has been agreed in principle, and we hope that the remaining difficult problems of the distribution of individual quotas can be resolved by summer. But, in order to make such an expansion possible, we must move in parallel to reach consensus on a number of key amendments to the present Fund Articles of Agreement: to establish a permanent council of ministers for the organization to reflect the fact that only in such a forum can the vital decisions of an interdependent world be taken; to eliminate outmoded provisions with respect to the role of gold in the system; to incorporate in the rules provisions which recognize and correspond to the reality of floating exchange rates; and to make the present currency resources of the IMF more usable. Stated so simply, the needed amendments might appear easily obtainable. But what is really at issue is the revision of basic elements of the constitution of the world's most important international financial institution. This is what I mean by governments getting down to fundamentals.

As we approach the agenda ahead, we must always bear in mind that the real challenge is not simply to muddle through the difficulties of this year or next. It is to proceed with a clear vision of our longrun objectives. We must make adjustments in our policies while maintaining the liberal and expanding trade and payments system which has so contributed to the prosperity of the post-World War II period. We must avoid indulging our nostalgia for an earlier era by returning to practices and rules which proved inadequate and unsustainable in the past and are incompatible with the demands and realities of the present. And we must resist the temptation in a time of stress to turn to government intervention as the solution to all our problems. The argument for continuing to rely on the liberal market system which has served us so well is like the argument for democracy—it may not be the best system that is conceivable, but it is far superior to the alternatives.

Exhibit 61.—Statement by Secretary Simon, April 9, 1975, upon signing the OECD* Financial Support Agreement, Paris, France

I am sure that the historic significance of this occasion escapes none of us. At a time of great challenge, creation of a major instrument of international financial cooperation, in which all share both the risks and the benefits, evidences vividly our recognition of our mutual interdependence. It testifies also to our determination to take those steps necessary to ensure that we remain masters of our own fate in the face of economic uncertainties of a dimension and complexity not seen for a quarter-century.

This agreement is an important complement to cooperation in energy which is central to resolution of the fundamental problems in that area. For countries committed to economic cooperation, it will provide assurance that financing will be available in case of need. And, by strengthening the confidence of private lenders and investors in the integrity of the system as a whole and in the ultimate strength of individual countries' positions, the Financial Support Agreement will make a major contribution to the operation of the world economic system.

It is our belief that the very existence of the Financial Support Agreement will contribute to this objective and that the assurance provided by this arrangement will itself serve to reduce the likelihood of developments which would require it to be brought into play. Like an insurance policy, it provides protection against unlikely but nonetheless possible contingencies.

This is not a time for complacency or self-satisfaction. We must continue to strive to adapt the basic rules which govern our economic relations to the realities of today amidst the urgent press of day-to-day problems. Our ability to maintain and invigorate our basic commitment to a liberal trade and payments system, despite temptations to deviate, will be the true test of our resolve.

It is often said that in every crisis there is opportunity. The energy crisis led to the intensified cooperation which we are consolidating here today. Now, the challenge is to continue together to forge a response which permits us not merely to get through this difficult period but to build a better world, and in so doing, to preserve the basic values which bind us together.

By our presence here, and our signatures, we testify again to our determination to find common solutions to common problems. I am happy to affix my name to this historic document.

Exhibit 62.—Statement by Assistant Secretary Cooper, May 5, 1975, before the Subcommittee on International Trade and Commerce of the House Committee on International Relations, on the Financial Support Fund

Mr. Chairman, I am pleased to appear before this subcommittee to discuss the proposed Financial Support Fund. This new international financial arrangement represents a key element of our efforts to promote effective international cooperation—in both energy and general economic policy—in a period of great uncertainty and change. An effective response to the financial and economic challenges posed by the severe increases in oil prices demands a unity of purpose and common effort among major oil-consuming nations. The Support Fund can play a major role in shaping that common effort.

Basic purposes and principles of Support Fund

The Support Fund Agreement signed by Secretary Simon on behalf of the United States on April 9 has its origins in proposals put forward independently by the United States and by the Secretary-General of the Organization for Economic Cooperation and Development (OECD) late last year. Those proposals were pursued intensively first by a working party of the Deputies of the Group of Ten major industrial nations. The outlines of the plan were accepted in principle by Ministers of the Group of Ten in Washington in January. Detailed technical and legal drafting was then assigned to a working party of the OECD, an organization whose membership includes nearly all the developed nations of the non-Communist world. The agreement therefore represents a major international

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*The 24-nation Organization for Economic Cooperation and Development (OECD) was established in 1961. Its purposes are (a) to promote economic growth and employment while maintaining financial stability; (b) to contribute to sound economic expansion in member as well as nonmember countries in the process of development; and (c) to contribute to expansion of world trade on a multilateral, nondiscriminatory basis.

cooperative effort. But the basic purpose and substance of the agreement closely parallel original U.S. concepts.

The proposals for a Support Fund arrangement were developed following a period of widespread concern—which has subsequently proved unwarranted—that the oil-importing world faced nearly certain financial disaster, that the private financial markets were utterly incapable of handling financing of the magnitudes and variety foreseen, and that a large new official recycling mechanism be imposed on the world to intermediate between the oil-exporting investors and the oil-importing borrowers. Those who held such views suggested various proposals involving more or less open-ended official financing arrangements between lenders and borrowers, displacing private markets and other existing financing channels, and frequently envisaging guarantees or other special incentives to induce the oil exporters to place their funds with the new arrangement. Proposals for a massive, open-ended IMF oil facility—involving IMF borrowings from the oil producers on the basis of market-related rates of interest, exchange rate and default guarantees to lenders, and virtually automatic credit to borrowers—perhaps best typified these schemes.

Our proposal for a Financial Support Fund was based on a different analysis of the situation and a different assessment of the requirements.

First, we felt it was not desirable to create a major new financial mechanism to deal with oil-related financing without addressing more fundamental problems. Any new arrangement must demand of its participants cooperation in energy policy as well as cooperation in broader economic and financial policy.

Second, the United States viewed the financial problems posed by the increases in oil prices as transitional in nature. Energy conservation and increased energy production in the oil-importing world will over time cut into the oil exporters' revenues. Rapidly growing demands in oil-exporting countries for foreign goods and technology will over time substantially increase their payments abroad. These transfers will impose the real costs of high oil prices, but they will also serve to make the financial problem temporary. Current projections are that the accumulated investable surplus of the oil exporters as a group will have peaked by the end of this decade, if not before, in the range of $170–$250 billion (at 1974 prices). If this expectation is correct, the largest annual imbalances between the oil importing and exporting groups have already occurred and will taper off toward the end of the 1970's. But large imbalances and financing needs will continue for the next several years, and their cumulative effects may mean that the severest tests still lie ahead.

Third, we believe that any official financial mechanism established should not seek to displace the private markets or other existing sources of financing. These arrangements performed well in 1974 in the face of rapidly changing circumstances and should be permitted and encouraged to continue to perform and adapt.

Fourth, in our view, the nature of the financing problems, or potential financing problems, faced by the developed oil-importing countries was not the unavailability of financing in the aggregate. The oil-exporting countries have no practical alternative to placement of the bulk of their financial surpluses in the capital and money markets of the major oil-importing countries. Instead, the danger is that an individual country may not be able to obtain on reasonable terms the external financing it needs to maintain appropriate levels of domestic economic activity, to avoid recourse to restrictions on international trade and capital flows, and to maintain cooperative energy policies.

The major dangers that to many seemed so prominent in the immediate aftermath of the oil price increases have been avoided thus far, and we hope that will continue to be the case. Nonetheless, there is no assurance at present that this favorable situation will continue, and that individual countries will not be driven to inappropriate and unfair policies by the unavailability, actual or prospective, of needed external capital. This possibility may increase as the imbalances, and countries' use of international financing arrangements, accumulate. Once begun, recourse to such policies could quickly spread, triggering a destructive and self-defeating spiral of restrictions on world trade and payments and moves toward excessive curtailment of economic activity. Our ability to achieve effective cooperation on the real problems of energy, growth, inflation, and economic development would be gravely jeopardized. The risk of such a trend is shared by all countries. It is manageable, but it must be managed.

This basic analysis, which has gained widespread acceptance, has determined several fundamental principles of the Support Fund's operations:

The Support Fund is designed to meet a common danger, and all risk associated with its operations will be shared fully and equitably, on a predetermined basis, among all participants. Risk will not fall—as it might in the absence of the Fund—on the one or two countries that might be in the strongest position when an emergency arises elsewhere in the system.

Commitment to cooperation in energy and general economic policy is a basic requirement of participation in the Support Fund. In the event the Fund has to be used, specific policy conditions will be attached to its loans. The need for a financial mechanism complementary to cooperation in energy and economic policy made it desirable that the arrangement be established within the general framework of the OECD, which provides the central forum for such cooperation among developed countries.

The Support Fund is a temporary device. Its authority to provide financing will lapse 2 years after it comes into existence, and no new institution or staff will be created. The Support Fund will be headquartered at the OECD in Paris; its policies and operations will be guided by financial officials from participating capitals, meeting as necessary to conduct the Fund's business; and needed staff work will be carried out by the OECD staff under agreed compensation arrangements. At the end of 2 years, of course, circumstances may show that we have been too optimistic and that the life of the Fund should be extended. But that does not appear likely at this stage.

The Support Fund is an insurance mechanism, a "safety net" to supplement other sources of financing, private and official, only in the event those other sources prove inadequate to meet world financing needs. To be eligible to request a loan from the Support Fund, a country must demonstrate not only that it is encountering serious external financial difficulties but also that it has made the fullest appropriate use of other sources of financing available to it. Loans will be based on market terms. The existence of the Fund should serve to strengthen the operations of the private markets and make recourse to the Fund's resources unlikely.

These principles assure that the new arrangement will serve as a mutual insurance fund in support of mutual objectives, with risk spread equitably and with any participant entitled to borrow from the Fund if its circumstances warrant. It will not be a regularly used financing channel or be viewed as a foreign aid device. There is no scope in the Support Fund for the provision of financing without appropriate policy conditions, or for concessional assistance. If the Fund is used, participants will make financing available to it on market terms, and the cost of financing to borrowers will be greater than the cost of financing to the Fund. The aim is to assure access to financing, not to provide financing on generous terms.

In essence, the Support Fund is designed to provide confidence:

Confidence to the private markets in the strength and integrity of the system as a whole; and

Confidence to participants in their ability to handle their own problems—to deal with their energy-related financing needs without dependence on the oil-exporting countries.

This self-confidence is essential to the close cooperation in energy and other policies that is needed in the period ahead.

The practical facts of the situation are that the major oil-importing countries *can* handle their own financing needs without relying on the agreement or specific investment policies of the oil-importing countries. The close relationship of the Fund to energy policy and the need to maintain confidence on the part of the oil-importing countries, individually and as a group, indicate that they *should* handle their mutual problems on their own.

Main operating provisions of Support Fund

Copies of the Support Fund Agreement have been made available to the subcommittee. Having outlined the basic purposes and principles of the Support Fund, let me now sketch its main operating provisions very briefly.

1. The Support Fund will be open to all OECD member countries prepared to commit themselves to cooperation in energy and general economic policy. In fact, all OECD members except Turkey have already signed the agreement, and Turkey intends to sign shortly.

2. Like any insurance policy, the resources of the Support Fund must be seen to be adequate to meet potential needs, and seen to be available promptly if

needed. Total country quotas in the Support Fund will amount to about $25 billion. The U.S. quota will amount to about $7 billion, or 27.8 percent of the total.

3. No money is to be paid in to the Support Fund unless and until the need arises. Quotas will simply be available on a standby or "call" basis in case of need.

4. Countries' quotas will determine (a) the distribution of default risk, (b) voting power, (c) obligations to provide financing, (d) rights to borrow, and (e) maximum financial obligations to the Fund.

5. The main financial decisions—decisions on loans and calls to provide financing—will require a two-thirds weighted majority vote plus a simple unweighted majority of the number of countries voting. Decisions on loans that raise a borrower's debt to the Fund above the amount of that country's quota, but less than twice its quota, will require a 90-percent weighted vote; and loans that cause a borrower's debt to the Fund to exceed twice its quota will require unanimous consent. In practice, therefore, the United States and any other single major participant could together exercise an effective veto on all operations of the Fund, and the United States alone will have veto power over any loans that raise a borrower's outstanding debt to the Fund above its quota.

6. All decisions will be taken by a Governing Committee composed of one senior financial official and one alternate from each participating government. An Advisory Board of experts nominated by members and designated by the Governing Committee will prepare the work of the Committee. No secretariat or permanent institutional structure will be created. The Fund will rely on the OECD Secretariat for necessary staff work.

7. Financing of Support Fund operations will be flexible. The Governing Board can decide to finance a loan by (a) "individual commitments," involving either a direct loan to the Fund or a borrowing by the Fund on the strength of individual countries' guarantees; or (b) borrowings by the Fund on the strength of the collective guarantee of all participants. Resources will be made available to the Fund on market-related terms.

8. In principle, all participants except the borrower will share in the provision of each financing operation according to quota shares. However, there will be some scope for countries to be excused from the obligations to provide financing to the Fund under "individual commitments" and also to "mobilize," or obtain early repayment of, a loan already made to the Fund. In either case, the country would itself have to be in serious balance of payments difficulty and obtain the approval of the Governing Committee by a two-thirds majority vote. These clauses relate strictly to the provision of financing. They do not excuse a participant from assuming its share of the default risk on any loan made by the Fund, a risk which in all cases will be shared in proportion to quotas.

9. Loan recipients will have to be facing serious balance of payments difficulties and making fullest appropriate use of alternative sources of financing available on reasonable terms. They will also have to follow policies consistent with the Support Fund's objectives, incuding cooperative energy policies, and will have to accept specific economic policy conditions established by the Governing Committee.

10. Loans may be "phased," with each installment contingent on the borrower's performance with respect to the agreed conditions. Loans may be made for up to 7 years and will bear interest adequate to cover the cost of resources to the Fund.

U.S. participation in Support Fund

Signature of the agreement establishing the Support Fund did not constitute an obligation of the United States to participate or provide financing to the Support Fund. The agreement expressly provides that it will enter into force for a signatory only after that country has obtained all necessary legislation or other authority constitutionally required or otherwise necessary for its participation. Most prospective participants will need domestic legislation, and all understand clearly that approval of the Congress will be needed before the United States can participate.

Preparation of the draft legislation to enable the United States to participate is near completion, and I hope that it can be transmitted to Congress in the very near future.

Conclusion

Mr. Chairman, the U.S. interest in preservation of a cooperative and smoothly operating world economy is unmistakable. That interest, reflected in the extensive framework of international cooperative arrangements developed since World War II, has been underscored with a vengeance by the events of the past 2 years or so. The proposed Support Fund is a basic element of our efforts to develop, together with other oil-importing nations, a cooperative response to the energy situation and to maintain a strong and open world economic order.

The Support Fund is based on principles of mutual support and equitable sharing of common risks. It will promote maximum reliance on the existing financial arrangements that have served us well to date, while providing a valuable multilateral insurance facility should those existing arrangements prove inadequate. Should the Support Fund not have to be used, that insurance will have been costless. If it must be brought into play, the benefits to U.S. interests will have been well worth the effort. The legislation that will come to the Congress shortly will embody a central element of U.S. foreign economic policy, and I hope it will receive your strong support.

Exhibit 63.—Communique of the Interim Committee of the Board of Governors of the International Monetary Fund on the International Monetary System, issued after its third meeting, Paris, France, June 10–11, 1975

1. The Interim Committee of the Board of Governors of the International Monetary Fund held its third meeting in Paris on June 10 and 11, 1975 under the chairmanship of Mr. John N. Turner, Minister of Finance of Canada. Mr. H. Johannes Witteveen, Managing Director of the Internatonal Monetary Fund, participated in the meeting. The following observers attended during the Committee's discussions: Mr. Henri Konan Bédié, Chairman, Bank-Fund Development Committee, Mr. Gamani Corea, Secretary General, UNCTAD, Mr. William Haferkamp, Vice President, EC Commission, Mr. Bahman Karbassioun, Advisor to the Secretary-General of OPEC, Mr. René Larre, General Manager, BIS, Mr. Emile van Lennep, Secretary General, OECD, Mr. F. Leutwiler, President, National Bank of Switzerland, Mr. Oliver Long, Director General, GATT, Mr. Robert S. McNamara, President, IBRD.

2. The Committee received opinions, including that of the Managing Director, on the World Economic Outlook and its implications for the management of domestic policies and international financial relationships. The Committee agreed that external financing would remain for some time a critical problem for a number of countries and that its solution would require both maximum efforts on the part of such countries to enhance their creditworthiness and cooperative efforts in capital exporting countries to encourage the needed flows of financial resources.

3. The Committee noted that, in accordance with the consensus reached in the Committee at its January meeting, the Executive Directors of the Fund have decided to continue in 1975 the Fund's oil facility and that in order to finance purchases under that facility, loans for substantial amounts have already been arranged with several oil exporting members and a number of other members in strong external positions. The Committee noted that negotiations would be continued in order to complete arrangements for the financing of the oil facility. The Committee welcomed the progress that has been made toward the establishment of a subsidy account to assist the members of the Fund most seriously affected by current conditions to meet the cost of using resources made available to them through the oil facility. The Committee welcomes the support pledged so far and urges other members to take similar action so that the account can be established as soon as possible. The Committee endorsed the decision of the Executive Directors to review all aspects of the facility in July 1975.

4. The Committee held a detailed discussion of the role of gold and there was widespread agreement that a solution would have to be based on the following broad principles:

(i) The objective should be an enhancement in the role of the SDR as the central asset in the international monetary system and, consequently, a reduction of the role of gold.

(ii) The official price of gold should be abolished.

(iii) Obligations to use gold in payments between the Fund and members should be abrogated.

(iv) There should be the sale of a portion of the Fund's gold at the approximate market price for the benefit of developing members in general, and particularly those with low income, and the sale of another portion to members at the present official price.

(v) With respect to the rest of the Fund's gold, there should be a range of broad enabling powers, exercisable with a high majority.

(vi) A reasonable formula should be found for understandings on transactions by monetary authorities with each other and in the market, which would include understandings that would be designed to avoid the re-establishment of an official price and would deal with the volume of gold held by monetary authorities.

(vii) An appropriate formula should be found for collaboration with the Fund in connection with the understandings among monetary authorities. Some countries felt that this collaboration should relate also to the reduction of the role of reserve currencies in the international monetary system.

The Committee was of the view that the Executive Directors should be asked to study the question of gold further in order that a final agreement can be reached on the basis of these principles.

The Executive Directors should study the establishment of a gold substitution account through which members would be able to exchange a part or all of their gold holding for SDR's issued by the Fund for this purpose.

5. The Committee also discussed the exchange arangements that members of the Fund should observe. There was widespread agreement that members should have a basic obligation to collaborate with the Fund and with other members in order to promote exchange stability, to maintain orderly exchange arrangements, and to pursue exchange policies that contribute to adjustments, and that the Fund should adopt policies in order to enable members to act consistently with their basic obligations whatever their exchange arrangements might be. The Committee reiterated its agreement that provision should be made for stable but adjustable par values and the floating of currencies in particular situations, subject to appropriate rules and surveillance of the Fund, in accordance with the outline of reform.

6. The Committee endorsed the principle of the improvement of the special drawing account and the general account and agreed that the Executive Directors should be asked to find agreed solutions on the few remaining issues. The Committee attached particular importance to the inclusion of effective provisions in the amended Articles under which the Fund's holdings of the currencies of all members would be usable, in accordance with appropriate economic criteria, in its standard operations and transactions. It was agreed that the Executive Directors should study a power to invest a part of the Fund's assets equal to its reserves for the purpose of raising income that would enable it to meet any administrative or operational deficits, and to report on this subject as soon as possible.

7. (a) It was agreed that a Council should come into being when a decision is taken by the Fund for that purpose under an appropriate amendment. The Council would strengthen the Fund by providing it with an organ composed in the same manner as the Committee of Twenty and the Interim Committee but with authority not only to exercise advisory functions, but also to take decisions under specific powers. The Committee shares the view of the Executive Directors that, except for a few powers of a political or structural character that should be reserved to the Board of Governors, all powers of the Board of Governors should be delegable in principle to the Council, to the Executive Directors, or to both concurrently, by decisions of the Board of Governors

(b) On the question of the majorities for the adoption of decisions of the Fund on important matters, it was agreed that an 85 percent majority should be required under the amended Articles for those decisions that can be taken now by an 80 percent majority.

(c) The Commitee noted with approval the draft of an amendment by which amendments to the Articles would become effective when accepted by three-fifths of the members having 85 percent, instead of 80 percent as at present, of the total voting power.

8. The Committee considered various proposals to assist members in dealing with problems arising from sharp fluctuations in the prices of primary products.

In this connection, the Committee requested the Executive Directors to consider appropriate modifications of the Fund's facilities on the compensatory financing of export fluctuations and on assistance to members in connection with their contributions to international buffer stocks. It was agreed that, after amendment, a member using the Fund's buffer stock facility would be able to retain any portion of its reserves held in the form of a reserve position in the Fund; this provision now applies to drawings under the Fund's compensatory financing facility.

9. The Committee considered the report of the Executive Directors on the progress made toward implementation of the understandings reached in the Committee last January with regard to increases in the quotas of members as a result of the sixth general review of quotas. The Committee noted with satisfaction that progress had been made in reaching agreement on quota increases to be proposed for individual countries. The Committee agreed that for the quota increases proposed as a result of this review, and subject to the amendment of the Articles, members should be given an option to pay 25 percent of the increase in quota (which in the past members have had to pay in gold) in special drawing rights (SDR's), the currencies of certain other members, subject to their concurrence, or in the member's own currency. The question of payment in gold by agreement with the Fund would be settled as part of the provisions on gold. The balance of the increase in subscription would be paid, as in the past, in the paying member's own currency. The Committee also recommended that there should be no obligation for a member to repurchase the amount of its own currency paid in excess of 75 percent of the increase in its quota. The Executive Directors have been asked to prepare and submit as promptly as possible to the Board of Governors, for consideration at its annual meeting in September 1975, a resolution that will include proposed increases in the quotas of individual members and provisions on the payment of corresponding subscriptions on the basis of the understandings reached by the Committee.

10. The Committee agreed to meet again in Washington, D.C., immediately before the annual meeting of the Board of Governors. The Committee agreed to meet in Jamaica in January and expressed its gratitude to the Jamaican authorities for the invitation.

Exhibit 64.—Address by Secretary Simon, June 13, 1975, before the International Monetary Conference of the American Bankers Association, Amsterdam, the Netherlands, giving an overview of the U.S. approach to the international economy

I welcome this opportunity to appear before you today as you conclude your annual conference on international monetary affairs. This gathering has a well-established reputation as one of the most important and prestigious in the financial world, and I am pleased to see that this year's meeting is continuing that tradition.

The past year has been tumultuous for both the banking community and the governments seeking to adjust to the challenges of the international economy. Each of us has had to deal with the continuing shock of high oil prices and large-scale movements of money between nations, with inflation that has abated but remains at unacceptably high levels, and with a severe and widespread recession that appears to be nearing its end.

We recognize that in meeting these challenges the policies and economic performance of the United States still bear heavily upon the fortunes of all other major industrialized nations. Today, I would like to ask you to join with me in a sweeping overview of my Government's approach to the international economy in which we participate. Our policies are not as well understood as they should be, and I hope that today I can place them in clearer perspective.

In particular, I want to respond to four accusations which have been leveled against the U.S. foreign economic policies in recent months.

First, our Government has been accused of neglecting the value of the dollar. I agree. We have.

Second, our Government has been acused of encouraging the oil-exporting nations to raise their prices. I agree. We have.

Third, our Government has been accused of believing that greater emphasis should be placed on a free market approach to problems of the international economy. I agree. We have.

Finally, our Government has been accused of not having an international economic policy. On that charge, I disagree, and I do so most emphatically.

Let me turn now to a more detailed consideration of each of these issues.

Neglecting the value of the dollar

Periodically, the United States has been charged with neglecting the value of the dollar.

I must say to you that in a very basic sense, we have indeed done too little to defend our currency. During the last 10 years, the value of the dollar as measured by the Consumer Price Index has fallen by 41 percent in the United States—a direct result of the most prolonged period of inflation in our peacetime history.

I mention this figure to illustrate that the value of the dollar is essentially based upon the condition of the U.S. economy. The dollar's exchange rate in large part records how well the American economy is performing in comparison to other economies. Thus, to maintain a strong dollar, the essential requirement is to assure a vibrant, inflation-free economy at home. This is the true defense of the dollar and amounts to the single most important contribution we can make to the health of the international economy.

Yet, over the past decade, the United States has pursued excessive and misguided fiscal and monetary policies which have built strong, inflationary forces into the structure of our economy. Moreover, in the private sector, we have discouraged the process of savings and capital investment to such a degree that our record of capital investment since 1960 has been the lowest of any of the major industrialized nations. By 1973, we began to experience capacity shortages in some of our most basic industries, seriously aggravating the pressures of inflation. There were, of course, other factors contributing to the extraordinary rates of inflation we have experienced recently—such as the fourfold increases in the price of crude oil and adverse food conditions—but the underlying causes of our inflation have been those mistaken policies that started in the mid-1960's.

Nor can we ignore the fact that the same forces that caused the inflationary wave that engulfed the United States in 1973 and 1974—in addition to weakening the power of the dollar—were the major factors causing the recession in the United States. Most economists now recognize that the housing industry and retail sales both fell sharply under the pressures of inflation, precipitating the economy's downward slide.

Thus, as we emerge from this current recession, we believe that we must proceed with a high degree of prudence. The central goal of our domestic economic policy is to achieve a period of sustained, durable economic growth *without* bringing on a resurgence of inflation. There is now abundant evidence that natural, cyclical forces within the economy in addition to expansionary governmental policies are bringing us out of the recession. The Government is certainly not leaving matters to chance. The largest tax cut in our history is now exerting a positive influence on the economy, as are the current budget deficits. In addition, the Federal Reserve has eased monetary conditions substantially and Board Chairman Arthur Burns has recently indicated that the Fed will continue to support the process of recovery by 5 to 7½ percent growth in the money supply.

In warming up the economy, however, we must avoid the temptations of overheating it. It is tempting to seek an immediate end to the problems of unemployment, but in the long run, that course would only lead to a sorrowful repetition of the boom-and-bust cycle of the past and would condemn millions of Americans—not to mention the citizens of other countries whose economic fortunes are closely tied to our own—to years of further hardship and suffering. We are determined, even at great political risk, to pursue balanced economic policies—policies that make sense not just for 1 year but for years to come.

It is in this sense that I can report to you today that we fully intend to do a better job of protecting the value of the dollar in the future.

Debates over the dollar quickly lead, of course, to differing views on exchange rate policies. Contrary to those who believe that we must try to return to a more rigid international monetary system or even one based on gold, I am a strong advocate of a more flexible system that reflects the diversity of the real world and allows nations greater freedom of choice in specific exchange rate arrangements, provided that they act in accordance with an agreed code of international behavior. Additionally, the United States is working for a system in which the role of gold is lessened so that we may curtail the destabilizing effects of that commodity on the monetary system. This objective is widely shared, and the International Monetary Fund's Ministerial Interim Committee has formally agreed to seek arrangements "to ensure that the role of gold in the international system would be gradually reduced."

Meanwhile, the combination of flexible rates and informal intergovernmental consultations developed over the last few years has worked remarkably well. You must only ask yourself how a more rigid international monetary system would have reacted to the shocks caused by the oil embargo and cutbacks in oil production, by economic boom and recession, and by widely disparate rates of inflation in different countries. It seems apparent that without increased exchange rate flexibility, we would have suffered huge and destabilizing reserve movements and the exchange market closures of the past. Moreover, we should not forget that the old system was abandoned because it didn't work: It only encouraged speculation, led to frequent devaluations, and allowed rapidly inflating countries to indulge themselves by "exporting" their inflation to others. While I do not suggest that I have the wisdom to define a system that will work for all ages, I do believe that to return now to a more brittle international monetary system would prove to be disruptive of international trade and investment and would be damaging not only to the United States but to foreign economies as well.

We should also recognize just how stable the dollar has been relative to other currencies during this period of widespread floating. When judged appropriately in relation to a relevant weighted average of other currencies, its value has increased about 3 percent over the past 3 months; it is stronger today than it was a year ago; and its value today is almost exactly what it was in early 1973, when generalized floating of currencies began. During this period, in fact, the dollar has been the most stable of the world's five major currencies.

Some have expressed concern over the growth in monetary reserves in 1974 and the early months of 1975, suggesting that excessive international liquidity, particularly in the form of dollar assets, may have given impetus to worldwide inflation. They recall similiar concerns voiced in earlier years when reserves were accumulating in the hands of European and Japanese monetary authorities. Looking behind the statistics, however, there are important differences between the situation of earlier years and that of today. In earlier years, a number of the countries accumulating reserves felt that those reserves were making it more difficult to restrain domestic credit, and in some cases controls were applied to capital imports in order to facilitate restrictive credit policies. By contrast, nearly all of the net additions to reserves last year, as reported by the International Monetary Fund, were acquired by the major oil-exporting countries, not the industrialized nations. Many oil consumers were able to avoid reserve losses only by borrowing abroad or by attracting capital inflows to meet their increased payments to the oil exporters. Few of the oil-importing nations, we believe, felt that international flows of liquid funds were interfering with internal monetary policies aimed at restraining domestic inflationary pressures. We also have some doubts about the usefulness and even the validity of data on international reserves. We know, for example, that not all liquid investments of the oil-producing nations have been reported in the reserve data. And, on the other hand, we know that the foreign investments of most of the oil producers are not for the purpose of intervening in exchange markets to maintain exchange rates; they are a temporary safekeeping of internal wealth. Under the circumstances, the very concept of reserves tends to become useless. Moreover, these reported reserve increases have accrued largely to governments and have been acquired by conscious governmental policies—not as unwanted inflows of funds attracted by relatively restrictive credit policies. Thus the reserve situation today is quite different from that of earlier years. My comments are not meant to suggest, of course, that higher oil prices have not been inflationary—only that their contribution to inflation has resulted mainly from the impact of those prices on the cost of production in consuming nations rather than the enlarged, statistical total of the world's liquid reserves.

Raising oil prices

A second indictment of the United States is that we have in effect been encouraging the oil-exporting nations to raise their prices.

Again, I must confess that through a failure in our policies at home we have invited foreign oil producers to take advantage of us, though we strongly believe their policies are mistaken and will prove contrary to their own interests.

By a slowness to heed the warnings of those who foresaw the energy crisis more than two decades ago, we sowed the seeds for that crisis. By our failure to alter our patterns of consumption more rapidly to conserve energy, we have allowed higher import prices to persist longer than they might have otherwise. And by our hesitancy to accept the need to develop new energy sources, we have given the cartel reason to believe they can continue raising their prices with impunity.

It is not easy to change comfortable habits. That there will be pains in adjusting to a new energy balance is inevitable. But we can no longer afford a "mañana" philosophy. Several European nations have already begun the process of adjustment; the time is long past for us to begin as well. The dependence of the United States upon foreign oil supplies has actually increased since the embargo, and unless we soon reverse directions, we will be reliant upon foreign sources for as much as 50 percent of our oil by the end of the decade.

After the most intensive consideration, the administration early this year put forward a strong and balanced program to bring about the needed adjustments in the United States to the new energy balance. While several Members of the Congress are seeking to develop an effective program, the fact remains that the overall performance of the Congress in the energy field over the last several months—and, indeed, over the last several years—has been marked by unconscionable dawdling and delay. Only the strong leadership of President Ford has averted a total failure in America's energy policies.

Nonetheless, I continue to remain optimistic about the future because there is a growing awareness in the United States that we can neither accept nor afford the monopolistic practices of the OPEC nations. We have been warned by the oil producers in recent weeks that they intend another large-scale price increase this fall, and some have attempted to justify that increase on an alleged 35-percent reduction in their purchasing power in 1974. As long as we lack an effective energy program, such price increases may be possible, but let there be no mistake about the sheer demagoguery used to justify them. The IMF index which is cited for a loss in purchasing power went up 35 basis points, but as the index shows, that increase is the equivalent of a 24-percent change in their prices, and of that amount, at least one-third can, in effect, be traced back to the earlier increases in oil prices. In effect, the oil producers have exacerbated worldwide inflation through their policies and now claim that because of that inflation, they are entitled to further price increases. Moreover, since 1955 the terms of trade of their oil exports have risen five times in comparison to the commodities they import, and since 1960, the export prices for oil have risen by seven times in comparison to their import prices.

Attempts to justify a new oil price increase on the basis of reduced purchasing power are just as fallacious as the efforts to justify earlier price increases on the basis of price rises in other commodities. The OPEC cartel has often cited a fourfold rise in the price of wheat, a 1,200-percent increase in the price of vegetable oil, and a 2,700-percent rise in the price of sugar as reason to raise oil prices. That argument conveniently ignores several basic realities. One is the fact that those other commodities are traded in essentially free markets, and changes in price have taken place in direct response to changing supply and demand conditions. This has been illustrated by the fact that wheat farmers have expanded production as prices have risen; by contrast, the oil cartel has restricted production as prices have risen. Second, it is important to emphasize that there have been decreases as well as increases in the prices of these other commodities. The price of wheat in U.S. markets, for instance, is almost 50 percent less than it was in early 1974, and raw sugar has declined from a peak of 65 cents per pound to 15 cents a pound today. If the OPEC nations truly followed the pricing patterns of other commodities, consumers today would be paying far less for oil today—and the interests of the entire world would be advanced.

I would hope that our Congress would be spurred to action not only by the increasing vulnerability of the United States but also by the realization that OPEC's policies are not invulnerable either. As the recession has helped to reduce worldwide demand for oil, OPEC has been forced to shut in a third of its productive capacity—over 12 million barrels a day—in order to hold the line on prices. Furthermore, during the past 3 years, as the OPEC countries recognize, significant discoveries of oil have been made in some 25 to 30 areas of the world outside OPEC, uncovering reserves estimated at roughly 35 billion barrels. These fields could produce 8 million additional barrels a day by the early 1980's, and this does not include new production from the United States, the Soviet Union, and the People's Republic of China.

The fact that in the face of slackening demand the OPEC nations are continuing to cut production rather than price underscores the conclusion that their pricing policies are based far more upon political than economic realities. If, however, the consuming nations adopt effective conservation and development policies, the day will inevitably come when market forces will once again begin to function effectively and oil prices will be reduced.

The efforts of the United States to become more self-sufficient in energy and to develop greater solidarity with other consumer nations do not stem from a desire to confront the OPEC countries or to block their economic development. To the contrary, we fully support their aspirations for development. Through joint economic commissions as well as less formal bilateral contracts, we are working cooperatively with these countries to establish their industrial and agricultural bases and to improve the living standards of their people. Thus, we are prepared to work with them in accelerating their economic development. For their part, these countries must recognize the responsibilities inherent in their new international role. They must realize that we continue to oppose arbitrary, monopolistic pricing policies imposed without regard to economc realities and exacting enormous penalties on the developing nations of the world. We are convinced that they can achieve their development objectives on a more secure basis with substantially lower oil prices. Extreme policies will only prove harmful to them as well as those of the rest of the world.

A free market orientation

A third charge leveled against the United States is that we are clinging unrealistically to the notion that more reliance should be placed upon a free market approach to the problems of both the international and domestic economies.

I have no hesitancy in saying that we believe that a free market will generally bring greater economic and social benefits than a market dominated by government. We are deeply committed to the principles of free trade and investment. We believe that the world community would be better served by removing many of the barriers that now exist to trade. We continue to welcome foreign investments in the United States and believe that foreign investment can make a significant contribution to the development of other countries. And we are anxiously seeking to discourage all people, including our own, from turning inwards, seeking refuge from today's economic storms at the expense of other nations. The tragic consequences of the beggar-thy-neighbor policies of the 1930's should be ample proof that a liberal economic order is far preferable to one marked by isolationism and restrictive trade.

Just as we favor a minimum of governmental interference in international commerce, we also believe that our Government should permit a maximum amount of freedom for the private sector at home. In fact, in many areas of our national life, such as oil and gas production, we would like to remove the many impediments that government has erected and release the full energies of our economy. We are mindful of the fact that several of the developing countries which have given wide scope to free enterprise have made remarkable economic progress. Indeed, history has long shown that a free enterprise approach is more productive than any other system known to man and, while it does not automatically guarantee an extension of personal and social freedoms, it is certainly a more powerful safeguard against their erosion than any other economic system.

The resiliency of the international market-oriented system has been vividly demonstrated during the financial turbulence of the past year and a half. Last year, speaking to your conference in Williamsburg, I expressed confidence that our private financial markets and our institutions would adapt safely and flexibly to the challenges of redistributing OPEC monies. Experience since then lends support to that view. Last year an estimated $60 billion of OPEC funds passed through the international financial system without occasioning serious economic disruption, showing that the system could accommodate itself far better than most skeptics believed.

Our commitment to a liberal economic order does not mean, however, that we are rigid ideologues who can see no role for government.

I do not mean to imply, for example, that the private markets have been, or are expected to be, our sole reliance in all eventualities. It is true that the United States has not favored a proliferation or an unbridled expansion of official financing mechanisms which seemed to us to carry important drawbacks. But we have taken the initiative to establish a major new facility among the OECD countries which provides an insurance mechanism for our financial system.

We have also sought agreement on a major, one-third expansion in the quotas, and hence the lending power of the International Monetary Fund. We have agreed with special and temporary arrangements within the IMF to help meet financing needs of member nations whose oil import costs have risen sharply. And, for those developing countries hardest hit by the increase in oil and other commodity prices, we have put forward proposals for a special trust fund to assist them.

The issue of government intervention in the economc system has recently arisen in the context of the call by developing countries for a New Economic Order. In the process of seeking to improve their economic conditions, these countries advocate sweeping changes in the rules of international commerce. In our view, many of these changes would actually impede their economic development.

The United States has long supported, in word and in deed, the legitimate aspirations of the developing countries to improve the conditions of life of their peoples. We also support their desire to participate more fully in the benefits of an expanding world economy. We are prepared to join with them in serious discussions to map out those policies and those actions best suited to continued progress toward a better and more prosperous way of life.

Difficult questions must be faced in the process of carrying out the searching reevaluation of relations with the developing countries now underway. Fundamental to this process is a careful reexamination of various forms of income transfer. In addition, we must seek a better recognition of the beneficial role that private investors now play in bringing about development, and we must find means of fostering policies within the developing countries that will most advance their prosperity.

While we are anxious to address these questions with imagination as well as compassion, I believe that the answer to the problems of development lies in strengthening the current international economic system rather than a radical restructuring of it. Rather than sweeping aside all of the arrangements of the postwar era, let us proceed on a case-by-case, issue-by-issue, problem-by-problem basis. The developing countries, as well as the industrial nations, would suffer from any misguided attempt to reverse the present movement toward greater liberalization of trade.

Many countries, of course, do not share our dedication to a market-oriented economy. That there will be philosophical differences even among free world countries is inevitable. Despite a common bond, each of us has a different world outlook, deriving from our varied experiences and national traditions.

Nonetheless, we must not ignore how well the cooperative arrangements of the post-World War II period have been able to accommodate these differences without undue strain. That system has rendered important gains to the developing countries. The industrial countries have freely committed themselves to an extensive program of financial assistance both bilaterally and through international institutions. Not only have the developing countries profited from the liberalization of world trade which has gone forward, but there is now agreement to extend special preferences to them in our trading rules. As a consequence, many developing countries, particularly the middle-income group, have been able to grow more rapidly than most developed countries.

My plea, then, is for a renewed sense of realism in our international economic relations. There is so much that can be done to improve the lives of all that is in the mutual interest of all that it would be foolish indeed to sacrifice the possible at the altar of the unrealistic.

International economic policy vacuum

A fourth accusation I sometimes read is that the U.S. Government has no international economic policy.

I can hardly believe that anyone seriously accepts that view. The truth is that no nation is more intimately involved in shaping a cooperative internatonal economic order. No nation is more deeply concerned with the welfare of other nations. In difficult times, I can understand why some might argue that since problems are many and progress is slow there must be no policy, but those who accuse us of lacking a policy often appear to have something else in mind.

I am particularly concerned with the mistaken notion that our international economic policy consists of the various technical arrangements and procedural mechanisms to which we are a party--so that the more of such machinery that exists, the better our policy. I emphatically disagree. The core of our international economic policy is our dedication to certain fundamental principles which express our commitment to a liberal international economic order. It is on the strength of our dedication, and our effectiveness and perseverance in its application, that our international economic policy must be tested.

The fundamental principles we espouse are not novel or surprising, but we believe they are essential to a dynamic and equitable international economic order:

We are firmly committed to avoiding beggar-thy-neighbor policies, as most recently affirmed by the OECD countries when they renewed their trade pledge at last month's Ministerial meeting in Paris.

We support the liberalization of world trade and are currently concentrating our efforts on the multilateral trade negotiations in Geneva.

We are committed to the free movement of capital investments, tempered only by the need to safeguard essential national interests.

We support a wide variety of mechanisms for providing financial and technical assistance and transferring real resources to the developing world.

We have explicitly committed ourselves to joining with other nations in examining the problems of trade in oil and other commodities so that we may adopt policies benefiting both producers and consumers.

We are committed to maintaining a sound dollar in the only way that is possible: by assuring the strength and stability of the economy at home.

We are pledged to work with other nations to develop long-range solutions to the energy challenge, and we intend to make a major contribution to that effort by achieving greater energy self-sufficiency at home.

We are committed to working with others to achieve an orderly and constructive evolution of international monetary arrangements.

And in all these international endeavors, we are committed to a spirit of full cooperation and conciliation among all nations with whom we share this planet.

Building upon these foundations, the United States has made a forthright and diligent effort to work with other nations in developing better solutions to the problems of energy, food, international finance, and other major issues. We believe that considerable progress has been made over the past year. Each step forward may have been modest, but the cumulative effect has been very substantial. Without the trappings and fanfare of a Bretton Woods conference, without claims that a system for all seasons has been engraved on parchment, we have begun to define a course that can guide us through one of the most turbulent periods of this century.

I have just flown to Amsterdam this morning from meetings of the Interim Committee and the Development Committee. As you know, the members of the Interim Committee have not yet been able to reach full agreement on a package of important measures to modernize the international monetary system. While we were disappointed that a final agreement was beyond our grasp in Paris, I was heartened by our progress in narrowing the range of contentious issues and I believe that we now have a foundation for a future accord. The two major issues that remain to be resolved relate to gold and exchange rate systems. We believe that the final package must be consistent with the agreed-upon goal of reducing the importance of gold in the monetary system and must allow each country freedom to determine its own system of monetary exchange, but within that framework we think that there is ample room for agreement.

The developments in Paris confirm our belief that the industrialized nations intend to resolve their differences and serve the interests of the entire world community if they work together in a spirit of conciliation and cooperation. We intend to be firm in our approach but not inflexible, principled but not impractical, dedicated but not domineering. And we intend to achieve results.

Conclusion

Ladies and Gentlemen: In sketching here the outlines of the U.S. international economic policies for the 1970's, I have not sought to address the role that the private sector, and particularly the banking community, must play in rising to the challenges of today, though as you must know, I regard that role to be more critical than that of our national governments.

I wanted to dwell on our governmental policies because they are in need of clarification and because we must all begin to recognize how long and difficult our agenda is for the future. The issues I have discussed here will be the subject of many more hours of intensive negotiations with my fellow Finance Ministers. The questions are complex, the pressures on policymakers manifold, and the challenge to their creativity great. It will not always be easy to resist the shortrun palliative which seems to promise immediate relief but undermines the longrun vitality of our system. I am certain, however, that if we can approach these tasks in an enhanced spirit of cooperation and enlightened realism and if we can count on the full support of the American people, we will continue to find better ways of advancing the causes of peace and shared prosperity.

Exhibit 65.—Press release, October 16, 1974, announcing foreign currency report form regulations

The Amendment to the Treasury regulations requiring weekly and monthly reports by banks on the Treasury Foreign Currency report forms was published today in the Federal Register. The forms and instructions, as approved by the Office of Management and Budget, will be published in the Register on Monday, October 21. Reports to be filed by nonbanks covering their positions in specified currencies will be instituted in the near future.

Initial reports by banks on the new monthly forms are required covering data as of the last business day of November, and on the weekly forms as of December 4, 1974.

The new reports are required by title II of Public Law 93–110, which amended the Par Value Modification Act, and which required the Treasury to institute new statistical reports of the foreign currency transactions of banks and other business concerns in the United States and of foreign branches and majority-owned foreign subsidiaries of U.S. firms. The reports will furnish information on the activities of large banks and other firms which affect the position of the dollar in the foreign exchange market.

The reports will provide data on the spot and forward positions and assets and liabilities of banks in the United States, including agencies and branches of foreign banks, and of foreign branches and majority-owned foreign subsidiaries of U.S. banks. Reports will be required of positions in nine major currencies (Belgian francs, Canadian dollars, Dutch guilders, French francs, German marks, Italian lire, Japanese yen, Swiss francs, and United Kingdom pounds) and, in the case of reports filed on behalf of foreign branches and subsidiaries of U.S. banks, in U.S. dollars.

The reporting exemptions are intended to limit reporting to major banks which are active in the foreign exchange market. The exemptions will be adjusted at a later date, if necessary, to accomplish this purpose.

In addition to requiring weekly and monthly reports from banks, the new regulations provide that the Treasury may require special reports when conditions in the exchange market warrant, and may also conduct special surveys related to the data.

An earlier version of the proposed regulations and proposed forms and instructions was published in the Federal Register on June 27, 1974, with provision for written comment. A number of revisions to the proposed forms and instructions were made on the basis of the comments received.

Exhibit 66.—Press release, February 24, 1975, announcing new foreign currency reporting requirements issued for nonbanking firms

Treasury officials today announced that the February 24 issue of the Federal Register will carry an amendment to Treasury Regulations that requires nonbanking firms to report foreign currency positions on specified forms.

The amendment applies to Treasury Foreign Currency Forms FC–3 and FC–4. The forms and instructions, as approved by the Office of Management and Budget, will also be published in the Register. Advance copies of the forms have already been mailed directly to a large number of firms.

Similar reporting requirements for banks in the United States were published in the Federal Register on October 16 and 21, 1974.

Initial reports by nonbanking firms are required on the new forms covering data as of the last business day of March 1975.

The new reports are prescribed under title II of Public Law 93–110, which amended the Par Value Modification Act and required the Treasury to institute statistical reports of the foreign currency transactions of banks and other business concerns in the United States and of foreign branches and majority-owned foreign subsidiaries of U.S. firms. The reports will furnish information on the activities of large firms which affect the position of the dollar in the foreign exchange market.

The reports will provide data on the foreign currency assets and liabilities and forward positions of business firms in the United States, including subsidiaries of foreign firms, and of their foreign branches and majority-owned foreign partnerships and subsidiaries. Reports will be required of positions in nine major currencies (Belgian francs, Canadian dollars, Dutch guilders, French francs, German marks, Italian lire, Japanese yen, Swiss francs, and United Kingdom pounds) and, in the case of reports filed on behalf of foreign branches, partnerships, and subsidiaries, in U.S. dollars.

Reporting exemptions are provided which are intended to limit reporting to major firms which are active in the foreign exchange market. The exemptions may be adjusted at a later date, if necessary, to accomplish this purpose.

Proposed regulations and proposed forms and instructions were published in the Federal Register on June 27, 1974, with provision for written comment. The forms as adopted contain a number of revisions to the proposed forms and instructions which were made in response to the comments received from the business community. The reporting system is managed by the Office of Statistical Reports, a component of the Office of the Assistant Secretary for International Affairs.

Exhibit 67.—Executive order, May 7, 1975, establishing the Committee on Foreign Investment in the United States

By virtue of the authority vested in me by the Constitution and statutes of the United States of America, including the Act of February 14, 1903, as amended (15 U.S.C. 1501 *et seq.*), section 10 of the Gold Reserve Act of 1934, as amended (31 U.S.C. 822a), and section 301 of title 3 of the United States Code, and as President of the United States of America, it is hereby ordered as follows:

SECTION 1. (a) There is hereby established the Committee on Foreign Investment in the United States (hereinafter referred to as the Committee). The Committee shall be composed of a representative, whose status is not below that of an Assistant Secretary, designated by each of the following:

(1) The Secretary of State.
(2) The Secretary of the Treasury.
(3) The Secretary of Defense.
(4) The Secretary of Commerce.
(5) The Assistant to the President for Economic Affairs.
(6) The Executive Director of the Council on International Economic Policy.

The representative of the Secretary of the Treasury shall be the chairman of the Committee. The chairman, as he deems appropriate, may invite representatives of other departments and agencies to participate from time to time in activities of the Committee.

(b) The Committee shall have primary continuing responsibility within the Executive Branch for monitoring the impact of foreign investment in the United States, both direct and portfolio, and for coordinating the implementation of United States policy on such investment. In fulfillment of this responsibility, the Committee shall:

(1) arrange for the preparation of analyses of trends and significant developments in foreign investments in the United States;

(2) provide guidance on arrangements with foreign governments for advance consultations on prospective major foreign governmental investments in the United States;

(3) review investments in the United States which, in the judgment of the Committee, might have major implications for United States national interests; and

(4) consider proposals for new legislation or regulations relating to foreign investments as may appear necessary.

(c) As the need arises, the Committee shall submit recommendations and analyses to the National Security Council and to the Economic Policy Board. It shall also arrange for the preparation and publication of periodic reports.

SEC. 2. The Secretary of Commerce, with respect to the collection and use of data on foreign investment in the United States, shall provide, in particular, for the performance of the following activities:

(a) The obtainment, consolidation, and analysis of information on foreign investment in the United States;

(b) The improvement of procedures for the collection and dissemination of information on such foreign investment;

(c) The close observation of foreign investment in the United States;

(d) The preparation of reports and analyses of trends and of significant developments in appropriate categories of such investment;

(e) The compilation of data and preparation of evaluations of significant investment transactions; and

(f) The submission to the Committee of appropriate reports, analyses, data and recommendations relating to foreign investment in the United States, including recommendations as to how information on foreign investment can be kept current.

SEC. 3. The Secretary of the Treasury is authorized, without further approval of the President, to make reasonable use of the resources of the Exchange Stabilization Fund, in accordance with section 10 of the Gold Reserve Act of 1934, as amended (31 U.S.C. 822a), to pay any of the expenses directly incurred by the Secretary of Commerce in the performance of the functions and activities provided by this order. This authority shall be in effect for one year, unless revoked prior thereto.

SEC. 4. All departments and agencies are directed to provide, to the extent permitted by law, such information and assistance as may be requested by the Committee or the Secretary of Commerce in carrying out their functions and activities under this order.

SEC. 5. Information which has been submitted or received in confidence shall not be publicly disclosed, except to the extent required by law; and such information shall be used by the Committee only for the purpose of carrying out the functions and activities prescribed by this order.

SEC. 6. Nothing in this order shall affect the data-gathering, regulatory, or enforcement authority of any existing department or agency over foreign investment, and the review of individual investments provided by this order shall not in any way supersede or prejudice any other process provided by law.

GERALD R. FORD.

THE WHITE HOUSE, *May 7, 1975.*

Exhibit 68.—Press release, May 21, 1975, announcing the organization and inaugural meeting of the Committee on Foreign Investment in the United States

Pursuant to Executive Order 11858, signed by President Ford on May 7, 1975, Secretary of the Treasury William E. Simon has designated Under Secretary For Monetary Affairs Jack F. Bennett to be chairman of the new interagency Committee on Foreign Investment in the United States. The designated representatives of other Government departments and agencies are: Thomas O. Enders, Assistant Secretary for Economic and Business Affairs, Department of State; Robert Ellsworth, Assistant Secretary for International Security Affairs, Department of Defense; John K. Tabor, Under Secretary, Department of Commerce; the Assistant to the President for Economic Affairs, L. William Seidman; and John M. Dunn, Acting Executive Director of the Council on International Economic Policy.

The major tasks of the Committee are to assess general trends and significant developments in foreign investment and to review investments in the United States which, in the judgment of the Committee, might have major implications for the U.S. national interests. The Committee is also responsible for considering proposals for such new legislation or additional administrative action as may be appropriate. The Committee will, as appropriate, seek the advice of other parts of the Government.

The Committee held its first meeting on May 20. The Committee reviewed procedures being developed for advance consultations with foreign governments on their major prospective investments in this country. It is anticipated that consultations with foreign governments will take place through diplomatic channels. Private investors wishing to consult on major foreign investments in the United States should contact the Secretary of the Committee on Foreign Investment in the United States, Room 5100, Main Treasury, Washington, D.C. 20220 (telephone number, 964–2386).

The Committee also reviewed the plans for the new Office on Foreign Investment in the United States being established by the Secretary of Commerce in order to carry out his functions under Executive Order 11858. The Office will be located in the Domestic and International Business Administration and will be headed by Deputy Assistant Secretary Lawrence A. Fox. The new Office will obtain, consolidate, and analyze information on foreign investment in this country and will also submit to the Committee reports, analyses, data, and recommendations relating to foreign investment in the United States, including recommendations as to how information on such investment can be kept current.

Developing Nations Finance

Exhibit 69.—Statement by Deputy Assistant Secretary Bushnell, July 24, 1974, before the Inter-American Committee for the Alliance for Progress (CIAP), Washington, D.C.

Mr. Chairman, Mr. Secretary-General, members of the Permanent Executive Committee of the Inter-American Economic and Social Council, representatives of the international financial institutions, ladies and gentlemen:

It is indeed a pleasure for me to be with you today for the fourth annual review of the economic policies pursued by the United States. Because of the interdependence of our economies, an interdependence which becomes more evident every year, this annual review is a valuable mechanism for us, individually and collectively, to analyze where we have come from and to assist us in determining what future courses we ought to follow in order to achieve the greatest amount of good for all the peoples of the Western Hemisphere.

We in this part of the globe are also inextricably involved with and impacted by the international economy. If anyone had doubts about these facts, the events of the past year have shaken him into a rude awakening to reality. One need not even mention the energy crisis in this regard. The impact of the temporary disappearance of the anchovies off Peru extends throughout the world and affects every household in the United States, even though few of the missing anchovies would have been marketed in the United States. All of us are now keenly aware of changes in the prices and availability of raw materials which come to us from every corner of the globe. Therefore, I hope we can utilize to the fullest this opportunity for hemispheric dialog to discuss matters of mutual concern. In this session we shall focus on financial matters of common interest.

My prepared statement will concentrate on the changes in the fundamental structure of the international economy, the importance of private capital, and international monetary reform, with emphasis on the various efforts being made to assist those countries most severely affected by higher energy prices.

Changed world scene

In the time since this group met last year, there have been major changes in the international economy. Virtually every nation is facing double-digit inflation, and the short-term prognosis for containing inflation is not good. In the United States price inflation, as expressed by the Consumer Price Index, was almost 9 percent in 1973. One must go back 22 years to find a higher rate of price increase. As you are well aware, price increases for agricultural products, which rose by more than 20 percent, led the way in the early part of 1973 and were followed by substantial increases in energy prices in the last quarter. The price of petroleum products remains several magnitudes higher than this time last year although world supply now seems to be outpacing world demand.

These dramatic price increases were not unique to the American economy. In 1973 the consumer price index for Latin America in the aggregate rose 35 percent, ranging from 4 percent to several hundred percent in individual countries. The U.S. economy was, therefore, one of those less severely hit by spiraling prices.

The net effect of this past year's changed world scene has been a major change in financial flows as international terms of trade shifted dramatically in favor of minerals producers and farmers. Within the United States there was a similar redirection of real incomes. The energy crisis in particular has resulted in a substantial and continuing transfer of wealth from the oil-consuming to the oil-producing nations. Oil-consuming nations generally face serious balance of payments problems as they reduce available reserves or take on additional debt to pay for oil import bills that have tripled or quadrupled. Some oil consumers were fortunate in that they were coincidentally experiencing substantially increased export earnings from commodities which were in short supply. As new supplies come on to the market, however, and industrial demand slows, commodity prices will begin to ease—some have already done so—and there is considerable danger that the economic effects of the oil price rise will spread and multiply.

Meanwhile, the oil-exporting nations are experiencing unprecedented export earnings and reserve accumulation and now face the challenge of channeling their huge monetary reserves into profitable activities, so that they may provide a solid income-generating base for the future. Even if oil prices fall—and the international financial problem may prove unmanageable if they do not—mechanisms must be found to channel these reserves to the countries that need them to finance current account deficits.

On the other hand, the income shift that has occurred may offer unexpected opportunities for promoting world economic growth. The reserves being accumulated by the oil-producing nations may be drawn primarily from consumption activities. If these resources can now be directed in large part to investment uses, particularly in the developing countries, our long-term development objectives will be furthered.

Monetary reform

We are thus faced with both challenges and opportunities for creative initiative. Some bold new initiatives have been proposed for mobilizing bilateral or multilateral governmental assistance through the various public lending institutions. The U.S. Government has supported these efforts and believes that a promising start has been made in dealing with the challenges before us. Despite serious disturbances in the economic and financial context surrounding its negotiations, for example, the Committee of Twenty last month reached positive decisions in a number of areas of critical importance in the present situation, and established the technical and political framework for a cooperative future evolution of the monetary system. Latin American representatives played an important role throughout the Committee's work, and the countries of the area can take pride in their contribution to a program of action that, in addition to setting the basis for future international cooperation, initiated a number of immediate steps that will be of major benefit to both developing and developed nations in the period ahead.

Some of these actions of significant interest are:

Agreement on an interim technique of valuing the SDR. This formula will increase the utility of the SDR during the present period of widespread floating and in that way will enhance the prospects that the SDR will become the central reserve asset in the monetary system—long a priority objective for the developing countries.

Establishment of guidelines for floating and provisions for improved surveillance, assessment, and consultation on the adjustment process. These procedures and guidelines provide needed content to agreed principles and will help to ensure the consistency and fairness of countries' behavior in this highly uncertain and difficult period. They thus provide a basis for confidence that responsibilities for adjustment will be fairly apportioned.

The IMF trade declaration, with its provision for prior IMF approval, can help create the needed restraint against escalation of restrictions on trade or other current account transactions for balance of payments purposes, which are potentially so detrimental to developing countries. I am convinced it is in the LDC interest for as many countries as possible—both developed and developing—to subscribe to the pledge, and strongly urge the Latin American countries to do so.

Establishment of an Interim Committee of the IMF (ultimately to become a Governors Council) to oversee the implementation of the decisions already made and to assure the continuity of the negotiations.

Recommendation to establish a Development Committee to serve as a responsible focal point for comprehensive and effective consideration of development issues and the transfer of resources to developing countries. This decision came in response to an initiative of the developing countries led in large measure by Latin American constituencies. The United States has supported this proposal from the outset. In our view, the Committee should be a continuing body and should have a mandate encompassing a broad range of development issues, including the assistance emanating from national and international agencies. The urgent needs of the developing countries most seriously affected by recent price increases and payments problems are appropriately a priority issue for this Committee, as was envisioned in the C–20 agreement.

Establishment of the IMF oil facility to supplement the private market facilities and supply needed assistance in meeting the impact of the increase in oil import costs. Provided that the resources are made available to the Fund, Latin American countries might have combined access to the oil facility on the order of about $1 billion through 1975. Not all the Latin American countries will need such assistance, and some may require more highly concessionary assistance than the oil facility can provide, but for a number of countries this new innovation can provide a useful supplementary source of financing.

In addition, establishment of the proposed IMF extended Fund facility, which we expect will be agreed upon shortly, as recommended by the C–20, will provide developing countries with increased access to IMF resources and permit repayment over a period longer than that applicable to regular IMF drawings. This facility will be designed to offer a form of lending which will be particularly useful for countries undergoing major policy shifts and improvements in economic structure that give rise to sustained payments disequilibria.

We recognize that the inability of the C–20 to reach agreement on the question of establishing a link between development assistance and SDR allocations was undoubtedly a disappointment to many—though we have discovered in our private discussions that many developing country representatives themselves have serious reservations about the link. I want to assure you that the agreement in the C–20 to reconsider the link is viewed seriously by the United States and that we will approach this review with an open mind. Nevertheless I should also caution that our opposition to the link has been based not on any failure to appreciate the needs of the developing countries, but on sincere concerns about the impact of a link on the development of the SDR as the system's central reserve asset and the efficacy of the link as a means of providing resource transfers. We do not know what the result of this reassessment will be. It must take place in the overall context of the discussions in the Fund and the Development Council. We will seek ways to meet our concerns and the needs of the LDC's in a manner which is consistent with the overall objectives for the monetary system and the world economy. We will not confine ourselves to proposals already considered and arguments already debated.

In our view, then, the C–20 can point to some very real accomplishments. In particular, agreement on the Interim Committee of the IMF goes far to ensure that there will be an effective, broadly representative forum to oversee the operation of the monetary system and guide its evolution. This body of high-level officials will be in a position to provide the leadership and policy direction urgently required in this period of great uncerteainty. The developing countries, and certainly Latin America, will have strong representation on this Committee and are thus assured of having an equitable voice in international deliberations on those issues which profoundly affect the world economy. The United States intends to take the opportunities offered by this new forum to work closely with Latin America as we have done during the C–20 negotiations.

The C–20 agreement on a program of immediate steps has also presented us with an extensive work program which will require further negotiations in the period immediately ahead. The C–20 has asked the IMF Executive Directors to prepare draft amendments on several subjects: establishment of the Governors'

Council; legalization of floating; a permanent IMF trade declaration; authorization of a substitution account; gold; an SDR-aid link (in parallel with reconsideration of the link itself); and improvements in the operation of the IMF general account and the SDR. The Interim Committee is to consider these amendments this fall with a target completion date to coincide with the completion of the current general review of IMF quotas scheduled for February 1975. The United States believes certain amendments would be desirable, to bring the Fund's basic structure and rules into conformance with today's economic realities and thus to strengthen its role in international monetary affairs. If a package of amendments broad enough to justify the legislative effort can be agreed upon, we will give it our enthusiastic support. (I ought to make it clear that the administration does not have final authority on these matters but must obtain congressional approval.)

At the same time, work on the quota review and the extended Fund facility must be completed. The Interim Committee and Executive Board must also begin to implement the agreed guidelines for floating, introduce new procedures for surveillance of the adjustment process (including experimental use of reserve indicators) and of developments in global liquidity, review the operations of the oil facility, and study arrangements for gold.

The success of this ambitious monetary reform program will depend ultimately on the ability of the international community to work together. It will require agreement on issues that can be worked out within the framework of the Committee of Twenty. It will also require bold cooperative initiatives to effect change in financial and trade relations as well as individual efforts to control inflation.

We all need the support and cooperation of the private sector to achieve these changes. The resources for development, whether mobilized via investments or taxes, must ultimately be provided by private individuals. Only private capital, moreover, has sufficient flexibility to respond to the kind of volume of funds and rapid market changes we are witnessing today.

Private capital

As is well known, my Government strongly believes that open international capital markets are highly desirable to assist developing countries and to facilitate capital flows between developed countries. We have during the past year removed the few legal restraints that remained from the emergency measures introduced before the dollar was devalued. Freedom of capital movement is particularly important to Latin America where net external resources currently account for some 12–15 percent of investment for the region as a whole, reaching above 40 percent for some countries.

The CIAP report suggests that some of our Federal and State regulations may make it unnecessarily difficult for developing countries to gain access to the U.S. capital market, and I know the SEC and other agencies are giving serious consideration to these points. At a recent seminar sponsored by AID, Latin American officials met with representatives of the SEC and the private financial community to educate one another to the procedures and problems involved in attracting private portfolio capital. Such exchanges should be encouraged. I have the impression, however, that such obstacles may not in practice be as great as the CIAP report suggests. Countries with demonstrated creditworthiness have had little difficulty in recent years raising capital in our markets on attractive terms. Several bond issues have indeed been oversubscribed, and some countries have had to introduce measures to turn eager lenders away.

In this regard, it seems to me that CIAP's recommendation for the systematic use of debt rescheduling as a means of providing development assistance is ill advised because of the danger that rescheduling will damage the climate for other financial flows. An additional danger is the spillover effect a rescheduling can have; i.e., the damage to the creditworthiness image of developing countries generally. The ability to attract portfolio investment obviously depends heavily on the lender's confidence that the repayment contract will be honored, and the use of rescheduling as anything but a very exceptional event can only erode that confidence. Moreover, the Congress has made abundantly clear in recent years that it views very negatively any form of "back door" financing. A policy such as CIAP advocates, therefore, would seriously weaken the administration's ability to gain funding for its budgeted assistance programs.

The CIAP review document again this year urges the establishment of a facility to assist Latin American exports to the United States. I seriously question the need and desirability of such a facility. In the first place, such a facility would provide a subsidy not to the Latin exporter but to the importer in the United States. Second, export credit facilities are generally designed to assist in the movement of capital goods. There are only a few countries in Latin America currently able to take advantage of such a facility, and those countries are probably in a good position to provide such financing themselves.

Although attitudes toward direct private investment still tend to vary widely in the hemisphere, progress has been made over the past year in settling outstanding disputes. With very few exceptions, investors and host countries have been able to reach amicable and mutually beneficial accommodations of each other's interests. Representatives of private enterprise, both domestic and foreign, home governments, and host governments are meeting in a variety of international and regional fora to understand better each other's needs and possibilities and to improve the international flow of capital and technology. We share the CIAP's hope that the working group on transnational enterprises, established by the Washington meeting of foreign ministers, will take full advantage of this period of calm and dialog to further our understanding of this powerful vehicle for international development and of the inevitable trade-offs that are implied by restrictions placed on their activities. The instability of rules or inconsistency in their application can frequently be more unsettling and costly to both sides than the rules per se. Investors have demonstrated enormous capacity to adapt to different rules of the game, so long as they can trust those rules to be fairly and consistently applied.

The latest Commerce Department data for yearend 1972 show a total of $13.5 billion of U.S. direct investments in Latin America, approximately 14 percent of our total direct investments abroad and 54 percent of our LDC investments. These investments are increasingly concentrated in the manufacturing sector, which now accounts for 40 percent of the total.

Undoubtedly differences in our respective philosophies and traditions will cause us to evaluate differently the costs and benefits involved to the host country in MNC activities and their regulation, and disputes regarding the fairness of treatment accorded foreign investors may from time to time still arise. Even where philosophical and legal principles differ, however, specific disputes are capable of peaceful settlement. That is the essence of diplomacy. In the Mexico City meeting of foreign ministers, Secretary Kissinger proposed that we explore the possibilities of creating a regional mechanism for facilitating the settlement of investment disputes. Such an accomplishment could enormously enhance the confidence of both investors and governments in their mutual relationship and make an important contribution toward stimulating capital flows within the hemisphere, not only from the United States to Latin America but also within Latin America.

Some of the suspicions and disputes that arise with regard to foreign investors may be the result of incomplete information regarding the firm's activities and from differences in accounting practices and concept among the tax authorities having jurisdiction over its various branches. The availability of information can be improved, and some disputes at least might be avoided by the conclusion of bilateral tax treaties among the governments of the Americas. This is an area that it might be useful to have our respective tax officials explore.

At present, the private sector accounts for around two-thirds of the capital flowing from the United States to Latin America, and as development proceeds that ratio will probably increase. Nevertheless, we recognize the continued need that many countries will have for concessional financing and for the technical assistance provided by the official lending institutions. For the countries hardest hit by the increased energy costs and world inflation generally, that need will be particularly great.

The United States has completed the payments for its share of the Ordinary Capital for the 1970 replenishment of the IDB, and the administration is requesting and advocating congressional approval of the funds necessary for us to complete our outstanding commitment to the Fund for Special Operations (FSO). We also recognize that at current rates of lending the IDB will soon need a capital replenishment, probably beginning in 1976. Additional FSO funds will be needed even sooner. We expect to carry our share of the burden in supporting both the Ordinary Capital and the FSO needs of the IDB and are looking forward to an exchange of views with other members on the various issues facing the Bank in connection with the proposed replenishment. We anticipate that a greater percentage of the concessional (FSO) funds will be available than in the past to the least developed countries as those countries with the stronger economies withdraw from using FSO funds.

We are encouraged that both the House and the Senate have given authorization for the fourth replenishment of the International Development Association (IDA) with a U.S. contribution of $1.5 billion to IDA over the next several years. We have, however, learned from that experience that we must present the Congress with a fully documented and complete case for such assistance. We shall therefore need to be more concerned than in the past with the operations of the multilateral institutions—not so much to monitor or influence them as to assure ourselves that we can give the fullest support when replenishment of their funds is necessary.

The new trust fund established by the Government of Venezuela will also make an important contribution to the economic development of her sister republics. The additional funds pledged for concessionary lending are particularly timely and welcome. We also continue to support the ongoing negotiations with the European countries and the Japanese for membership in the IDB, thereby bringing additional resources into the Bank.

A key concept running throughout this statement deals with cooperation. And the spirit of cooperation that was begun in Mexico City several months ago ought to be carried forward from this session to meet head-on the issues that confront us all. So far cooperation has been primarily a government-to-government effort. Let us resolve at this session to broaden the scope of cooperation and to encourage the participation of all members of our respective countries in the effort to make the Western Hemisphere a better place to live in for us all.

Exhibit 70.—Remarks by Deputy Assistant Secretary Bushnell, September 17, 1974, before the Consulting Engineers Council and the International Engineering and Construction Industries Council, Washington, D.C., on the international development banks and procurement

As a newcomer to problems of the international development banks and procurement, I appreciate this opportunity to obtain your views and suggestions. We at the Treasury Department have found our relationships with the Consulting Engineers Council and the International Engineering and Construction Industries Council to be fruitful. Personal contacts—and particularly the two Hershey Conferences on procurement—have made possible the sort of dialog between business and government that help us in our efforts to improve the procurement systems of the development banks.

Too often the role and the importance to economic development of the international development banks—and of other aid programs—is considered only in terms of the amounts of financing provided. This is not my view. The great advantage developing countries have today in comparison with economies which modernized a half-century ago is that they can tap the immense reservoir of technical and managerial expertise that has been built up in the developed economies. This knowledge and experience is what is really valuable for the less developed countries. The financial resources provided through the development banks and other assistance programs are mainly just a means of purchasing this knowledge—whether the knowledge is transmitted through such services as your firms provide or in the machinery and equipment purchased with the loans.

In short, I believe the underlying basis of economic development is precisely the sort of knowledge and expertise which is your business. One need look no further than the eagerness of those countries with newly increased oil revenues to acquire such services to confirm the paramount importance of your services. Increasingly the Communist countries are showing the same sort of eagerness to tap the cumulative experience of the U.S. technical community.

Given my philosophy on this point, a key question I would like to raise with you today is how well do the development banks do in maximizing the transfer of technical and management skills to the less developed countries? How could they do better? The bottom line on the annual statement for the development banks should be their total contribution to development through the provision of technology, funds, and encouragement to adopt economic policies to support economic and social development.

But the bottom line for your firms depends on how much business you can get in competition with your competitors from around the world. I have lots of opportunities to hear from various developing countries how they think the banks are doing. This is an opportunity for me to hear from you what your problems are.

We believe your organization is vital for articulating U.S. business needs to the various executive departments of the Government. It is also important for explaining to the Congress the importance of the international development banks to long-range U.S. interests. In these times of rapid international political and economic change, the importance of these banks in fostering open market economies cannot be underestimated. Their efforts in the areas of institution building, good economic management, financial efficiency, rational economic planning, and international trade are conducive to the development of private enterprise. And all of this brings the borrowing countries into the international financial and commercial system.

Contrary to popular belief, the banks actually help the U.S. economy, even in the short run. The net balance of payments result of U.S. participation in the World Bank, for example, has been positive in 4 of the last 5 fiscal years, with a combined net inflow of $1.5 billion. Procurement generated by the international financial institutions' loans is important not only for the U.S. trade account but also for market penetration and the transfer of American technology to the developing countries.

I'm sure you are interested in the current lending outlook in the banks and the possible effects on U.S. procurement. In the fiscal year ending last June, World Bank and International Development Association lending commitments reached $4.3 billion, an increase of about 27 percent over the previous year. Similarly, the Inter-American Development Bank increased lending in 1973 by 11 percent over 1972 to reach $880 million. The Asian Development Bank, the youngest regional bank to which we belong, hopes to commit $400 million this calendar year and to increase lending by $50 million annually over the next few years.

The types of projects funded may be almost as important in determining the amount of U.S. procurement share as the overall lending level. Many of you may think that the policies being stressed to reach the poorest 40 percent of the world's population will lead to a reduction of lending for power, transportation, communications, and large-scale industry as the banks increasingly commit themselves to rural development, education, rural water supply, population, and urban development projects. But the dollar amount of conventional infrastructure loans is not decreasing, and will likely not decrease in the near future even though lending for the so-called social sectors may rise as a percentage of total commitments.

It is, of course, true that loans for the social sector involve more local procurement than conventional infrastructure projects. But I understand that so far the United States has done reasonably well in procurement on projects in these sectors. To maintain this record, American firms will need to be flexible and aggressive. Specifically for you consulting engineers, those firms which adapt to the multidisciplinary approach implied in these projects will be particularly successful in working on the various bank projects in the years ahead.

The geographic distribution of loans by the international financial institutions with major increases for the poorest areas of the world—mainly in Africa and Asia—represents a challenge for the United States as we are not as strong commercially in these regions as we are in our traditional trade areas of Latin America and Europe.

However, with this international financial institutions' expansion in Africa and Asia—where historically Europe and Japan dominated trade—I believe American exporters will come to appreciate more fully the objectivity of international competitive bidding systems used by the banks. We believe that the banks' procurement systems ensure efficiency of public expenditures and equity as regards sources of supply among member countries. And while we, as a member country of the banks, will work to improve procurement operations, we do not believe that a superior alternative procurement system exists.

Specifically, we do not anticipate any change in the policy that, in general, procurement be open to all member countries of each respective bank. Tying contributions to procurement from a single country would be contrary to the international nature and economic goals of these institutions, and could work to our detriment. Uunder the current system, for each dollar the United States contributes to the banks, American firms are eligible for approximately $3 on procurement contracts, because the U.S. contribution is matched by contributions from others. We have an equal opportunity to compete, and our success will depend on our motivation and abilities.

Declining U.S. procurement shares during the recent past reflected, in large part, the overvaluation of the dollar relative to other major world currencies. However, with the dollar devaluation and rates of inflation in some other developed countries even higher than ours, international competitive bidding rules have again begun to help American firms overcome European advantages in Africa and Japanese predominance in Asia. We just received the latest results on U.S. procurement from our executive director at the Asian Development Bank. As of June 30 of this year, the U.S. share of procurement, including consultant services, from the ADB's Ordinary Capital operations stood at 12.4 percent; this represents a steady increase from a level of about 8 percent a year ago. A recent General Accounting Office report credits exchange realignments for a 70-percent increase in foreign contracts won by American engineering and construction firms in 1973 in connection with projects financed from all sources, including the international financial institutions. A jump from a 1972 figure of $3.6 billion to $6.1 billion in 1 year is a welcome sign for all U.S. exporters.

Of course, the American consulting firms represented here are in a more enviable position than the remainder of American business. You represent an industry where our competitive advantage is particularly great, and your share of bank-generated procurement was 36 percent for the International Bank for Reconstruction and Development in fiscal year 1973 and 34 percent for the Asian Development Bank in calendar year 1973. For the Inter-American Development Bank we do not have an exact figure, but the percentage is even higher because of our strong competitive position in this hemisphere. To the extent that American consultants get contracts, we may be assured that U.S. suppliers and contractors are not discouraged.

Turning to the U.S. Government's policy towards the international development banks, you can be confident that our support and leadership role in the multilateral development institutions will be continued. One of President Ford's first acts upon taking office was to sign the $1.5 billion International Development Association replenishment bill. Just last week in a message to the Congress, the President reiterated his support for the Asian and African Development Bank authorization bills. And yesterday, in a letter to Congressman Gonzalez, President Ford wrote, "Like the other international development lending institutions in which the United States participates, the Asian Development Bank supports important international economic and foreign policy objectives of the United States."

As I said, the administration supports the authorizing legislation before the House for $412 million for the Asian Development Bank and a $15 million contribution to the African Development Fund. Over the next few years we anticipate U.S. funding of these banks to continue on a scale reflecting our economic strength and interests in the developing countries of the world.

As with other members of these banks, we want to ensure our fair share of procurement. In the last 2 or 3 years the Departments of Treasury, State, and Commerce have sought to increase Government support of U.S. business efforts to obtain contracts arising from international financial institutions' loans. The State Department has invigorated its commercial representation abroad, and Commerce has instituted a number of information programs—the Exporters Information Reference Room and the TOPS computerized information system should be known to you.

We at Treasury, through the Office of International Development Banks and through our executive directors at the international financial institutions, have sought to monitor and modify, where necessary, the international financial institutions' procurement policies.

At Treasury's instigation, various studies of specific procurement practices have been undertaken; the quality, quantity, and promptness of early warning information has been improved; and data reporting on the U.S. procurement share has been upgraded. We will remain responsive to the views of organizations like the Consulting Engineers Council.

Along that line, I should say a few words about a recent General Accounting Office report, which some of you have seen, entitled "Improved Government Support Can Increase U.S. Share of Foreign Engineering and Construction

Projects." One GAO recommendation was that Treasury seek a change in the World Bank guidelines that discourage the shortlisting of more than two consulting firms from any one country. We have investigated this issue and are not sure that such a modification would be to your benefit. The rule is not now rigidly enforced and, as it stands, could work in favor of U.S. firms, given the increasing bank emphasis on Africa and Asia, where an expansion of the shortlists would probably hurt rather than help you to get more business. The existing policy gives borrowers the benefit of diversity in project experience and technical approach.

The GAO report also mentions a topic about which we have been deeply concerned—accusations of bias in the banks. A consultant was hired by Treasury to investigate the problem, and the International Bank for Reconstruction and Development has also explored the question. Neither the IBRD, Treasury, nor our executive directors have uncovered any evidence of bias. For the few instances of substantial improper behavior—generally on the part of borrowers or consultants—remedial machinery exists within the institution and has been utilized by our executive directors. We are prepared to react most strongly if evidence of bias is produced.

Currently, U.S. nationals comprise 26.5 percent of the World Bank's professional staff, approximately 25 percent of the Inter-American Development Bank's professional staff, and nearly 10 percent of the Asian Development Bank's professionals. But we want to see more Americans in the banks' staffs—not because we expect our own citizens to compromise the international character of the banks—but because the institutions will benefit from American expertise and outlook.

You consulting engineers can be proud of your share of international-financial-institutions-generated procurement. But for ultimate American success, you and your colleagues in business and we in Government must rededicate ourselves to aggressive marketing, hard work, and Yankee ingenuity. You have a great deal to offer the developing countries. But a maximum contribution to development and to your own profits will require aggressive efforts on-the-spot in developing countries.

To continue helping you, we must have your views on a regular basis, because it is only your practical experience that can give us realistic guidance in this matter of procurement. Since in my job I have a major responsibility for overseeing the U.S. Government role in relation to the international financial institutions, I would especially like to have your candid views.

Exhibit 71.—Communique of the Joint Ministerial Committee of the Boards of Governors of the International Bank for Reconstruction and Development and the International Monetary Fund on the Transfer of Real Resources to Developing Countries (the Development Committee), January 17, 1975, released at the close of their meeting in Washington, D.C.

1. The Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries (the Development Committee) held its second meeting in Washington on January 17, 1975, under the Chairmanship of Mr. Henri Konan Bédié, Minister of Economy and Finance for the Ivory Coast. The meeting was held in the headquarters building of the Pan American Health Organization. Mr. Robert S. McNamara, President of the International Bank for Reconstruction and Development, and Mr. Johannes Witteveen, Managing Director of the International Monetary Fund, took part in the meeting, which was also attended by Mr. Abdel Wahab Labidi, President of the African Development Bank, Mr. Shiro Inoue, President of the Asian Development Bank, Mr. M. G. Mathur, Deputy Director-General of the GATT, Mr. Antonio Ortíz Mena, President of the Inter-American Development Bank, Mr. E. van Lennep, Secretary General of the OECD, Mr. Maurice Williams, Chairman of the DAC, Mr. Mahjoob Hassanain, Director of the Economic Department of OPEC, Mr. Gabriel van Laethem, Under Secretary General of the United Nations and Dr. Raul Prebisch, Under Secretary General of the United Nations Emergency Operation, Mr. Gamani Corea, Secretary General of UNCTAD and Ambassador Paul Jolles of Switzerland.

2. The Committee received several reports presented by the Executive Secretary, Mr. Henry J. Costanzo, on the initial work program adopted at the inaugural

meeting, related to the situation of the most seriously affected developing countries, measures to adjust to the new outlook in commodity prices, and the future work program of the Committee.

3. The members of the Committee engaged in a general exchange of views regarding the present situation and prospects of the developing countries. Members noted that many developing countries found themselves in serious difficulties as a result of substantial adverse changes in their terms of trade and an inadequate flow of external capital and were being forced to take adjustment measures in many cases harmful to their long-term economic and social development. The members recognized that this situation was likely to continue in the immediate future, and expressed their particular concern over the pressing difficulties in prospect for the poorest and the most seriously affected of the developing countries.

The Committee agreed that the industrialized countries should seek to adopt such adjustment measures considered necessary in their circumstances in such a way as to avoid any reduction in the net flow of real resources to the developing countries, seeking to improve the conditions under which developing countries and international development finance institutions may have access to their capital markets, and to improve the real volume and the quality of official development assistance provided to the developing countries and should avoid trade restrictions that could negatively affect developing countries' exports. The Committee also noted the importance of continued and expanded cooperation, particularly in the transfer of technology and management skills, between the industrialized and surplus oil-producing countries, in order to promote the development of the latter countries and thereby to assist the overall long-range adjustment process and also in order to promote the development of other developing countries.

The Committee recognized the important and increasing flow of resources being made available by the surplus oil-producing countries to the developing countries and to the international financial institutions. In welcoming such interest and participation on the part of these countries, the Committee agreed that these countries should seek to continue and expand this flow of resources, in accordance with their financial capacity to do so.

4. The Committee agreed that the situation of the most seriously affected countries requires urgent treatment, and that measures should be taken to cover the short-term requirements created by the present international situation. In this context, the Committee welcomed the action taken by the Interim Committee with respect to a continuation and expansion of an oil facility in the Fund and the establishment of a special account in order to reduce for the most seriously affected members the burden of interest payable by them. The Committee also reviewed several additional possible courses of action. It was agreed that the Executive Boards of the Bank and the Fund should be invited to study the desirability of creating a special trust fund that would provide, for the period immediately ahead, additional highly concessional resources to meet the requirements of the most seriously affected countries, and the possible modalities of such a fund.

5. The Committee invited the Executive Board of the Bank to undertake an immediate study of the concept of "third window" lending by the Bank on terms intermediate between those of the Bank's regular loans and those of IDA's concessional credits. The Committee welcomed the willingness expressed by some members to support and to provide financial resources for such a facility.

6. For its immediate work program, the Committee instructed the Secretariat to propose such measures as might be considered for early implementation to promote increased use of capital markets by developing countries, and to facilitate their access to such markets; to report to the Committee on an appropriate work program in response to the conclusions of the recent World Food Conference on the financing of food, fertilizer, and food production; and to review the adequacy of existing information systems on the flow of resources to the developing countries.

7. The Committee also agreed that the future work of the Committee should focus on the basic long-term needs of the developing countries and, in this connection, welcomed the intention of the President of the Bank to initiate urgently a study of the capital requirements of developing countries to maintain a reasonable rate of growth in per capita income for the remainder of the decade. The Committee instructed the Executive Secretary to initiate a broad

and continuing review of the question of the transfer of real resources, using as a basis the work of the Committee of Twenty and taking into account the conclusions of the Bank's study, in order to formulate recommendations as to how the required transfers of real resources might be met through existing or new financial mechanisms and arrangements, including arrangements for commodity price stabilization. The Committee welcomed the study to be undertaken by the Executive Directors of the Fund, as agreed by the Interim Committee, on the Fund's facilities for compensatory financing and assistance to international buffer stocks of primary products.

8. The Committee was glad to note the announcements made at the meeting of actions which permit the full effectiveness of the IDA IV replenishment, and urged sympathetic consideration of the proposals recently put forward by the IBRD for an increased program of normal Bank lending.

9. The Committee agreed to hold its next meeting in Paris during the first part of June 1975.

Exhibit 72.—Statement by Secretary Simon as Governor for the United States, April 24, 1975, before the eighth annual meeting of the Board of Governors of the Asian Development Bank, Manila, Philippines

On behalf of the U.S. delegation, I want to express to all of you our pleasure at attending this eighth annual meeting of the Asian Development Bank.

I also want to extend to you the warmest personal greetings of one of the strongest friends of this organization, the President of the United States.

In the 8 months since he has taken office, President Ford has already made one visit to the Asian area. He is also meeting with a number of Asian leaders this calendar year. His trip and these meetings constitute a visible symbol of the United States continuing commitment to this part of the world.

Role of the United States in Asia

Because of recent events in Indochina, I would like to open my remarks this afternoon by talking briefly about the United States in Asia, for it is important that all of us keep that role in perspective.

The history of American friendship and mutual cooperation with the nations of this region extends back for more than a century. We have sacrificed many of our finest young men fighting in Asia to preserve human freedoms. We have supported the efforts of many people here to gain their independence and to become viable nation-states. And we have given generously of our financial resources, contributing more economic and humanitarian assistance to regional ADB members since World War II than the rest of the world combined.

Since the last World War, U.S. bilateral concessional assistance to regional members of the ADB has totaled $35.3 billion. Moreover, we have provided a significant share of the resources of the multilateral institutions, not only the ADB to which we have contributed $342.6 million in concessional funds and share subscriptions, but also to the World Bank and IDA, to which our contributions have totaled $10.3 billion.

As some of the countries of this region have proposed, less concessional lending has become more appropriate. The U.S. Export-Import Bank has loaned $7.8 billion to the regional members of the ADB, of which $1.9 billion has been lent in the past 3 years. I might also note that two-thirds of all allocation of our Public Law 480 program is being targeted on ADB regional members in the current fiscal year.

Against this background, the developments in Indochina are a source of deep concern for my Government, as I am sure they are for all Asian governments. The fall of the Cambodian Government less than 2 weeks ago, and the tragic scenes we are witnessing in Vietnam, seem to contradict the hopeful evolution which has taken place elsewhere in the region in the last several years—an evolution toward cooperation and away from confrontation, toward peace and away from war.

I have no doubt that many governments of Asia are concerned that Indochina, and our reactions to events there, may portend a basic change in the U.S. role in Asia. There have been public expressions of that concern already—suggestions that the United States can no longer be relied upon by its friends. I can certainly understand those fears, but in view of the long history of our friendship in this region and our resolve for the future, I am confident that such fears are unwarranted.

President Ford spoke directly to these questions in a major foreign policy address to our Congress earlier this month. He urged that foreign governments not be misled, for our will remains strong and our purposes clear. In the President's words:

"We will stand by our friends.
"We will honor our commitments.
"We will uphold our country's principles."

Nowhere are those views more relevant than in Asia. We have basic commitments in this region, both bilateral and multilateral. We regard those commitments as important to our own interests and to the interests of the nations with which we are associated, and we will uphold them. There will be no change in the fundamental direction of American policy toward Asia—and there will be no American "withdrawal" from this vast region. Our friends need not fear, and our adversaries should beware of adopting policies which are predicated on a miscalculation of our firmness of purpose.

The United States will continue to seek better relationships with the major Communist powers—as we believe this benefits all nations—but at the same time we will continue to place highest value on our relations with our friends of long standing in Asia and around the world. We will continue to work cooperatively with our friends in maintaining and strengthening the security of Asia, and we will join our efforts to theirs in building prosperity in the region. For the United States, there can be no alternative in a world that is increasingly interdependent. The United States, as a nation of the Pacific as well as the Atlantic, must and will remain actively involved in the problems and the development of Asia.

The international economy

Just as the United States is learning to live in an interdependent environment, so too the nations of Asia find that their economic destinies are increasingly linked to those of the global community. The challenges posed in the areas of food and fuel are but the most dramatic examples of an interdependent world. Before focusing, then, on the Asian Development Bank, let me spend a few moments reviewing the state of the international economy.

At last year's meeting of the Bank, inflation was plaguing much of the world. That inflation grew partly out of the simultaneous boom conditions of 1972 and 1973 in the major countries and partly from longstanding government policies in many countries, including my own, that served to fuel inflationary pressures. The steep increase in international food and oil prices, of course, severely aggravated that inflationary trend.

Since last year's meeting, most of our countries have moved temporarily into a generalized condition of minimum or negative growth and substantial unemployment. Inflation, while diminishing, also continues to be the most fundamental long-term economic problem facing many nations. With the acute strains of current economic conditions, there is a natural tendency for nations to turn inward and to seek economic solutions at the expense of their trading partners. Although the solutions must begin at home, we can all do a better job at solving our problems through international cooperation. Mutual prosperity depends on mutual cooperation more heavily now than ever before.

Clearly, the central challenges of international economic policy today are:

First, to restore economic growth and price stability around the world;

Second, to adapt to the energy shock in ways that will provide more secure sources of energy and will support a pattern of orderly growth; and

Third, to adjust our financial policies to accommodate massive shifts in international flows of funds.

The role of international development banks must be seen in the context of these challenges. But these institutions should not be diverted from their fundamental purpose of promoting long-term economic growth. They should not try to solve short-term balance of payment problems for which other institutions exist and for which other vehicles are being developed.

In 1974, many of the developed countries which have traditionally transferred resources and capital to the developing world were themselves unable to cover their imports of goods and services with export earnings and had to borrow on an unprecedented scale. Yet these countries, including my own, held steady in continuing their aid for developing countries. For most donor countries, this is a new situation in which they must, in effect, borrow in order to provide assistance.

In most cases, the interest and terms of such borrowing are far harder than the terms of the aid they are giving.

The nonoil developing countries were also forced to increase their borrowings substantially, thereby adding to an already heavy debt burden.

For all oil-importing nations, there were also fears that the international financial system might collapse from the disruptions of traditional payment patterns and fears that some countries might even be forced into bankruptcy. Neither of these fears has materialized. Despite some strains, the financial system remains sufficiently flexible and open to adapt successfully to the changed patterns of international capital flows. We have worked together in both the public and private sectors to establish new financial techniques and mechanisms where there has been concern that supplemental arrangements were needed. Countries were also able to avoid potential bankruptcies by adjusting their domestic policies and by obtaining a certain amount of assistance from other nations. In both instances, the success of the oil-importing nations in averting possible disasters was due in no small measure to the willingness of governments to cooperate.

Cooperation among nations has helped us to make a good beginning in coping with many new challenges facing the developing nations. In particular, establishment of the Development Committee associated with the International Monetary Fund and the World Bank gives us a better institutional framework for addressing the problems of the developing countries. The new Committee is giving priority attention to the needs of the countries most seriously affected by a decline in their terms of trade. Among the specific items in the Committee's current work program are:

A U.S. proposal for a special trust fund to channel funds on a highly concessional basis to the developing countries most in need;

A study of ways to enable developing countries to make greater use of markets; and

A followup to the conclusions reached in the World Food Conference on the financing of food, fertilizer, and food production.

The United States plans to take an active part in the forthcoming meeting in June of the Development Committee. We are keenly aware of the plight in which many of the poorest countries find themselves today, and through the Development Committee we are determined to see that the international community takes appropriate action.

Already a substantial volume of funds has been made available from the International Monetary Fund's regular resources to many countries with balance of payments difficulties—developed and developing countries alike. Moreover, about 2.5 billion SDR's have been loaned from the IMF special oil facility established last year. It has been agreed that the IMF's oil facility will be continued in 1975.

Looking beyond 1975, IMF members have agreed in principle to seek an increase in IMF quotas which will place the Fund in a position to make substantial resources available to countries in need. The United States has agreed to such an increase, provided that agreement can be reached on a series of important amendments to the IMF Articles of Agreement.

It is our hope that agreement on this comprehensive package of quotas and amendments can be completed by the IMF's Interim Committee in June. The United States is prepared to work with other IMF members to develop arrangements under which members' access to IMF resources could be expanded and to facilitate greater usability of the Fund's currency holdings.

A major step has also just been taken to provide the international payments system with an additional measure of insurance. Together with the other OECD countries, I was pleased to have signed, 2 weeks ago, an agreement on a new facility to be called the Support Fund, that supplements IMF and other sources of financing. This agreement establishes a $25 billion safety net to be available to participating countries as a supplement to, but not a substitute for, established international institutions. The United States continues to view the IMF as the principal source of multilateral assistance for those members facing temporary balance of payments difficulties. It is our hope that this safety net will never be used, but the confidence it gives should make a major contribution to the effective functioning of the international financial system. By so doing, it will help to avoid a situation in which individual countries, anxious to gain greater protection, would be tempted to take restrictive measures which would in the end be detrimental to all.

Turning to trade matters, let me reemphasize that in adapting international trade policies to the new situation, we must discourage nations from turning inwards and seeking unilateral solutions to their problems. Toward that end, the United States has recently enacted legislation, the Trade Act of 1974, which will help us to work constructively and positively toward an increasingly open world trading system. Let me reassure you that we are firm in our resolve to implement the Tokyo Declaration with its special consideration for the needs of the developing countries. A specific mandate in our Trade Act gives special consideration to developing country interests.

The forthcoming Geneva negotiations will necessarily be long, but we are working to resolve the full range of outstanding problems in international trade.

In short, while the challenges of the international economy have grown substantially in size and complexity, we are well advanced in formulating an international response that will be equal to them. The most important task now before us is to continue our efforts to meet these challenges through improved international cooperation.

Stronger U.S. support for the Bank

It is within this context that the United States views the need for international cooperation to accelerate basic economic development. We recognize that the Asian Development Bank is a critical multilateral institution for furthering such development in this region.

Within the last several months, the Congress in our country has signaled our own support for the Bank by taking two important actions:

Last December, $362 million was authorized as the U.S. share in the Bank's replenishment of Ordinary Capital, and

Last month, an appropriation was made of the second $50 million for the Asian Development Fund and the paid-in portion of our first installment to the replenishment of Ordinary Capital.

Yesterday, on behalf of my Government, I transferred this second $50 million contribution to the Asian Development Fund and arranged to subscribe to a further $121 million of ordinary share capital.

We have been particularly pleased with the performance of the Bank during the past year under the fine leadership of President Inoue. Let me highlight just a few of the trends we find most favorable:

The Bank has recognized the importance of increasing food production by expanding its own support of agriculture. Last year 25 percent of all loan projects were in the agricultural sector. The Bank has also increased its lending activities for fertilizer plants and feeder roads.

By setting up the Asian Development Fund in 1974, the Bank has established an integrated source of concessional resources for countries with low per capita income whose balance of payments outlook is not sufficiently strong to rely solely on Ordinary Capital loans. The Bank has also properly decided to reserve the use of concessional funds to the poorest of its member countries.

In addition, the Bank followed a responsible course in 1974 by raising its interest rate to 8¾ percent on Ordinary Capital loans and by adopting a split rate under which it charges 9½ percent for loans to high-income countries. This is a step in the right direction toward "graduating" borrowing countries that can obtain external financing quite readily in the private capital market.

The Bank's net income for 1974 has increased substantially to $26.4 million. In my view, the Bank ought to transfer some of its net income to the Asian Development Fund, beginning next year.

I might also note that the Bank has borrowed in the U.S. market for the first time since 1971. I welcome this entry into our market. At the same time, I hope that the Bank will avoid borrowing in currencies which are not internationally traded and are thus potentially subject to large and arbitrary changes in value. In stepping up its borrowing, the Bank should also be mindful of the dangers of increasing liquidity beyond its needs.

Finally, let us recognize that the Bank has also made progress in administrative reorganization, including the establishment of an independent evaluation group. This sets the stage for further improvement in implementation of loans.

In considering the progress made by the Bank, it is wise to remember that the amount of new loans is not itself the measure of the Bank's contribution to sustained economic development in its member countries. The key measure of the Bank's role is how much development actually takes place, and this depends on the quality of Bank-supported projects and on the Bank's contribution to the process of building institutions, training personnel, and setting reasonable priorities within member countries.

Looking ahead to the coming year, we see the Bank planning to expand its lending program, increase the volume of resources in the Asian Development Fund, and, later, to increase the Bank's capital base.

Concerning the Asian Development Fund, my own Government still has $50 million to be appropriated by our Congress before we can contemplate seeking authorization for additional resources. As we address the question of additional funding within the United States, I strongly urge that, apart from seeking new resources from member countries, the Bank also make every effort to obtain participation and special contributions from nonmember countries that have especially strong external positions.

As for Ordinary Capital, the Bank recently has been able to obtain some special increases in capital from Indonesia and Malaysia, and I understand that within the next year it will obtain a special increase from the Federal Republic of Germany. It would be highly desirable if member countries in a position to do so would make available similar special increases to the Bank's Ordinary Capital.

Given the Bank's tight resource position, it will also be important to make every effort to fund new projects in cooperation with private investors and banks in the form of parallel and joint financing. By actively seeking this type of arrangement, the Bank could, with a given amount of its resources, contribute more widely to the development of its member countries.

The private sector is important to the Bank, not only as a colender but also as a recipient of Bank loans. In fact, since a private sector free from government controls is the most certain underpinning for economic development, the Bank should seek to increase the share of its lending to productive enterprises outside the public sphere.

With the very rapid growth in lending over the last few years, it would be prudent in the period immediately ahead to concentrate on improving the quality of new loans and on continuing to seek more effective implementation of loans underway. To further this effort, the Bank must work toward a system of more intensive project supervision. As the Bank becomes stronger it should also become more active in the difficult sectors where innovative lending is needed—such as in rural development and smalltown water supply projects which reach lower income groups.

We hope the Bank will also continue to strengthen its cost-estimating procedures for projects in order to avoid the cost overruns that have become a major problem for the institution. I strongly believe that cost overruns should normally be financed from other sources, leaving funds of the Bank available for new projects. Assuming the projects financed by the Bank are among the highest priority undertaking for the borrowing country, alternative financing can be found.

While increased production and productivity should remain the chief objective in agricultural loans, we believe the Bank should also place special emphasis on projects which ensure that benefits will be widely shared among the rural population of its member countries.

With regard to post-project evaluation, I congratulate the Bank on its adoption of an independent audit mechanism. This year the Bank should move ahead rapidly to schedule the evaluation of projects under this new independent arrangement.

Conclusion

Gentlemen, if I may, I would like to conclude my remarks with a brief personal note.

This visit to Manila, where the Philippine Government has been such a gracious host, brings me near the end of an extended trip around the world. In Paris, I signed the agreement establishing the $25 billion Support Fund that I mentioned earlier. In Moscow, I led an American delegation that discussed means of increasing trade with the Soviet Union. I also met there with General Secretary Brezhnev, where we exchanged assurances that each of our countries remained firmly committed to a policy of détente.

During the 7 days that followed, I had the privilege of visiting two Asian countries, India and Sri Lanka. In New Delhi, I met with Prime Minister Gandhi and in Colombo, with Prime Minister Bandaranaike. On both occasions, our discussions focused on means of increasing mutual cooperation between our countries.

Throughout this journey, I have been struck by one central fact: The nations of the world today share the same aspirations. All of us yearn for peace and economic progress. All of us want to overcome the uncertainties and complexities of today's environment. And all of us want our children to grow up in a world that is secure from hunger and war.

Across the globe, there is talk today of crisis—the crisis of hunger, the crisis of the international economy, the crisis of Indochina, and so on. The list is long and imposing. But in each country that I visited, there is also a recognition that in every crisis, there is also opportunity.

We have within our grasp today the opportunity to build an international community in which the blessings of economic and social progress can be extended to every child. Certainly, we have our problems. We will always have them in the international community. But let us not allow our problems to become insurmountable barriers or to obscure the interests that we share together. Let us instead meet these problems head-on by recognizing our common bonds and working together to find solutions.

The United States is eager to participate in this process. As we prepare to celebrate the 10th anniversary of the signing of the charter for the Asian Development Bank, I pledge to you that the United States shall remain a steadfast friend in the search for peace and economic progress.

Exhibit 73.—Statement by Secretary Simon as Governor for the United States, May 20, 1975, before the 16th annual meeting of the Board of Governors of the Inter-American Development Bank, Santo Domingo, Dominican Republic

On behalf of the American delegation, I want to thank the Government of the Dominican Republic for serving as such a gracious host for this 16th annual meeting of the Inter-American Development Bank. It is indeed fitting that the representatives of the Inter-American family gather in the place where Christopher Columbus first arrived in the Western Hemisphere.

Economic development in Latin America continues to have high priority for the United States. We recognize that many of our southern neighbors measure, in part, the degree of our interests and commitment to Latin America in terms of our support for their economic and social development. This is an important meeting because the IDB's resources require early replenishment. We are prepared to discuss a major replenishment which would include $1.8 billion from the United States over a 3-year period. This surely would represent a substantial increase in the resources provided the Bank annually by my country.

Joining us here today are several distinguished representatives from the U.S. Congress. As members of key committees responsible for legislation affecting international financing institutions, they have a special interest in the affairs of the Bank.

I am particularly pleased that when our meetings are adjourned, these Congressmen will have the opportunity to visit several projects financed by the IDB and thus to see firsthand the results of the Bank's efforts. Their participation here and in visiting IDB projects expresses in a very practical way the continued support for the economic development of Latin America by all parts of the U.S. Government and our people.

We share your pride today in the notable economic progress that has taken place in Latin America in recent years. The development process in most countries of the region has reached a point where high and steady growth rates have become a normal phenomenon. According to the latest figures compiled by the Bank, Latin American countries as a group have sustained a very impressive 7-percent rate of growth a year over the past several years. By comparison, the rate of economic growth in the United States has averaged less than half of that amount during the same period. While our economy remains large and dynamic, we rank near the bottom of the hemisphere in terms of growth rates. In recent months, the United States has experienced a negative rate of growth. There is growing evidence, however, that the economic recession in my country is nearing its end, and we expect to be on the road to recovery before the end of the year—a process that will, of course, be helpful to all of us since the United States remains the largest market for Latin American exports.

Because of the strong growth rate in Latin America in recent years, several nations in the region, when measured in terms of sustained growth and diversification, competitiveness in international markets, and—most importantly—in terms of their ability to attract, use, and service large amounts of private foreign capital on commercial terms, are now approaching the status of developed countries. The substantial private flows of loan capital to Latin America over the past several years attest to the confidence of private investors in the future of Latin America. This remarkable progress achieved by your countries is a tribute to the talent, the hard work, and the perseverance of people throughout the hemisphere.

Our continuing commitment

Plainly, however, the economic growth of recent years has not been equally shared among Latin countries. There are still very real needs in many of the poorer countries of the hemisphere for continued and increased concessional assistance. Moreover, even those countries with strong and rapidly expanding economies, which can afford to service ordinary capital loans, continue to need long-term capital from the Inter-American Development Bank.

As a Nation blessed with relative abundance, we in the United States will not shirk our responsibilities in this hemisphere. The economic development of Latin America continues to be a high priority of the U.S. Government, and we look upon the Bank as a major vehicle by which that objective can be realized. Two months ago, the Congress indicated our continued support for the Bank by appropriating US $225 million for the Fund for Special Operations.

My fellow Finance Ministers will appreciate the fact that like many American countries, the United States now finds itself short of the capital required to meet our own internal investment needs. Those needs are impressively large, and they will demand a full-scale effort, especially since the United States has not been keeping pace in its capital investments. We must devote many of our resources to this purpose if we are to remain internationally competitive and to meet our needs for urban renewal, revitalize our transportation, expand energy resources and development, and modernize our industrial plants.

Moreover, in 1974, many of the developed countries, which have traditionally transferred resources to the developing world, were themselves unable to cover their imports of goods and services with export earnings and thus had to borrow on an unprecedented scale. For most donor countries this was a new situation where they themselves were forced, in effect, to borrow in order to provide assistance. In most cases, the interest and terms of such borrowing were much harder than the terms of the aid they were giving.

Despite these difficulties, the donor countries, including my own, held steady in continuing their aid for developing countries. Maintenance of these aid levels in the current economic environment is clear and convincing testimony to our continuing commitment to the process of economic development.

Yet it is only fair to add that under these conditions, sustained support for the programs of the international development banks will heavily depend on their performance. The fine performance over the past decade and a half of the Inter-American Development Bank gives us confidence that it will continue to be a critical and effective multilateral institution for furthering economic development in most Latin American countries.

Evaluating the Bank's performance

Let us turn, then, to an evaluation of the Bank's record and its policies for the future.

Looking over the past few years, especially 1974, the Bank has registered several outstanding achievements under the impressive leadership of its President, Mr. Antonio Ortíz Mena:

> At the end of 1974, the Bank reached agreement with 10 European countries as well as Japan and Israel for their entry into the IDB as member countries.
>
> Negotiations on the U.S. $500 million Venezuelan trust fund were completed and the agreement was signed earlier this year.

The IDB, through the work of its Group of Controllers, has been in the vanguard of the international development banks in the field of independent evaluation of programs, activities, and operations. We look forward to progress on the Group's recommendations to the Board.

The Bank has also continued to hold the line on staff expansion, thus emphasizing efficiency and avoiding the waste of a growing bureaucracy.

In considering the progress made by the Bank, it is wise to remember that the annual amount of new loans is not itself the proper measure of the Bank's effectiveness. As I told a recent meeting of the Asian Development Bank, the key measure of a development bank's success is how much development actually takes place through the quality of bank-supported projects and the bank's contribution to institution building, training, and priority setting in its member countries.

In order to achieve the best results, we strongly believe that the limited resources of the Fund for Special Operations should be reserved for the countries that have a genuine, pressing need for concessional assistance and have demonstrated by their own self-help efforts that such assistance is justified. We recognize, also, that in several of these countries medium-term prospects do not permit servicing of more expensive capital. However, some of the countries in the so-called limited market and intermediate categories ought to begin the process of "graduating" from the FSO.

For those member countries that are most developed, I would urge, in the context of the next replenishment of the Bank, that they make a part of their own contribution to the FSO in the form of convertible currencies. Such a demonstration of support for the Bank will immeasurably strengthen the ability of the executive branch of my Government to assure that the United States makes a substantial input to the next replenishment.

I know that even the economically most advanced member nations have pockets of poverty or sectors of their population which are extremely poor. In our judgment, however, eligibility for concessional lending should depend on the country's ability or inability to attract and service loans on ordinary terms; and that depends on the country's overall economic strength and balance of payments. The internal distribution of income within a country is determined by the projects financed and by the country's general economic policies.

With the very rapid growth of IDB lending over the last several years, it would be prudent in the period immediately ahead to concentrate on improving the quality of new loans, improving the estimation and control of project costs, and achieving more efficient implementation of loans underway. The Bank is well-managed and ably staffed. Nonetheless, I am sure my fellow Governors will agree that we must continue to strive for higher standards of excellence in all aspects of the IDB's operations.

There are a number of operational and policy measures that should be considered in this regard. For example, increased emphasis should be given to establishing realistic conditions and then adhering to those conditions which are, after all, designed to help the borrowers. The Bank should also seek ways to reduce the accumulation of undisbursed funds, particularly on old loans. The fact that there are still large amounts of undisbursed funds from loans made before the end of 1970, many of which are less than 50 percent disbursed, underscores this point. These amounts are larger than need be for a well-run bank like the IDB. Another area in need of attention is cost overruns, which have become a major problem for the IDB. Not only do cost overrun loans preempt Bank funds which are scarce and are needed for new projects, but they also divert a great deal of valuable staff time from other new projects that should be claiming more attention on the part of the Bank. Assuming the projects financed by the Bank are among the highest priority undertakings for the recipient countries, we believe that alternative means of financing should be found for these cost overruns.

I believe an important step that can be taken to ensure progress on these operational matters which I have discussed would be for the Board of Directors to insist that before approving new projects they be brought to a sufficiently advanced stage of preparation to ensure efficient implementation. This requirement will no doubt be easier to express than to accomplish, but the Bank now has an established reputation for prudent, able management and such an approach is certainly within its capabilities.

As for the Bank's lending policy, we believe the Bank should become even more active than in the past in the sectors where innovative lending is needed, such as rural development and other types of projects which reach lower income groups. While increased production and productivity should remain the chief objective in agricultural loans, we believe the Bank should place special emphasis on projects which ensure that benefits will be widely shared among the rural populations of its member countries.

In view of the rich potential of the Latin American countries for helping the world surmount the growing food crisis, we strongly support the Bank's efforts in the field of agriculture and endorse its initiative in seeking to establish a Hemisphere Agricultural Consultation Group. We urge the Bank to continue to expand its funding of international agricultural research institutions in Latin America. It is through agriculture that the IDB member countries can make a great contribution to solving one of the world's greatest resource problems, for Latin America has great potential not only for feeding its own people better but also for increasing exportable surpluses of agricultural food products. For this reason, the IDB should make a concentrated effort to reverse its recent tendency to lend increasingly for infrastructure projects at the expense of lending for the agricultural sector.

We would also regard any move to reconsider nonproject lending at the IDB as unfortunate. Loans for sectors or general programs are superficially attractive since they usually can be quickly disbursed and provide balance of payments support. The regional development banks, however, should not be diverted from their fundamental purpose of financing projects which promote long-term economic growth. They should not try to solve short-term balance of payments problems for which other institutions exist and for which other vehicles are being developed.

Although we are focusing in this meeting on intergovernmental relationships and the affairs of an official lending institution, we should also not lose sight of the overwhelming importance of the private sector as a supplier of external capital to Latin America. Approximately three-fourths of net financing flows to Latin America comes from private sources. Despite our balance of payments problems and our domestic investment needs, the United States has maintained, and will continue to maintain, a free and open capital market. Latin American countries, along with other nations of the world, will continue to have access to this valuable source of funding. At the same time, let me stress that it is up to each developing country to establish a suitable investment climate and record of creditworthiness.

Given the Bank's tight resources position, we would encourage the Bank to step up its efforts to fund new projects in cooperation with private investors and banks. It would appear that a large volume of resources could be available to the Bank in the form of parallel, joint, and other types of cofinancing in collaboration with the private sector. I urge the Bank to pursue more actively cofinancing techniques that would pioneer a new cooperative arrangement with the private sector in providing development finance. This could help the Bank, with a given amount of its resources, to contribute more widely to the development of member countries. It would also be a significant initial step in assisting member countries to establish substantive financial relations for further access to international capital markets. The private sector is important to the Bank not only as a source of financing but also as a recipient of Bank loans largely through development finance companies. Most Latin American countries have a dynamic private sector. Since a private sector free from government controls is the most certain underpinning for economic development, the Bank should seek to increase the share of its lending to productive enterprises outside the public sphere.

In our view, the job of the international development lending institutions is to supplement private investment, not to substitute for it. The IDB and its institutional colleagues were established to be innovative and to pioneer in those areas which are not, at least in the early stages of development, attractive to private enterprise. Countries should not look to these public institutions to fill resources gaps created by a poor investment climate or by the failure to mobilize and efficiently utilize domestic resources. The U.S. Government is eager to work with the nations of this hemisphere to help you find ways to draw more effectively upon the private capital available in our country.

State of the world economy

Let me direct your attention now to broader economic issues facing the member countries of the Bank, for it is clear that our hopes for economic development hinge to a large degree upon the general health of the international economy.

At the time of last year's meeting of the Bank Governors, inflation was plaguing much of the world. That inflation grew partly out of the simultaneous boom conditions of 1972 and 1973 in the major countries and partly out of long-standing government policies in many countries, including my own, that served to fuel inflationary pressures. The steep increase in international food and oil prices, of course, severely aggravated that inflationary trend.

Since last year's meeting, some of our countries have moved temporarily into a generalized condition of minimum or negative growth and substantial unemployment. Inflation has diminished, but it continues to be the most fundamental long-term economic problem facing many nations.

With the acute strains of current economic conditions, there is a natural tendency for nations to turn inward and to seek economic solutions at the expense of their trading partners. Although solutions must indeed begin at home, joint efforts at international cooperation will permit all of us to do a better job at solving our problems. In today's interdependent world, mutual prosperity depends on mutual cooperation more heavily than ever before.

Cooperation among nations has already helped us to make a good beginning in coping with the many new challenges facing the developing countries. We have begun a constructive dialog to respond to the problems of the developing countries in the context of the new Development Committee, which is associated with the International Monetary Fund and the World Bank. The Committee began by focusing attention on the emergency financing problems of the poorest developing countries. We are hopeful that the international community will resolve to establish a trust fund for such emergency financial assistance in 1976, after the IMF oil facility with its subsidy account terminates lending.

While searching for answers to the problems of the poorest developing countries, we remain mindful of the severe short-term dislocations being suffered by middle-income countries. The Development Committee will meet in June, and I can assure you that the United States will be energetic in seeking cooperative solutions to these pressing problems.

Already a substantial volume of funds has been made available from the International Monetary Fund's regular resources to many countries with balance of payments difficulties—developed and developing countries alike. Moreover, about 2.5 billion SDRs have been lent from the IMF special oil facility established last year.

Looking beyond 1975, IMF members have agreed in principle to seek an increase in IMF quotas which will place the Fund in a position to make substantial resources available to countries in need. The United States has agreed to such an increase, provided that accord can be reached on a series of important amendments to the IMF Articles of Agreement.

A major step has also just been taken to provide the international payments system with an additional measure of insurance. Together with the Finance Ministers of the OECD countries, I was pleased last month to sign an agreement on a new facility to be called the Support Fund. This agreement established a $25 billion safety net to be available to participating countries as a supplement to, but not a substitute for, established international institutions such as the International Monetary Fund. The United States continues to view the IMF as the principal source of multilateral assistance for those members facing temporary balance of payments difficulties. It is our hope that this safety net will never be used, but the confidence it gives should make major contributions to the effective functioning of the international financial system. By so doing, it will help to avoid a situation in which individual countries, eager to gain greater protection, would be tempted to take restrictive measures which would in the end be detrimental to both developed and developing countries.

Turning to trade matters, let me reiterate that in adapting international trade policies to the new economic environment, our goal must be to avoid the temptation for each country to seek unilateral solutions to its problems. Toward that end, the United States has recently enacted legislation, the Trade Act of 1974, which will help us to work constructively and positively toward an increasingly open world trading system.

The United States and Latin America share a number of mutual concerns in the field of trade. For example, several Latin American countries and the United States are major exporters of some temperate-zone agricultural products for which we have a common interest in persuading other countries to lower their barriers. On tropical products, too, the United States supports Latin American interests, and cooperative action on the part of Latin America and the United States in the multilateral trade negotiations helped initiate negotiations on tropical products this past March.

Let me also reassure you that we are firm in our resolve to implement the Tokyo Declaration with its special consideration for the needs of the developing countries. I should also point out that a specific mandate in our Trade Act gives special consideration to developing country interests.

The United States also fully recognizes the concerns of Latin American exporters over the wide fluctuations that have occurred in recent years in commodity export prices. Commodity prices have fallen sharply during the past year after rising to record levels in early 1974. Although most commodity prices are still well above the pre-1972 levels, the declining prices of many primary products have not been matched by price decreases for imports such as oil and manufactured products. Thus, there is a genuine basis for concern over the effects of falling commodity prices on the balance of payments and the serious threat such prices pose to long-term development plans.

The United States and other industrialized nations are sensitive to these concerns and are currently studying methods that could address them properly. We continue to believe market forces of supply and demand are generally the best allocator of resources. Within the United States, the Treasury Department is chairing an interagency task force to study the problem and to formulate recommendations for U.S. commodity policy. Our general policy approach is that we are willing to continue discussing individual commodities on a case-by-case basis. While we emphatically disapprove of unilateral producer actions that artificially raise prices by restricting supplies to consumers, the United States is prepared to work with other countries concerned with commodity issues in a spirit of mutual cooperation.

Conclusion

In closing, let me reemphasize our fundamental commitment to the "new dialog" between Latin America and the United States. The nations of our hemisphere share a history of mutual support in good times and in times of crisis. We also share the hope of a better life for all of our people. The United States recognizes the importance of its longstanding economic interrelationship with the countries of Latin America, and we recognize a continuing obligation to assist in the economic development of this region. Let us remember that the oldest United States aid program is not the Marshall plan but the Institute of Inter-American Affairs, which was established in 1942 under the inspired leadership of the man who is now the Vice President of the United States, the Honorable Nelson Rockefeller.

Since 1960, the United States has provided over $8.5 billion in various forms of assistance to the member countries of the Inter-American Development Bank. We have also made major contributions through the World Bank and IDA. We are particularly pleased that some of these funds have helped to provide the seed money for the remarkable economic progress that several Latin American countries have achieved.

Let us, then, take heart from the progress of the past as we look forward to a new era for the Inter-American Development Bank—an era which will bring a sizable increase in its capital resources, greater concentration of the Bank's concessional resources on the poorest member countries, innovative cofinancing techniques for private sector collaboration, and, hopefully, a stronger momentum toward economic development throughout the hemisphere. We in the United States look forward to working with the other members of the Bank in this vital endeavor.

Exhibit 74.—Statement by Assistant Secretary Cooper, June 6, 1975, before the Foreign Operations Subcommittee of the Senate Appropriations Committee, on contributions to the international development banks

Gentlemen, I am here today to support the administration's request for funding of the international development banks. Over the past three decades the United

States has been the leading force in the development and expansion of the World Bank, the Inter-American Bank, and the Asian Development Bank. We also assisted with drafting the charter of the African Development Fund.

In the main part of my statement, I will try not to overburden the presentation with statistical details in order to focus more directly on the basic rationale for U.S. support of these banks. I have, however, annexed to my presentation further data on each individual bank covering such matters as the capital structure and the number and type of loans for their respective institutions.[1] Also included for the record is an annex on the African Development Fund, for which the administration has submitted a bill to the Congress to provide for U.S. participation.[1] I would like, in this introduction, to discuss what the development banks are, what they do, and why it is in the U.S. national interest to support them in their activities.

Let me start off by stating very clearly that we in Treasury do not believe development of the poorer countries is primarily a matter of money. Certainly money is needed. But the key factors determining the success of development efforts are the policies each country follows and the efforts each makes to increase production. The building of sound and efficient institutions in developing countries is essential to assure a maximum development impact from whatever resources are available.

It is precisely in such areas as economic policies and priorities and institution building that the development banks play their most important role. The banks can direct their funds to support successful development efforts made by the countries themselves and thereby reinforce their technical and policy assistance roles. We continue through our executive directors to stress in each of the banks that simply lending money is not enough and that the bank's role in helping improve the priorities and institution building capabilities of developing countries is fundamental.

The development banks have developed highly competent professional international staffs which help the developing countries with the complex problems of priority setting and institution building. These international staffs bring together outstanding professionals from both developed and developing countries. In both the World Bank and the Inter-American Bank there are more Americans than any other nationality and overall Americans make up about 25 percent of the development bank staffs.

From the U.S. national point of view, it is clear that these banks encourage development in the poorer countries along lines which are both effective and compatible with our own economy. The development banks, of course, lend to countries which have a wide range of economic systems. As apolitical institutions the banks do not try to change the basic economic system a country has chosen for itself. However, within this constraint, the banks stress the role of market forces in the effective allocation of resources, the development of outward-looking trading economies, the critical role of private enterprise, and the importance of spreading development benefits to the poorer people. In recent years the banks have placed greater emphasis on agriculture, the family farm, and cooperatives—an emphasis we have encouraged and supported. In short, the basic approach of the international development banks to economic development is consistent with U.S. views, including views consistently expressed by the Congress.

We, of course, believe that use of the market and the provision of incentives and a favorable climate for individual initiative are the most effective ways of speeding development and of sharing the fruits of economic growth among all the people. With the help of these banks a great many of the developing countries are finding, in a very practical and pragmatic way, the advantages of a market-oriented, private initiative approach. There are, of course, adaptations to local conditions; these are needed and desirable. The multinational character of the banks strengthens them in assisting with such adaptations, in many cases assisting more effectively than any single bilateral donor could.

Let me take just a few examples to illustrate how the banks promote economic development that is compatible with our own economy and therefore serves our national interests in both the short and long run.

Procurement practices.—It is important to development that governments are effective in administering large procurement programs honestly and efficiently. For procurement with their financing all the development banks not only require

[1] Not included in this exhibit.

international competitive bidding but also help teach institutions in the developing countries how to administer such bidding fairly and effectively. The borrowing countries as well as our own industry, exporters, and contractors benefit from the insistence by the banks on standard rules in this regard. The borrowers get high-quality products and services at competitive prices and our firms are assured access to bank-financed contracts. Open competitive bidding practices get built into the procurement systems of borrowing countries and over time they tend to be applied even on non-bank financed projects. Our exporters benefit from the wider adoption of such practices.

Fostering private enterprise.—The development banks provide substantial support to the private sector in most of the countries where the banks have made loans. They supply capital primarily by lending to domestic development finance companies which both raise additional domestic capital and relend to local industry, commerce, and agriculture. The banks have made loans through December 1974 aggregating more than $3 billion for this type of catalytic program. In addition, the International Finance Corporation has made a total of 332 commitments in over 50 countries for $1.4 billion to help develop the private sector. Expanding and strengthening the private sector is one way the banks help build economies in developing countries with which our economy can have compatible trade and investment relationships.

Aid to agricultural sector.—Many loans have also been directed towards enhancing the opportunities and ability of private farmers, including small holders and cooperatives, to increase their production and income. By December 31, 1974, the development banks had channeled $7 billion into the agricultural sector. The World Bank, the largest lender, had invested $5 billion, the IDB $1.7 billion, and the ADB $0.3 billion. The development of private farming, including family farms, on a widespread basis is a basic American tradition, and we strongly support the efforts of the banks in this area.

The development banks are part of an international structure in which the developed and developing countries work together on international problems. By cooperating with the other developed countries in funding these institutions, we improve the effectiveness of our own efforts. Other donor countries strongly support this cooperative approach, and multilateral institutions are being used for an increasing share of total non-Communist development assistance.

In 1965, 3 percent of official development assistance (ODA) (funds for concessional assistance and capital subscriptions) flowed through the four international development banks (IBRD, ADB, IDB, and AFDB). By 1973 their share had grown to 12 percent of ODA. In addition, the banks channeled larger amounts to the developing countries through hard loans financed by their borrowing in world capital markets.

Bilateral aid remains, of course, of major importance. There are special aspects of economic assistance that require bilateral programs, especially where we have special techniques or products to impart, where we have special interests in individual projects or programs, or where security considerations are heavily involved. But U.S. support for the multilateral institutions is essential if we are to meet today's and tomorrow's challenges of improving the prospects for the millions in developing countries which our bilateral programs do not reach. By channeling part of our total economic assistance funds through the development banks, we help bring forward much larger amounts of assistance from other donors and thereby facilitate faster development of the poorer borrowing countries than would be possible with our money alone. By using the banks, we can avoid what could develop into a costly competitiveness among donor countries. The guarantees we and others provide in the form of callable capital, which will probably never be needed, permit the banks to mobilize very large amounts of funds from the private capital markets worldwide.

These institutions provide an effective and cooperative international approach to the economic development of the third world. They provide the developed and developing countries with an established and systematic framework for consultations on economic policies, development needs, and economic performance. The development banks are not debating societies which engage in seemingly endless rhetoric about this or that restructuring of the world economy—they are working institutions that get things done.

So far, I have been discussing the merits of the banks as a group of similar institutions and it is reasonable to ask why our funding requests involve four banks—why not just one? Since most of the developing countries belong to the World Bank, why the need for regional banks? Despite the greater resources and the longer period of experience of the World Bank, the regional banks have an important role to play and reflect the desires and needs of their regional members for organizations aware of and responsive to the unique problems of each region. The regional banks, drawing a large part of their staffs from the countries of the region, have expertise and understanding of local conditions, and local needs and problems which must be taken into account in the transfer of technology to these areas. Larger, more complex projects are usually directed to the World Bank initially, but even then, the World Bank often collaborates with the regional banks in joint financing.

Now let me turn to the appropriations which are required to keep these institutions operating effectively in fiscal year 1976. The lending programs anticipated by the World Bank group, the Inter-American Bank, and the Asian Development Bank in fiscal year 1976 approximate $8.2 billion. To provide the U.S. support for this level of lending we are, at this time, asking for appropriations of $820.6 million. This total compares with $1,006 million requested last year, and $619 million actually appropriated for the development banks last year. For several reasons, our contribution, on the order of 10 percent of this year's lending program, provides essential underpinning for much larger flows of assistance to poorer countries. First, there is the interdependence of our contribution and those of other donor countries, i.e., we provide only a fractional part of the contribution to each bank or fund—a third in IDA, somewhat less in the ADR, more in the IDB. Second, the banks' capital subscriptions and guarantee authority support the borrowing of large sums in the private capital markets of the member countries. Finally, the repayment of loans provides funds which are then relent to support new projects. Japanese and European repayments on old IBRD loans, for example, are helping to finance new projects. Other countries such as Iceland and Gabon are no longer borrowing. There are substantial repayments by many countries that are still receiving loans.

The $820.6 million appropriation being requested for fiscal year 1976 for the individual banks calls for $375 million for IDA: $275 million for the Fund for Special Operations of the IDB: $50 million for the Asian Development Bank Special Funds, $24.1 million for the paid-in portion of Ordinary Capital of the ODB, and $96.5 million for ADB callable capital. The requested appropriations are for installments of each institution's ongoing program for their resource replenishment. These programs had been negotiated with other donor countries after consultation with congressional committees. In these negotiations we have sought, and achieved, broader burden-sharing. U.S. contributions these replenishments are essential to insure the participation of others and the continued operation of the institutions at effective levels. The Congress has earlier authorized programs for these purposes covering these amounts.

I should note at this point that we will later be asking for an authorization and supplementary appropriation to enable the United States to participate in the replenishment of the Ordinary Capital of the IDB. This request will be presented after further consultations with the committee and after negotiations with the other members of the Bank. Also, if the Congress authorizes a U.S. contribution to the African Development Fund, for which bills are pending, we shall be requesting an appropriation for that purpose.

Let me now turn to some particular issues which I know are of interest to the committee. First, what is the effect of our support for the development banks on our balance of payments? Excluding funds held by the development banks in U.S. financial markets, the total of all the inflows and outflows of dollars resulting from transactions involving the banks from their inception to end 1974 (nearly 30 years for the IBRD) has resulted in a net receipt of about $600 million by the United States. In addition, the banks maintain substantial investments in U.S. financial assets as a result of timing differences between borrowing and disbursement of funds. As of the end of 1974, they held about $1.8 billion in long-term investments in the United States, and they also have large amounts in short-term assets.

The absolute magnitudes of the various types of flows are, of course, much larger—e.g., the total net outflow of capital (subscriptions paid in plus net sales of bonds, loan participation, et cetera in the United States) totaled over $6 billion as of end 1974, while development bank-financed purchases of U.S. goods and services and direct expenditures of the banks in the United States totaled nearly $7 billion. Thus, I can safely say that the net balance of payments impact of our involvement in the development banks has been very small indeed, and over time the sums made available as a result of U.S. capital subscriptions and the banks' access to U.S. financial markets have been more than equalled by purchases of goods and services in the United States.

In addition, of course, some portion of the funds invested in the United States awaiting disbursement to finance ongoing development projects will also be spent on U.S. exports of goods and services. Over the years, our share of development bank-financed procurement of goods and services has averaged 28 percent. This percentage has fallen off slightly in more recent years as our share of world exports has fallen. We are intensifying efforts to increase the U.S. share. In short, our assistance to developing countries through the development banks does not strain our balance of payments.

In the longer run we benefit, as the development of the borrowing countries proceeds, making them more reliable and active trading partners with which to develop our foreign commerce.

Let me turn now to the reasons President Ford and Secretary Simon decided it was essential for us to ratify the fourth IDA replenishment. We faced a serious dilemma. In January of this year IDA had virtually exhausted its funds available for commitment. IDA had been operating for 6 months on advance commitments by other countries against pledges that would become fully effective only when the United States would sign up for the fourth replenishment. Additional advance contributions were not coming forward. Without U.S. ratification of our $1.5 billion share of the replenishment, the continued use of $3.0 billion in contributions promised by other donor countries was not possible. As most IDA loans are to countries with less than $200 per capita income, the lack of further IDA financing would have slowed development in many of the poorest developing countries. Prompt U.S. ratification was imperative to avoid a situation in which the United States appeared to be responsible for stopping a large part of assistance from Western countries to the poorest developing countries.

On the other hand, we are keenly aware that such contributions can only be made through the normal appropriations processes and Congress had not yet considered even the first installment of our contribution to IDA IV. So, to enable IDA to continue its lending to the poorest of the developing countries, the administration ratified the IDA IV replenishment with the explicit notification to the IDA that "in accord with customary United States legal procedures, the U.S. contributions will be provided only after enactment of the necessary appropriations bills by the Congress." This is the first time this committee is formally considering appropriations to IDA IV. I believe that both the burden-sharing and other aspects of this replenishment meet the desires of the committee to hold down U.S. expenditures while expanding the development effectiveness of IDA.

We faced a situation in the Asian Development Bank similar to that in IDA. Our contribution to the capital of the Asian Bank consists of two parts—the paid-in component, 20 percent, which is contributed partly in cash and partly by letter of credit, and the callable contribution, 80 percent, which is our guarantee in the unlikely event of a call on this capital because of defaults on many ADB loans. For fiscal year 1975, the Congress appropriated $24.1 million for the paid-in portion of our subscription of the first year of a 3-year ADB capital replenishment. However, the Congress did not appropriate the callable portion. It was neither feasible nor logical to proceed with the paid-in contribution, which involves budget outlays, and not the callable portion. Moreover, we already have appropriations for $120.6 million of callable capital in the ADB as a result of our initial contribution. Therefore, we subscribed for the total first-year contribution with the callable subscription based on the authorizing legislation, Public Law 93-537. However, I would point out that we did not sign up for the entire 3-year subscription because we believe it is proper for the Congress to review this issue of appropriation of ADB capital this year. We are again requesting appropriation of the callable as well as the paid-in capital because the ADB is a relatively new bank and the availability of additional appropriated callable capital would provide additional confidence to investors in ADB bonds.

Last year congressional members raised many questions about the newly rich oil-exporting countries. One of the key questions was: What are these countries doing to assist others? In 1974 the OPEC countries stepped up their aid commitments—in the form of loans and grants—to the tune of some $8.5 billion, up from $3 billion in 1973. Disbursements of OPEC assistance totaled about $2.5 billion in 1974. In addition, OPEC countries purchased substantial amounts of World Bank bonds and loaned funds to the IMF oil facility. OPEC country aid does not make up for a more than quadrupling of oil prices and their assistance tended to be concentrated in areas close to the lending countries, but these figures do indicate that the OPEC countries are moving into the aid field in a substantial way. We are encouraging them to continue to do so and in particular to provide more of their concessional assistance through the development banks, including early contributions to IDA.

We want to expand the burden-sharing aspect of the development banks' operations by opening new relationships between the banks and capital surplus oil-exporting countries. Continued U.S. contributions are essential, however, if such new relationships are to be brought about. It is clear that others will not give more if we give less. If we maintain our support for the institutions, we can encourage others to do more.

The increased financial strength of the OPEC countries offers new opportunities for cooperation with them in respect to the development banks. Most of these countries have in the past been borrowers of the banks. Now lending to them is being carefully monitored and lending to them on concessional terms has been virtually phased out. OPEC countries are participating in the newly formed Development Committee where new initiatives in meeting overall development needs are being studied.

Venezuela has established a $500 million trust fund, which is being administered by the IDB, thus increasing the resources available to that institution. And while we were disappointed in the lack of concessional resources in this new trust fund, the Venezuelan Government has indicated that it is seeking ways to make available additional funds on soft terms. The World Bank is discussing with OPEC countries the need for contributions to support concessional lending.

Next let me turn to the problem of earmarking. In addition to the appropriations, the administration is requesting the removal of the "earmarking" provisions of fiscal '75 appropriations legislation for the Fund for Special Operations of the IDB. We agree with the underlying congressional interest that the IDB should emphasize projects that directly help low-income groups, and we are encouraging bank management in this direction. However, it is not always easy to find sound technical projects which effectively benefit the poor while increasing production or providing needed services at costs which the recipients can afford. Partly because other projects may have higher economic payoff, projects benefiting the lower income groups may sometimes not be given the highest priority by the borrowing country.

We do not believe that earmarking is the way to approach this problem of reaching the lower income groups. The Bank is already making substantial loans to cooperatives and will make more new loans to cooperatives this year than the earmarked amount. The Bank is also proceeding with a substantial grant to further the development of credit unions in Latin America. This technical assistance grant procedure promises to be more effective than loans in reaching the poor at this stage when many of the existing credit unions which might be borrowers are primarily urban and middle class and when the need is to spread credit union activity to rural areas and productive activities. Finally, savings and loan associations in Latin America are almost exclusively middle and upper class oriented. IDB lending to such institutions to finance housing that only the relatively well-off, urban population could afford would be inconsistent with the IDB's and our own general development thrust.

The imposition of earmarking flies in the face of the multilateral decisionmaking process by making the development banks merely the administrator of funds provided under restrictive conditions. If even five or six donor countries engaged in such a practice, the managements of the banks would find it virtually impossible to support coherent development programs in borrowing countries and the multilateral process of setting priorities would be negated. And if one country insists on such a practice, we can expect others to try to impose their priorities which may or may not be in the economic field. Where there are specific individual programs which the Congress wishes to earmark money to support, this should be done through our bilateral aid program.

We are continuously working at improving our oversight activities in regard to the banks' lending programs and project implementation. Embassy, AID, and Treasury officials make visits to projects as frequently as possible. At every opportunity we encourage and facilitate project visits by Members of Congress. As I stressed earlier, we believe that the basic thrust of the policies and operations of the development banks is in the right direction. We continue to seek improvements. However, given the institutional and multilateral framework in which we participate, we must accept the fact that we sometimes can get results only gradually.

The recent past provides examples of how policies in these institutions can be changed in emphasis. In the case of program loans we have seen the World Bank attaching more conditions to insure more effective economic performance on the part of the borrowing country. We see a greater emphasis on agricultural development as perceptions of the food requirements of the world are refined, largely with U.S. leadership. We see a gradual but growing emphasis on projects to benefit the poorest 40 percent of the population in borrowing countries as the question of income distribution is analyzed. In the past few years our influence has been used to introduce systems of postevaluation of loans and projects into the management systems of the banks as suggested by the Congress, and we believe that considerable progress has been made. But in such efforts our influence must be used in cooperation with other member countries and within the structure of the charters of the banks in order to preserve them as effective international institutions.

Mr. Chairman, members of the subcommittee, what we are looking at here, when we propose additional funding for the international development banks, is part of the world economic agenda—the agenda of an increasingly interdependent world economy. We continue to be reminded in very forceful terms of the interdependence of nations and the importance of mutual economic cooperation. This part of the agenda involves economic development in the third world—development assistance. Other areas of interdependence are on the agenda also—international trade, international finance, energy, and raw materials—and all are closely linked to the question of providing development assistance to less developed countries.

We seek the cooperation and participation of the less developed countries in dealing with trade, finance, energy, raw material problems. The less developed countries give high priority to the prospects for their own economic development and they seek to maximize the assistance which can be obtained from the developed and other more fortunate countries. The continuation of our assistance in financing their development is closely related to their ability and willingness to cooperate with us in other economic fields.

In view of the committee's interest in project information, we are also annexing sample data on lending in three countries. We are providing this additional material for the record for the first time this year to illustrate the role and impact of development bank lending activities in the context of individual countries. We are, of course, prepared to supply data on additional projects, countries, or additional information on the international financial institutions at your request.

We have also been discussing with the committee's staff the provision of additional information to keep the committee fully informed on operations of the development banks throughout the year. It is our hope that we shall be able to work out informal arrangements to preserve the confidential nature of operational information generated by these international organizations while at the same time permitting this committee to keep current on questions and trends in the programs of each of the development banks of which we are a member. We would welcome an input of congressional views and ideas throughout the year as we develop our policies on bank operations in the National Advisory Council—the interagency group charged with coordinating U.S. Government policies in relation to these institutions. Of course, we are only one member of these banks and cannot always immediately affect their operations.

Mr. Chairman, you and this committee have a difficult task in weighing the many appropriations for foreign operations. In conclusion, I ask that you keep in mind the importance of the broad framework of international cooperation of which the development banks are an integral part as you consider the appropriations needed for these banks to do their job of accelerating development worldwide.

Exhibit 75.—Communique of the Joint Ministerial Committee of the Boards of Governors of the International Bank for Reconstruction and Development and the International Monetary Fund on the Transfer of Real Resources to Developing Countries (the Development Committee) after its third meeting, Paris, France, June 12–13, 1975

The Joint Ministerial Committee of the Boards of Governors of the Bank and Fund on the Transfer of Real Resources to Developing Countries (the Development Committee) held its third meeting in Paris on June 12–13, 1975, under the chairmanship of Mr. Henri Konan Bédié, Minister of Economy and Finance for the Ivory Coast. The meeting was held in the Centre de Conferences Internationales. Mr. Robert S. McNamara, President of the International Bank for Reconstruction and Development, Mr. H. Johannes Witteveen, Managing Director of the International Monetary Fund, and Mr. Henry J. Costanzo, Executive Secretary of the Development Committee, took part in the meeting, which was also attended by the following observers: Mr. Abdel Wahab Labidi, President of the African Development Bank; Mr. Chedly Ayari, President of the Arab Bank for Economic Development in Africa; Mr. Saeb Jaroudi, President of the Arab Fund for Economic and Social Development; Mr. Shiro Inoue, President of the Asian Development Bank; Mr. Claude Cheysson, member of the Commission of the European Communities; Mr. Maurice Williams, Chairman of the Development Assistance Committee; Mr. Yves Le Portz, President of the European Investment Bank; Mr. M.G. Mathur, Deputy Director-General of the GATT; Mr. Antonio Ortíz Mena, President of the Inter-American Development Bank; Mr. E. van Lennep, Secretary-General of the OECD; Mr. Gabriel van Laethem, Under Secretary-General of the United Nations; Mr. Gamani Corea, Secretary-General of UNCTAD; and Ambassador Paul Jolles of Switzerland.

The Committee reviewed the present situation and the medium and long-term prospects of the developing countries, in the context of analyses prepared by the IMF on the short-term balance of payment outlook of developing countries, and a World Bank study on the capital requirements of developing countries to the end of this decade. The Committee noted with concern the continued deterioration of the position of most of the developing countries. The Committee broadly endorsed the conclusion of the World Bank study that, if the developing countries are to achieve adequate growth rates in the remaining years of the decade, they will require substantial increases in capital flows, both official and private, and that among other things they will have to undertake at the same time efforts to increase domestic resource mobilization and to expand exports. In particular, the Committee felt that the low-income countries faced a very difficult prospect and recommended that their requirements for concessional assistance should be met on a priority basis. The Committee agreed with the conclusions of the Bank study about the substantial additional requirements for external capital of the middle and high-income developing countries. Noting the conclusions of the IMF study that the balance of payments needs of the most seriously affected countries would continue to be large in 1975 and 1976, the Committee recommended urgent steps to meet these needs through existing and new mechanisms.

In the light of this situation, the Committee re-emphasized the urgency of improving the real volume and quality of official development assistance, both bilateral and multilateral, and reviewing its distribution with a view to improving the share for the poorer countries, and reaffirmed their commitment to support steps toward these ends in both the industrial and the surplus oil-producing countries. The Committee welcomed the decisions of some of its members to expand the volume and improve the quality of their assistance, but noted that the existing quantum of aid was still far below the 0.7 per cent of GNP target for the middle of the Second Development Decade. In this connection, the Committee noted that negotiations for the IDA V replenishment were scheduled to start later this year. In view of the requirement for additional capital by IDA recipients, it was agreed that a replenishment providing for an expansion in real terms would be most helpful.

The Committee agreed that in order to help achieve acceptable rates of growth for developing countries, there should be an expansion of the lending programs of the World Bank and the regional development banks, consistent with their capital structure and the availability of funds. The Committee urged that the capital base of the development finance institutions be reviewed.

In response to the serious difficulties faced by the developing countries, the Committee, as a first concrete step, decided to lend its unanimous support to the establishment for one year of a new intermediate lending facility in the World Bank (known as the "third window") to lend on terms intermediate between those of IDA and of the World Bank. It further decided to urge the World Bank to proceed with its establishment in the fiscal year beginning July 1, 1975, in order to lend to the developing countries in that year up to $1 billion in assistance separate from other Bank operations. Since these funds will be limited, there will be need for eligibility criteria which will favor the developing countries with an annual per capita income of less than $375, but it was recognized that there was need to have some flexibility in the matter of the upper limit of the criteria. It was pointed out that the third window operations could also have some redistributive effect on other Bank Group financing, to both the poorest and the middle and higher-income developing countries. The Committee noted with satisfaction that 11 countries had offered contributions towards an interest subsidy fund from amongst industrial and oil-exporting countries. Some other countries indicated their likely support to this cooperative effort by some industrial and oil-exporting countries, in a multilateral framework, for the assistance of the developing countries in the present difficult situation but suggested some alternative ways of financing.

The Committee considered the report of the Executive Boards of the IBRD and IMF on proposals to create a special trust fund to be administered by the IMF to provide additional highly concessional resources to meet the balance of payments needs of low-income developing countries for the next few years. Some members of the Committee felt there was an urgent need for establishing such a fund as soon as possible. In order to facilitate early concrete action on a trust fund, the Committee agreed to urge the Executive Directors of the IMF to consider all aspects of the establishment of such a trust fund as well as to continue their study of all possible sources of financing.

It was appreciated that the magnitude of the flow of resources required by the developing countries was such that private capital flows must continue to play a substantial role in helping to meet the overall capital needs for development. The Committee noted the importance of measures to facilitate and expand the access of developing countries to capital markets and recommended expanded technical assistance to developing countries seeking such access. The Committee agreed to establish a working group to make a review of regulatory and other constraints affecting access to capital markets, and also to study further proposals to support developing countries' access to private markets, including the use of multilateral guarantees. The Working Group should present a status report on progress at the next Committee meeting.

The Committee recognized that fluctuations in the prices and earnings of commodities which account for a major portion of the exports of developing countries can present severe problems to these countries both in their balance of payments and in the maintenance of development expenditures and investment levels. The Committee recognized the need for effective measures to reduce such fluctuations, which could make a significant contribution to development efforts. The Committee noted measures recently taken and others under consideration to help moderate fluctuations in commodity prices or export earnings including proposals to negotiate appropriate agreements. Many members urged the Bank, and the regional organizations, to study ways and means of assisting in the financing of commodity stabilization schemes, including buffer stock arrangements. Many members also expressed strong support for the Bank's proposal to consider providing financing to the tin buffer stock. The Committee welcomed the request of the Interim Committee to the Executive Directors of the IMF to consider appropriate modifications in the terms of its compensatory financing facility and its buffer stock facility.

The Committee also noted that appropriate trade liberalization policies could provide very substantial benefits to the developing countries and expressed its earnest hope for maximum progress in trade liberalization during the on-going multilateral trade negotiations.

The Committee took note of new institutional arrangements established as a result of the World Food Conference as well as of initial steps toward creation of the proposed International Fund for Agricultural Development.

It was agreed that the next meeting of the Committee would be held in Washington, D.C., in the first week of September, during the Annual Meetings of the Boards of Governors of the Bank and the Fund. It was also agreed to meet in January 1976, in Jamaica, in conjunction with the meeting of the Interim Committee.

TESTIMONY ON INTERNATIONAL MATTERS

Exhibit 76.—Other Treasury testimony in hearings before congressional committees

Secretary Simon

Statement before the Subcommittee on Multinational Corporations, Committee on Foreign Relations, U.S. Senate, on the effect on the U.S. and world economies of increased capital flows to the oil-exporting countries, August 12, 1974.

Statement published in hearings before the Joint Economic Committee, 93d Congress, 2d session, on U.S. proposals for international cooperation in energy and finance, November 25, 1974, pp. 2–9.

Statement published in hearing before the Subcommittee on Financial Markets of the Committee on Finance, U.S. Senate, 94th Congress, first session, on the effect of petrodollars on financial markets, January 30, 1975, pp. 3–13.

Under Secretary for Monetary Affairs Bennett

Statement published in hearings before the Subcommittee on International Finance of the Committee on Banking and Currency, House of Representatives, 93d Congress, 2d session, July 9, 1974, pp. 5–12.

Statement before the Subcommittee on Foreign Commerce and Tourism of the Committee on Commerce, U.S. Senate, on foreign investment in the United States, May 7, 1975.

Assistant Secretary Cooper

Statement published in hearings before the Subcommittees on International Organizations and Movements and on Foreign Economic Policy of the Committee on Foreign Affairs, House of Representatives, 93rd Congress, 2d session, December 18, 1974, pp. 2–6.

Statement before the Subcommittee on Foreign Operations of the Appropriations Committtee, House of Representatives, on contributions to the international development banks, May 14, 1975.

Deputy Assistant Secretary Bushnell

Statement published in hearings before the Subcommittee on Merchant Marine of the Committee on Merchant Marine and Fisheries, House of Representatives, 93d Congress, 2d session, November 21, 1974, pp. 67–70.

Organization and Procedure

Exhibit 77.—Treasury Department orders relating to organization and procedure

No. 200, Amendment 4, November 20, 1974.—Organizational Change, Office of the Assistant Secretary for Administration

Pursuant to authority vested in the Secretary of the Treasury by Reorganization Plan No. 26 of 1950, and the authority redelegated to me by Treasury Department Order No. 190, Revised, there is hereby transferred to the Office of Audit, the functions and responsibilities of the Fiscal Management Staff effective December 8, 1974.

The Fiscal Management Staff has the responsibility for improving financial management relating to administrative appropriations, which includes, but is not limited to providing coordination and professional assistance to the various bureaus and offices of the Treasury Department. This includes the development of accounting systems, procedures, and accounting forms and the review and approval of such systems, procedures, and forms for the purpose of transmitting them, when appropriate, to the Comptroller General for his review and approval.

The personnel, records, and property relating to the functions and responsibilities of the Fiscal Management Staff created by Treasury Department Order No. 200 of March 18, 1963, (then titled "Fiscal Management Division") are included in the transfer to the Office of Audit.

All previous orders concerning the Office of Budget and Finance remain in effect; and to the extent any previous orders are in conflict with the provisions of this order, they are hereby amended accordingly including those specifically cited above.

WARREN F. BRECHT,
Assistant Secretary for Administration.

No. 234, DECEMBER 18, 1974.—DIRECTIVE TO SELL GOLD

By virtue of the authority vested in me as Secretary of the Treasury by Section 9 of the Gold Reserve Act of 1934 (31 U.S.C. 733) and Reorganization Plan No. 26 of 1950, I hereby authorize and direct the Under Secretary for Monetary Affairs, Jack Bennett, to take all necessary and proper measures, including direction of other officials of the Department and utilization of the services of other government agencies, for the public sale of 2,000,000 fine troy ounces of gold on January 6, 1975.

WILLIAM E. SIMON,
Secretary of the Treasury.

No. 221-3, DECEMBER 24, 1974.—TRANSFER OF FUNCTIONS TO THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

By virtue of the authority vested in me as Secretary of the Treasury, including the authority in Reorganization Plan No. 26 of 1950, it is ordered that:

1. There is hereby transferred, as specified herein, the functions, powers and duties of the Internal Revenue Service arising under laws relating to wagering, to the Bureau of Alcohol, Tobacco and Firearms (hereinafter referred to as the Bureau).
2. The Director of the Bureau shall perform the functions, exercise the powers, and carry out the duties of the Secretary in the administration and enforcement of the following provisions of law: Chapter 35 and Chapters 40 and 61 through 80, inclusive, of the Internal Revenue Code of 1954, insofar as they relate to activities administered and enforced with respect to Chapter 35.
3. All functions, powers and duties of the Secretary which relate to the administration and enforcement of the laws specified in paragraph 2 hereof are delegated to the Director. Regulations for the purposes of carrying out the functions, powers and duties delegated to the Director may be issued by him with the approval of the Secretary.
4. All regulations prescribed, all rules and instructions issued, and all forms adopted for the administration and enforcement of the laws specified in paragraph 2 hereof, which are in effect or in use on the effective date of this Order, including amendments thereto, shall continue in effect as regulations, rules, instructions and forms of the Bureau until superseded or revised.
5. All existing activities relating to the assessment, collection, processing, depositing, or accounting for taxes (including penalties and interest), under the laws specified in paragraph 2 hereof, shall continue to be performed by the Commissioner of Internal Revenue until the Director shall otherwise provide with the approval of the Secretary.
6. (a) The term "Commissioner of Internal Revenue" whenever used in regulations, rules, instructions, and forms issued or adopted for the administration and enforcement of the laws specified in paragraph 2 hereof, which are in effect or in use on the effective date of this Order, shall be held to mean the Director.

   (b) The term "internal revenue officer" and "officer, employee or agent of the internal revenue" wherever used in such regulations, rules, instructions and forms, in any law specified in paragraph 2 above, and in 18 U.S.C. 1114, shall include all officers and employees of the United States engaged in the administration and enforcement of the laws administered by the Bureau, who are appointed or employed by, or pursuant to the authority of, or who are subject to the directions, instructions or orders of, the Secretary.

7. All delegations inconsistent with this Order are revoked.
8. This Order shall be effective immediately.

WILLIAM E. SIMON,
Secretary of the Treasury.

No. 233, REVISION 1, DECEMBER 26, 1974.—DELEGATION TO THE ASSISTANT SECRETARY FOR ADMINISTRATION OF RESIDUAL AUTHORITY FOR THE ORDERLY TERMINATION OF ECONOMIC STABILIZATION ACTIVITIES

The orderly termination of the Economic Stabilization Program has been substantially completed by the Office of Economic Stabilization, which was established by Treasury Department Order No. 233, June 28, 1974 (39 F.R. 24522), and pursuant to that order, ceases to exist on December 31, 1974. Nevertheless, it is necessary to provide for a number of continuing activities, including the appropriate disposition of certain reports and records of the Economic Stabilization Program; the servicing of requests from the public for access to documents filed under the Economic Stabilization Program; and the continuation of compliance and enforcement efforts, pursuant to section 218 of the Economic Stabilization Act of 1970, as amended, with respect to action or pending proceedings, civil or criminal, not finally determined on April 30, 1974, or any action or proceeding based upon any act committed prior to May 1, 1974.

Therefore, by virtue of the authority vested in me as Secretary of the Treasury including that in Reorganization Plan No. 26 of 1950, and that delegated to me by Executive Order 11788, June 18, 1974 (39 F.R. 22113), it is hereby ordered as follows:

1. All powers and duties delegated to the Secretary by Executive Order 11788, June 18, 1974 (39 F.R. 22113), are delegated to the Assistant Secretary for Administration except for (a) the authority contained in subsections 5(a) (2) and (3) of that order, and (b) the authority contained in subsection 5(b) (1) of that order.
2. All regulations, rules, instructions and forms issued or adopted by the Office of Economic Stabilization for the administration of the Economic Stabilization Program pursuant to the Economic Stabilization Act of 1970, as amended, are hereby continued in effect as regulations, rules, instructions and forms of the Department of the Treasury, until superseded or revised. All references in Chapters I through VI of Title 6 of the Code of Federal Regulations to the Office of Economic Stabilization or its Director, the Cost of Living Council or the Director or Chairman of the Council, the Construction Industry Stabilization Committee, or any other official or agency which exercised authority delegated by the Council shall for procedural purposes be deemed to refer to the Assistant Secretary for Administration.
3. The authorities delegated by this order may be further redelegated by the Assistant Secretary for Administration.
4. Any delegations of authority heretofore made by the Assistant Secretary for Administration pursuant to Treasury Department Order No. 233 are hereby ratified and continued.
5. This order supersedes Treasury Department Order No. 233, issued June 28, 1974.
6. This order is effective January 1, 1975.

WILLIAM E. SIMON,
Secretary of the Treasury.

No. 190, REVISION 10, JANUARY 6, 1975.—SUPERVISION OF BUREAUS AND OFFICES, DELEGATION OF AUTHORITY, AND ORDER OF SUCCESSION IN THE TREASURY DEPARTMENT

1. The following officials shall be under the direct supervision of the Secretary:
   The Deputy Secretary
   The Executive Assistant to the Secretary
      Deputy Assistant and Director, Executive Secretariat

2. The following officials shall be under the supervision of the Secretary, and shall report to him through the Deputy Secretary:
   Under Secretary for Monetary Affairs
   Under Secretary

General Counsel
Assistant Secretary (Tax Policy)
Commissioner, Internal Revenue Service
Comptroller of the Currency

3. The following officials shall be under the supervision of the Under Secretary for Monetary Affairs, and shall exercise supervision over these organizational entities indicated thereunder:

Assistant Secretary (Trade, Energy, and Financial Resources Policy Coordination)
- Deputy Assistant Secretary for Trade and Raw Materials Policy
- Deputy Assistant Secretary for Energy Policy
- Deputy Assistant Secretary for Financial Resources Policy Coordination

Assistant Secretary (International Affairs)
- Deputy Assistant Secretary for International Monetary and Investment Affairs
- Deputy Assistant for Development Finance Policy
- Deputy Assistant Secretary for Research

Assistant Secretary (Economic Policy)
- Office of Domestic Gold and Silver Operations
- Office of Financial Analysis

Fiscal Assistant Secretary
- Bureau of Government Financial Operations
- Bureau of the Public Debt

Treasurer of the United States
Special Assistant to the Secretary (National Security)
Special Assistant to the Secretary (Debt Management)
- Office of Debt Analysis

U.S. Savings Bonds Division

4. The following officials shall be under the supervision of the Under Secretary, and shall exercise supervision over those organizational entities indicated thereunder:

Assistant Secretary (Administration)
- Office of Administrative Programs
- Office of Audit
- Office of Budget and Finance
- Office of Computer Science
- Office of Equal Opportunity Program
- Office of Management and Organization
- Office of Personnel

Assistant Secretary (Legislative Affairs)
Assistant Secretary (Enforcement, Operations, and Tariff Affairs)
- Office of Law Enforcement
- Office of Operations
- Office of Tariff Affairs
- Office of Foreign Assets Control
- Bureau of Alcohol, Tobacco and Firearms
- U.S. Customs Service
- Bureau of Engraving and Printing
- Bureau of the Mint
- U.S. Secret Service
- Consolidated Federal Law Enforcement Training Center

Special Assistant to the Secretary (Public Affairs)
Office of Revenue Sharing

5. The following officials shall exercise supervision over those organizational entities indicated thereunder:

General Counsel
- Legal Division
- Office of Director of Practice

Assistant Secretary (Tax Policy)
- Office of Tax Analysis
- Office of Tax Legislative Counsel (also part of Legal Division)
- Office of International Tax Counsel (also part of Legal Division)
- Office of Industrial Economics

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Commissioner, Internal Revenue Service
 Assistant Commissioner (Accounts, Collection, and Taxpayer Service)
 Assistant Commissioner (Administration)
 Assistant Commissioner (Compliance)
 Assistant Commissioner (Inspection)
 Assistant Commissioner (Planning and Research)
 Assistant Commissioner (Technical)
Comptroller of the Currency
 First Deputy Comptroller
 Deputy Comptrollers
 Chief, National Bank Examiners

6. The Deputy Secretary, the Under Secretary for Monetary Affairs, the Under Secretary, the General Counsel, and the Assistant Secretaries are authorized to perform any functions the Secretary is authorized to perform. Each of these officials shall perform functions under this authority in his own capacity and under his own title and shall be responsible for referring to the Secretary any matter on which actions should appropriately be taken by the Secretary. Each of these officials will ordinarily perform under this authority only functions which arise out of, relate to, or concern the activities or functions of or the laws administered by or relating to the bureaus, offices, or other organizational units over which he has supervision. Any action heretofore taken by any of these officials in his own capacity and under his own title is hereby affirmed and ratified as the action of the Secretary.

7. The following officers shall, in the order of succession indicated, act as Secretary of the Treasury in case of the death, resignation, absence, or sickness of the Secretary and other officers succeeding him, until a successor is appointed, or until the absence or sickness shall cease:

A. Deputy Secretary
B. Under Secretary for Monetary Affairs
C. Under Secretary
D. General Counsel
E. Commissioner of Internal Revenue
F. Assistant Secretaries, or Deputy Under Secretaries, appointed by the President with Senate confirmation, in the order in which they took the oath of office as Assistant Secretary, or Deputy Under Secretary.

8. Treasury Department Order 190 (Revision 9) is rescinded, effective this date.

WILLIAM E. SIMON,
Secretary of the Treasury.

NO. 189, REVISION 2, AMENDMENT 1, MAY 15, 1975—AUTHORITY TO REDELEGATE CERTAIN FUNCTIONS OF EQUAL EMPLOYMENT OPPORTUNITY

The authority to make determinations of the compliance posture of Treasury Department contractors which was delegated to the Assistant Secretary (Administration) in Treasury Department Order No. 189 (Revision 2, August 5, 1973) may be redelegated by the Assistant Secretary (Administration) without limitation.

WILLIAM E. SIMON,
Secretary of the Treasury.

NO. 200, AMENDMENT 5, MAY 20, 1975.—TREASURY EMPLOYEE DATA AND PAYROLL DIVISION

Pursuant to the authority of Reorganization Plan No. 26 of 1950 (5 U.S.C., App., 64 Stat. 1280), as implemented by Treasury Order No. 190 (revised), there is hereby established the Treasury Employee Data and Payroll Division as a division of the Office of Management and Organization.

The function of this Division is to establish policy and procedures, in conjunction with Treasury Bureaus and Offices, affecting Department payroll and personnel information systems, and to provide management overview and technical guidance in the development, maintenance and refinement of Department payroll and personnel information system and their interface with related systems. In carrying out this function, this Division:

1. Develops and administers the implementation of standardized payroll procedures, instructions and guidelines.
2. Monitors the efficiency of payroll and personnel information systems; approves modifications and enhancements; and establishes a Departmental forum to review requirements and related matters.
3. Represents the Department in matters relating to payroll and administers the payroll aspects of the Department's retirement, insurance, and similar programs.
4. Coordinates and administers the Departmental system for maintaining employee statistics (REST).

WARREN F. BRECHT,
Assistant Secretary (Administration).

No. 234–1, June 3, 1975.—Audit of Gold Stock

I hereby authorize and direct the Fiscal Assistant Secretary of the Treasury, with the cooperation and assistance of the Director of the Mint, to conduct a continuing audit of United States-owned gold for which the Department of the Treasury is accountable with the objective of verifying the accuracy of the inventory of gold and the adequacy of related accounting records and internal controls in accordance with Treasury Audit Policies established by Administrative Circular No. 224.

This order is issued under the authority contained in 5 U.S.C. § 301, 31 U.S.C. § 66a, and the authority vested in me as Secretary of the Treasury by Reorganization Plan No. 26 of 1950.

WILLIAM E. SIMON,
Secretary of the Treasury.

No. 189–1, June 9, 1975.—Delegation of Equal Employment Opportunity Functions

Pursuant to the authority delegated to me by Treasury Department Order No. 189 (Revision 2) of August 5, 1973, and Treasury Department Order No. 189 (Revision 2) Amendment 1 of May 15, 1975, I hereby delegate to the Director of the Office of Equal Opportunity Program the authority to make decisions and dispositions on complaints of discrimination, acceptance of affirmative action plans by Treasury components, and determinations of the compliance posture of contractors.

The authority to make decisions and dispositions on complaints of discrimination, and acceptance of affirmative action plans by Treasury components may not be redelegated by the Director. The authority to make determinations of the compliance posture of Treasury Department contractors may be redelegated by the Director.

This Order rescinds Treasury Department Order No. 189 (Revision 2) Supplement 1 of August 13, 1973.

WARREN F. BRECHT,
Assistant Secretary (Administration).

No. 234–2, June 21, 1975.—Directive To Sell Gold

By virtue of the authority vested in me as Secretary of the Treasury by Section 9 of the Gold Reserve Act of 1934 (31 U.S.C. 733) and Reorganization Plan No. 26 of 1950, I hereby authorize and direct the Assistant Secretary for International Affairs to take all necessary and proper measures, including direction of other officials of the Department and utilization of the services of other government agencies, for the public sale of approximately 500,000 fine troy ounces of gold from the United States' gold stocks on June 30, 1975. Any actions heretofore taken by the Assistant Secretary for International Affairs in connection with such sale are hereby ratified and confirmed as the actions of the Secretary.

WILLIAM E. SIMON,
Secretary of the Treasury.

STATISTICAL APPENDIX

TABLES

The statistical tables to this Annual Report will be published in the separate Statistical Appendix.

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