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Press releases.

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

FOR IMMEDIATE RELEASE February 3, 1976

DAVID F. BRADFORD
APPOINTED DEPUTY ASSISTANT SECRETARY FOR TAX POLICY

Treasury Secretary William E. Simon today announced the appointment of Dr. David F. Bradford to the position of Assistant Secretary for Tax Policy.

In this position, Dr. Bradford is the chief economic advisor to the Treasury Assistant Secretary for Tax Policy and also is head of the Treasury's Office of Tax Analysis. Dr. Bradford assumed the position on October 20, 1975; he succeeds George S. Tolley.

To fill the position with the Treasury Department, Dr. Bradford has taken leave as Professor of Economics and Public Affairs at Princeton University, where he was involved in research centering on public finance and urban problems.

Dr. Bradford is a 1960 Phi Beta Kappa graduate of Amherst College (B.A., economics) and he holds advanced degrees from Harvard University (M.S., applied mathematics, 1962) and Stanford University (Ph.D., economics, 1966). In 1963-64 he attended Churchill College of Cambridge University, England.

In 1965-66, Dr. Bradford served as a consultant to the Assistant Secretary of Defense. For the academic year 1965-66, he was an acting Instructor in Economics and a Research Associate at Stanford University.

Dr. Bradford joined the Princeton University faculty in 1966 as an Assistant Professor of Economics, advancing to Associate Professor of Economics and Public Affairs (1971) and Professor of Economics and Public Affairs (1975) -- a joint appointment with the Woodrow Wilson School of Public and International Affairs. During 1975, he served as Associate Dean of the Woodrow Wilson School.

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Dr. Bradford is a member of the American Economic Association and the Econometric Society. He has served as a consultant to the National Advisory Commission on Selective Service, the U.S. Bureau of the Budget, the Office of Economic Opportunity, the National Science Foundation and the National Aeronautics and Space Agency.

Dr. Bradford is published widely in the areas of public finance and urban economics.

Dr. Bradford was born January 8, 1939, in Cambridge, Massachusetts, is married to the former Gunthild Klarchen Huober and resides in Washington, D.C. with his wife and two children.

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FOR IMMEDIATE RELEASE February 2, 1976

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $ 3.1 billion of 13-week Treasury bills and for $3.8 billion of 26-week Treasury bills, both series to be issued on February 5, 1976, were opened at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing May 6, 1976			26-week bills maturing August 5, 1976		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	98.799	4.751%	4.89%	97.457	5.030%	5.25%
Low	98.778	4.834%	4.98%	97.430	5.084%	5.30%
Average	98.784	4.811%	4.95%	97.439	5.066%	5.29%

Tenders at the low price for the 13-week bills were allotted 98%.
Tenders at the low price for the 26-week bills were allotted 59%.

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Received	Accepted	Received	Accepted
Boston	$ 75,185,000	$ 74,685,000	$ 34,100,000	33,100,000
New York	3,541,835,000	2,347,435,000	5,147,380,000	2,893,970,000
Philadelphia	32,710,000	31,710,000	38,490,000	4,490,000
Cleveland	43,395,000	43,395,000	212,385,000	172,385,000
Richmond	21,620,000	21,620,000	32,530,000	16,030,000
Atlanta	47,450,000	46,450,000	57,390,000	43,790,000
Chicago	343,320,000	257,620,000	429,295,000	266,885,000
St. Louis	54,970,000	34,970,000	40,885,000	14,385,000
Minneapolis	37,200,000	32,200,000	40,000,000	20,950,000
Kansas City	37,075,000	27,800,000	22,145,000	20,145,000
Dallas	43,260,000	39,240,000	29,790,000	25,970,000
San Francisco	220,215,000	145,015,000	469,985,000	287,935,000
TOTALS	$4,498,235,000	$3,102,140,000 a/	$6,554,375,000	$3,800,035,000 b/

a/ Includes $353,295,000 noncompetitive tenders from the public.
b/ Includes $155,300,000 noncompetitive tenders from the public.
1/ Equivalent coupon-issue yield.

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FOR IMMEDIATE RELEASE

STATEMENT BY THE HONORABLE WILLIAM M. GOLDSTEIN
DEPUTY ASSISTANT SECRETARY FOR TAX POLICY
U.S. DEPARTMENT OF TREASURY
BEFORE THE
NEW YORK STATE BAR ASSOCIATON
NEW YORK CITY, JANUARY 29, 1976

Two hundred years ago England imposed on the American Colonies a tax on newspapers, tea and liquor, and this was a sufficient irritant to provoke a revolution. I wonder how much more violent that revolution would have been if England had imposed on the Colonies the Internal Revenue Code of 1954, as amended?

This is not idle speculation. Former Treasury Secretary Barr first observed almost 10 years ago, and Secretary Simon observed only last month, that we may be faced with an incipient taxpayers' revolt. While I would not push the parallel too far, I think it is clear that sufficiently serious criticisms of the Internal Revenue Code have been voiced by a sufficiently broad cross-section of the taxpaying population for it to be appropriate to consider whether the time is ripe for a "revolution" in the field of tax law. Should we cease our frantic efforts to patch up the Code and, instead, step back and attempt to restructure the system entirely? This restructuring is what I have in mind when I speak of "real" tax reform. This afternoon I would like to discuss with you whether real tax reform is needed, some of the options for real tax reform, the mechanics of achieving such reform and the role of the Bar in the consideration of these issues.

Is real tax reform needed?

To find the answer we should consider three additional inter-related questions.

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What are the ultimate goals of our system of taxation?

Is the system attaining these goals?

And, most importantly, are the failures of the system attributable to causes which can be avoided through real tax reform?

Commentators generally have suggested three goals toward which a system of taxation should strive: simplicity, equity and neutrality. Let me briefly explain these concepts as I understand them:

Simplicity The system should be as simple as possible and, in any event, the level of complexity of each of its provisions should not exceed the comprehension of the group of taxpayers directly affected by any such provision. It is thus not inappropriate for corporate reorganization provisions to be more complex than provisions dealing with standard deductions for individuals.

Equity The tax burden should be distributed on the basis of a rational theoretical framework within which similarly situated taxpayers bear equal tax burdens and principles of progressivity are uniformly implemented.

Neutrality The classic explanation of this concept is that tax laws should not be utilized by Congress to influence the business and personal decisions of taxpayers, nor should such influence result inadvertently. Put another way, individuals and businesses should conduct their affairs without regard to taxes and the tax law should impact upon the resultant transactions as it finds them. In the real world, however, it is clear that no tax system which imposes taxes at other than very low rates can be completely neutral. Probably the most that can be hoped for is to limit the utilization of the tax system to influence nontax decisions to situations involving very significant national policy and to avoid inadvertent influence of this type. I will refer to this goal as limited neutrality.

I am certain we can all agree that our tax system should strive to achieve simplicity and equity. With respect to the third goal, limited neutrality, we can also agree that the system should not unintentionally influence decisions. The extent to which the tax system should be utilized to forward national policy is open to debate, however; it should be clear that the system should not be utilized to foster so many divergent national policies that incentives become seriously distorted. For example, the substantial tax benefits accorded to certain low-income housing projects led directly to many bad projects. In short, the question "what are the goals of our system of taxation" is not difficult to answer.

The second question, "is our present system achieving these goals" is also easily answered. The answer is, "no". The Code and Regulations are unbelievably lengthy, complicated and confusing; what's more, they are growing at a prodigious rate. In many cases the provisions are actually inequitable; even worse, and more important, the average individual taxpayer perceives the system as so inequitable that voluntary compliance may be in jeopardy. Finally, the tax laws have been utilized to advance such a wide range of divergent national policies that the incentives sought to be provided are distorted and frequently do not operate as intended.

The third question is much more difficult to answer. Are the failures of our tax system attributable to causes which can be avoided through real tax reform?

I can identify four causes of such failures.

First, the Code provisions are sometimes not drafted in the simplest and shortest form; the alternative tax on capital gains comes to mind as an example. Moreover, such provisions occasionally produce unforeseen inequities or inadvertent influences. Finally, new provisions sometimes make old provisions irrelevant without physically removing them from the Code. In general, however, the Code is very well drafted and the incidence of unforeseen inequities and inadvertent influence is not high. Although this type of problem should not be difficult to remedy once identified; it is very difficult to develop momemtum for technical amendment acts as indicated by the tortured path of the so-called "Deadwood Bill" through Congress.

Second, the goals of our tax system frequently conflict with one another. Everyone agrees that simplicity is a desirable goal, but simplicity is almost always abandoned in the face of the other goals. The concept of recapture of depreciation on the sale of an asset is not complicated. Sections 1245 and 1250 are, however, very complicated and take up approximately 10 pages of the Code; this is because the goals of equity and national policy have prevailed over simplicity. Section 341(e), a monument to the triumph of intended equity over simplicity, may soon be overshadowed in complexity if the LAL provisions in the Tax Reform Act of 1975 are enacted. The recent history of tax exemption of the interest on municipal bonds illustrates the dominance of changing national policies over both equity and simplicity. Congress has desired to support the financing of these governmental entities even at the cost of permitting very rich people to pay no tax - <u>but</u> only where such financing is for "proper" purposes -<u>but</u> pollution control may be an important, if not wholly proper, purpose - <u>but</u> the whole municipal bond market may be adversely affected by too much pollution control financing - and so on.

The question of what priorities we should assign to our tax goals deserves careful attention. Are we willing to say that, in certain cases, we will endure inequity or ignore national policy in order to achieve a simple Code? Are we willing to say that in some cases national policy should be sacrificed to equity? I would hope so, in both cases, since the national policy in question can almost always be implemented outside of the tax Code.

Third, different parties have different views as to how each of the tax goals should be achieved, and even the views of the same party may differ over time. A Code provision often represents a less than perfect compromise of the views of different parties. Also, over time, different parties will be successful in their efforts to influence legislation so that provisions will reflect contrasting views of how a particular goal should be achieved. For example, the investment tax credit provisions are designed to support a very significant national policy -- the encouragement of capital formation by industry -- and are theoretically consistent with the goal of limited neutrality. As drafted, however, the provisions reflect a series of less than successful compromises and changes of view on how that policy should be implemented. Should the credit be available without regard to where property is used or only if property is used within the United States? Should the credit be available to all taxpayers, or only to corporate taxpayers, or only to certain types of corporate taxpayers? What rate of credit should be available and how long should a taxpayer be required to retain the property in order to receive various levels of credit? The resulting provisions clearly do not satisfy the goal of limited neutrality and are complex and perhaps inequitable as well. It may be that this cause of failure is a natural by-product of our democratic process and that no system of taxation can completely avoid these influences.

The fourth cause of failure in our system of taxation is an inherent conflict within the system itself. Our system is premised on the so-called "accretion" concept of income which means that the tax is based on the <u>sum of</u> consumption and change in net worth during the accounting period. Taxes levied on this base are not neutral with respect to the decision of whether to save or consume; the system discourages savings and encourages current consumption. The yield which an individual can receive by putting money in the bank is reduced by the income tax, thus diminishing the individual's incentive to forego current consumption. Many of the most complicated Code provisions are designed to overcome this anti-savings bias. For example, the deductions for contributions to qualified pension plans, special treatment of capital gains, investment tax credit, and depreciation in excess of "economic depreciation" all have the same practical effect as exempting or deferring the tax upon the income from the investments involved, and they thereby make the tax system more neutral with respect to savings. So long as we retain both a tax system based on the accretion concept and the policy of encouraging capital formation, we may have to tolerate the complexity, inequity and lack of limited neutrality occasioned by provisions designed to overcome this anti-savings bias.

This examination indicates that the answer to the third of our initial questions is far from clear. Perhaps the causes of failure in our current system of taxation would, to a considerable degree, be inherent in any system we could devise and we will just have to live with our system's shortcomings. The implications of this conclusion would be profound, and rather sad; the question deserves very careful consideration.

I would like to turn now to a description of some of the options available if real tax reform is pursued.

The Federal Government derives its tax revenues from five major sources: individual income tax, corporate income tax, payroll and self-employment taxes, estate and gift taxes, and excise taxes. Which of these should be brought within the purview of real tax reform?

Approximately two-thirds of tax revenues are derived from the income tax, corporate and individual. As Secretary Simon indicated in Congressional testimony last year, the integration of individual and corporate income taxes is extremely important in order to encourage capital formation by avoiding the double taxation of the income from corporate capital. In view of this inter-relationship, I believe that these two taxes certainly should be included in any real tax reform proposal.

Approximately 30 percent of Federal tax revenues are derived from payroll taxes and the tax on self-employment income. These taxes and the benefits they provide, of course, have a very significant social and economic impact. For example, although current payroll taxes fall far short of adequately funding social security retirement benefits, workers tend to regard future social security benefits as a substitute for private retirement savings and they reduce their own retirement savings accordingly. Recent estimates by Professor Martin Feldstein of Harvard suggest that the rate of private savings and hence, in the long run, our nation's capital stock is reduced by 30 to 40 percent by this single phenomenon.

I believe that the decision whether to include payroll and self-employment taxes in real tax reform depends largely on the direction in which these taxes are heading. If, as the present Administration believes, the programs funded by these and perhaps new taxes are regarded as compulsory insurance and such taxes can be assessed on a basis designed to assure full funding, a good case can be made for excluding them from real tax reform. That is, the "trust fund" concept would be a fact rather than a theory. If, on the other hand, we continue the past practice of not adequately funding these programs, then the payroll and self-employment taxes may have to be regarded as just another revenue source which should be included in the reform effort.

Approximately two percent of Federal tax revenue is derived from estate and gift taxes. The major function of these taxes is to redistribute accumulated wealth as it passes from one generation to the next. Since a basic change in the personal income tax is likely to have certain implications for the accumulation of family wealth, it would probably be appropriate to include estate and gift taxation within the purview of real tax reform.

Excise taxes account for approximately 7 percent of Federal tax revenue. These taxes probably can be excluded from reform since the interaction of excise and income taxes is not substantial.

Having considered the types of taxes to be included in real tax reform, let us turn to what is generally regarded as the most significant, and certainly the most controversial, aspect of any such reform program - namely, determining the base of the personal income tax . Indeed, this type of tax reform is frequently referred to as base broadening tax reform. Broadening the base of the tax will, in general, contribute to simplicity by eliminating Code provisions which exclude certain income and allow most of the deductions and credits. It will also contribute to equity by treating most taxpayers generally the same. Finally, it will contribute to neutrality by removing many of the special incentives from the law and, most significantly, by permitting sharply reduced tax rates.

In discussing base broadening, the first class of items to be considered consists of items presently excluded from income. Some of these are quite easy to identify while others may appear to the tax practitioner as merely a gleam

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in some economist's eye. Among the more obvious exclusions provided for by the Code are one-half of long term capital gains, gains on property held until death, social security benefits and interest on municipal bonds. Moving from the obvious towards the exotic, a second grouping might include fellowships and scholarships received; welfare payments of all types, including food stamps, school meals, medicaid and, medicare, unemployment compensation, and employer contributions to pension and profit sharing plans. A third grouping might include fringe benefits associated with employment such as group life insurance, cafeterias, parking, travel, business lunches and military cash and kind allowances. Next, we must consider disability compensation, workmen's compensation, veterans' compensation, gifts and bequests and attributed earnings on pension funds and the investment element of life insurance policies. Finally, we come to the economists' favorite -- the fair rental value of owner-occupied dwellings.

Turning to the deduction side, any serious study must commence with an evaluation of personal exemptions and the standard deduction. It would then go on to consider such items as state and local taxes, medical expenses, medical insurance premiums, interest paid on mortgage and personal loans, expenses for child care, uniforms and tools, charitable contributions of money and property, alimony, and, in general, every type of cost or expense for which a deduction is presently allowed under the Code. Finally, the credits allowed on personal income tax returns would have to be considered; this would include not only such items as the retirement income credit but also such pending "public-policy" proposals as the credits for garden tools and home insulation.

I have not produced the foregoing list to bore you, even though I know that you have reviewed such lists in the past. The purpose of the listing is to demonstrate the vast complexity of any study of real tax reform. In addition, it should be clear that the result of any such study would depend upon the totality of the items considered and the treatment accorded thereto, rather than the treatment of any single item.

Real tax reform would also have to give serious consideration to many tax issues faced by business. Even if the integration of the personal and corporate income tax is assumed, the income of corporations would still have to be measured. In addition, business and investment income other than corporate would have to be measured and appropriately taxed. Thus, such items as permissible methods of accounting, depreciation, investment credit, deferral of foreign source income, depletion, and the special treatment of such industries as timber would all come under review.

In my view, consideration of each of the above items should be undertaken with a strong bias in favor of simplicity and equity and a strong motivation to achieve limited neutrality. Even where significant public policies are involved, every effort should be made to implement such policies outside of the tax system.

As if the task already described were not sufficiently onerous, we really should return to one of the problems I noted earlier - the fact that even a broadly based income tax would perpetuate the present anti-savings bias of our system of taxation. Since, as noted above, many of the more complex and inequitable provisions of the Code are presently designed to counteract this bias, broadening the base of an accretion-type income tax by eliminating such countermeasures would serve to exaggerate such bias rather than ameliorate it. Hence, a major decision in proceeding with real tax reform is whether an effort should simultaneously be made to remove the anti-savings bias of an accretion-type tax.

Let me offer a brief example to illustrate what we mean by the anti-savings bias. Since money can be used to make more money, one dollar today is worth more than one dollar a year from today. Speaking very generally, prevailing money market rates at any given time reflect the discount factor one must use to determine the present value of money to be received in the future. For example, if the highest grade corporate bonds are yielding 9 percent, that indicates that \$109 a year from today is worth \$100 today. To state this in a slightly different way, the decision of whether to spend \$100 today or to invest it at 9 percent and spend \$109 a year from today is neutral. Our present system of taxation does not, however, give a taxpayer that choice. We tax both the wages which produced the \$100 of capital as well as the earnings on that capital. Assuming a 50 percent incremental bracket, the $100 invested at 9 percent will produce, after taxes, $104.50 a year from today. Since the present value of $104.50 in one year is less than $100, there is a strong incentive to consume the $100 currently; i.e., there is an anti-savings bias.

Expanding the tax base would increase the impact of that bias since there would certainly be fewer investments one could make, directly or indirectly, on which the income would be either untaxed or taxed at reduced rates. Integration of corporate taxes would help alleviate the present bias, but it might still be desirable to provide incentives to encourage savings, thus reintroducing some complexity and inequity.

The suggestion has been made that the anti-savings bias can be eliminated by abandoning accretion as the basic concept of ascertaining income, and substituting "consumption". Speaking very generally the consumption concept involves a cash flow calculation of how much an individual has consumed during the accounting period. Put another way, consumption income is accretion income with increases in savings deducted (or decreases in savings added). For example, if an individual earned $10,000 and at the end of the year had increased his savings by $3,000, he would receive a deduction of $3,000 and pay tax on the $7,000 which he had consumed.

A system based on the consumption concept of income does not bias a taxpayer in his decision of whether to consume currently or save. Let us say I am taxed at an over-all rate of 50 percent and I am about to earn another $200. I have a choice, I can consume these earnings or I can save them. If I consume them I will have no deduction from income and I will pay a tax of $100 and consume $100. If, however, I save the $200, I receive a $200 deduction and pay no tax. Assuming I have invested these savings at 9 percent, I will have $218 at the end of the next year. If, at that time, I make the decision to consume, my savings will go down by $218, thereby producing $218 of taxable income. I will pay a tax of $109 and consume $109. In summary, my decision at the time of earning the $200 is between consuming $100 immediately or $109 one year later. Since the current value of the $109 is $100, the tax impact

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on such decision is neutral; there is no anti-savings bias. It should be noted that although the payment of tax on the earnings in question was delayed by one year the Treasury has not been harmed since it received $109 of tax instead of $100.

Implementing an income tax based upon consumption involves other theoretical benefits and some drawbacks as well, the discussion of which is well beyond the scope of my remarks today. And, of course, the theoretical and practical problems of effectuating a transition from our present system would be vast to say the least.

My purpose in mentioning the consumption-type tax, as well as in outlining the directions in which reform might proceed if the accretion concept is retained, is to give you some feeling for the broad range of options open to us if we undertake real tax reform. Obviously changes of this magnitude require very careful study and we at the Treasury are presently exploring alternative ways in which we might move toward this goal. We are also considering whether this is an appropriate time to move full steam ahead. I personally think it is.

Assuming that the study <u>should</u> proceed, there are various proposals as to the most efficient and effective <u>modus operandi</u>. Several groups, including the Bar Association of the City of New York, have recommended a special commission. Others have suggested, or are about to suggest, that the staff of the Joint Committee on Internal Revenue Taxation assign the requisite personnel solely to this task for a period of years. Finally, the Treasury Department itself, with a strong, independent group of expert advisors, might undertake to develop an initial legislative proposal after intensive study and economic and statistical analysis. If the latter route were chosen, this would obviously require a major allocation of human and financial resources within our offices of tax policy and tax analysis. Regardless of whether the study of real tax reform is headed by a special Commission, Congress or the Treasury Department, input from the organized Bar, and especially the Tax Bar, will be extremely important. We hope that the major Bar Associations, including particularly your own Tax Section, will support this project with enthusiasm and will provide the benefit of your accumulated wisdom and experience.

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To date, I must confess some disappointment in the reaction of many leaders of the Tax Bar to the study of real tax reform. I should hasten to add that certain of their brothers in the accounting profession appear equally unenthusiastic. As a group, of course, lawyers are conservative and tend to resist change. More particularly, we tax lawyers have become attached to the present Code and regulations which we have studied and to some extent mastered. Limited tax reform bills introducing even more complexity, such as the Reform Act of 1969 and the House passed Tax Reform Act of 1975, have proved quite unsettling to the Tax Bar and, at first glance, the prospect of the type of real tax reform I have been discussing today may strike terror in our collective hearts.

But, upon reflection, I would hope that you would agree with the following points. We tax lawyers can only function effectively when giving advice with respect to, and acting within, a system of taxation which is itself functional. Our system of taxation today is rapidly approaching the point at which it will cease to work. Right now it does not work very well; many taxpayers who lack access to expert advice simply cannot cope with the complexity of the Code and they fall back upon the hope of either not getting caught or working out some kind of rough justice compromise if they are in fact audited. If this attitude spreads even to those taxpayers who have expert advice, or if significant numbers of taxpayers simply abandon voluntary compliance, we will have arrived at the chaotic and potentially corrupt system of negotiated tax liabilities found elsewhere in the world, and the Internal Revenue Code will be of interest primarily to philosophers.

In the highest view of our profession, we owe it to our clients in general, and even to ourselves, to carefully study any proposal which affects such a wide cross-section of our citizens and which would constitute such a fundamental element of our economic and political structure. In this context, I ask that if this study proceeds, we all use restraint in evaluating the project before it is completed and suggest that our clients do likewise. The impact of the possibility (and I emphasize the word possibility) of the implementation of such emotion-arousing concepts as the repeal of the charitable and home mortgage interest deductions,

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the elimination of capital gains and the taxation of municipal bond interest must not be viewed in isolation. Rather, we must be patient and reflect upon the entire proposal to see if it creates a system which is simple, fair and relatively neutral. If the great majority of citizens will benefitd from such a system, we should enthusiastically support it. If significant groups or important incentives are, nevertheless, damaged by the proposal, and such injuries cannot be remedied outside the tax system, then and only then, should appropriate modifications be suggested and adopted.

In summary, there are many of us, including myself, who feel that real tax reform is an idea whose time has come. We may be wrong, but that judgment can only be made after a careful and detailed study of the type which I have briefly described today. If such study is to provide satisfactory answers to these difficult questions, we will need your help, support, patience and restraint.

Thank you.

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FOR A.M. RELEASE, TUESDAY, FEB. 3, 1976

SOCIAL SECURITY PAYMENTS DEPOSIT BY COMPUTER
BEGINS IN GEORGIA, EXTENDS NATIONWIDE IN 1976

The second phase of a long-range program to eliminate a large part of government check-writing and mailing -- cutting costs and reducing risk of lost or stolen checks -- begins today in Georgia.

There nearly 50,000 social security beneficiaries will have their February payments directly deposited by electronic funds transfer (EFT) to their checking or savings accounts.

The system in April will be expanded to include 350,000 social security beneficiaries in Florida. By year's end it will become nationwide with an estimated 6 million social security participants.

Plans are underway for bringing civil service and railroad retirement annuitants into the system later this year. Payments to veterans and their dependents and salary payments to Federal employees will follow.

At the end of 1979, according to Treasury Department projections, 18 million, or 40 percent of the total volume of recurring monthly payments by the Federal government will be made by electronic transfer.

This new and improved system of making recurring monthly benefit payments will be unparalleled for reliability and convenience to the individual.

It will, in addition, save Treasury Department and other government agencies involved, and ultimately the taxpayer, millions of dollars. Treasury estimates it alone will save in excess of $25 million annually when the system becomes fully operational in five years.

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The individual, however, is the big gainer, particularly the elderly and infirm. These beneficiaries will be spared the repetitiously nagging concern each month over whether their checks will arrive on time or at all, since thousands are lost, stolen or forged each year.

The first phase of the program was started in November 1974 in Georgia, with the mailing of checks to banks and savings institutions rather than to the homes of beneficiaries. This part of the program was completed nationwide last fall with more than 3.5 million participants.

Conversion to electronic funds transfer was first tested last November in Georgia, and again in January. Similar tests are being made in Florida in advance of the new system becoming operational there in April.

The testing in advance of implementation will be followed across the country as EFT goes nationwide. The testing facilitates coordination by Treasury, Social Security, Federal Reserve and the cooperating financial organizations on all aspects of the system prior to actual computerized transfer of payments. For further information call Les Plumly, (202) 964-2525.

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FOR RELEASE UPON DELIVERY

STATEMENT BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE THE HOUSE COMMITTEE ON THE BUDGET
FEBRUARY 3, 1976

Mr. Chairman and members of this distinguished committee:

I am pleased to be with you this morning to discuss the President's economic program. Your Committee plays a key role in the budget process and in bringing an organized and responsible approach to Congressional legislation. Because Federal expenditures now have such an important impact on the allocation of resources in our society and on the stability of our economic system, the decisions reached will have significant implications for our future economy.

As Mr. Lynn was with you earlier this week to discuss the details of the President's budget and Mr. Greenspan is with me this morning, I will focus my remarks on Federal revenue estimates and on certain concepts which underlie a durable, orderly and sustained economic recovery. It is obvious that we all share such basic goals as achieving greater economic growth, reducing the unacceptable rate of unemployment and of moderating the rate of inflation. However, there can be disagreement about what tradeoffs will be required to achieve simultaneous progress toward all of these goals, about the best mix and timing of economic policies and about the proper time horizon for planning purposes. In our discussion today, I hope that we can come to a better understanding of these issues and of the need for responsible budgetary policies.

We begin this important budget planning session with significant and solid improvement in the U.S. economy during 1975. As we know, the turning point in the economy came around April ending the most severe recession since World War II. Final sales, real gross national product and industrial production have shown solid gains and give us all considerable optimism for further progress in output

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growth. Significant improvement also has been made in reducing the rate of inflation and expanding employment opportunities. This is an impressive turnaround from the situation which prevailed one year ago.

Despite this progress, we must not become complacent. Inflation and unemployment remain serious problems. Embedded in the present recovery are risks which must be watched closely. If inflation should escalate, it will bring on severe problems that ultimately could halt the recovery. We then would repeat the pattern of inflation-recession-unemployment of the last several years, but with even more serious consequences.

Throughout much of the past fifteen years, the concept that the U.S. Government must continually intervene to stabilize the economy has come to dominate policy decisions. However, because of the lagged impact of fiscal and to a lesser extent, monetary stimulus, such actions have often been counter-productive and have accentuated rather than stabilized fluctuations in the business cycle.

The proper role of government is to create an environment for sustained, orderly and durable economic growth through its fiscal, monetary, and regulatory policies. With respect to fiscal policy, the beginning is the budget. As you know, proposed Federal expenditures total $394.2 billion under the Administration's plan, and Mr. Lynn already has discussed the details with you. The other side of the picture, of course, is Federal revenues which I wish to take a few minutes to discuss.

<u>Federal Revenue Estimates</u>

The Department of the Treasury is responsible for estimating Federal revenues as a basis for planning fiscal policies. The beginning point for our estimates is the preparation of detailed GNP forecasts by a trio of the Treasury, the Council of Economic Advisers and the Office of Management and Budget. Using these general forecasts and specific revenue information obtained from a variety of sources, the Treasury prepares monthly collection estimates. I might add that in my testimony of September 29, 1975, before the House Budget Committee, the detailed estimating procedures for revenues were described. Attached is a copy of that testimony.

The estimating process obviously depends upon several factors: (1) the accuracy of the GNP forecasts; (2) changes in the mix of economic results which cause adjustments in estimates of personal income and expenditures, business spending and profits, unemployment, government transfer payments, etc.; (3) the refinement of statistical estimating procedures; and (4) the frequent revision of tax legislation which can be anticipated only in part. As a result, actual receipts always vary from those which are forecast. However, the discrepancy usually is relatively small. In fact, it is amazing to me that with all the uncertainty involved our revenue estimates are as accurate as they are. Budget estimating errors over the past six years together with 1950 and 1960 are summarized in Table 1.

As shown in Table 2, Federal Budget receipts are estimated at $351.3 billion for FY 1977. These estimates take into account the Tax Reduction Act, enacted on March 29, 1975, and the Revenue Adjustment Act, enacted on December 23, 1975. The President has proposed additional tax reductions to become effective July 1, 1976, if spending is properly controlled. His recommendation would make permanent the six-month extension of the Revenue Adjustment Act of 1975 and add about $10 billion of additional tax relief. He also has asked for some special tax incentives in order: (1) to stimulate construction in areas of particularly high unemployment; (2) to encourage broader ownership of common stock; (3) to ease the burden of estate and gift taxes on farms and small businesses; (4) to take initial steps to integrate individual and corporate taxes so as to stimulate investment; (5) to bring about more investment in the hard pressed utility area; and (6) to encourage residential construction. Recommended also is an increase in social security and unemployment trust fund taxes, and these would increase revenues in FY 1977. The details of these proposals and their impact on Federal revenues for FY 1977 are summarized in Table 3.

Looking five years into the future, receipts are projected to increase from $351.3 billion in FY 1977 to $585.4 billion in FY 1981. These projections, shown in Table 4, are based on the legislative initiatives recommended by the President and they also are based on the integration of individual and corporate income taxes, as outlined in my testimony before the House Ways and Means Committee last July. The assumption embodied in the projections is that such integration will begin January 1, 1978. The revenue projections are consistent with the economic assumptions and legislative initiatives proposed by the President in his budget message. Those assumptions should not be interpreted as forecasts for years beyond 1976, since they do not include the potential impact of policy decisions made between now and the end of the 5-year period, 1981. Nor are the projections to be considered recommendations for policy actions. The figures merely represent extrapolations of conditions beyond next year. Nevertheless, the projections indicate that a balance in the Federal budget will be achieved by FY 1979 if current assumptions are correct and the recommendations in the President's budget message are adopted.

The Need for Responsible Accounting

The balance of the Federal budget by FY 1979 would have a favorable impact on the future development of the U.S. economy. Because of the cumulative nature of government spending programs over the years, decisions made during this budget-planning period will largely determine whether or not we will achieve responsible fiscal policy goals in the future. Thus, the long-term impact of current policy decisions should be the basis for all of our economic planning.

There can be confusion about what is necessary to deal with a current problem and the effect of that action on future fiscal flexibility. Too often we in government are prone to make decisions without proper consideration of the cumulative impact of those decisions on the future. To deal with this problem, I am proposing that government accounting be placed on an accrual basis where unfunded liabilities are fully recognized. This would thwart the natural tendency for those at all levels of government to want to claim revenues too early and expenditures too late, thereby postponing the day of reckoning. We have had recent examples of the sharp and painful adjustments that must occur to a local government when things are continually swept under the rug until eventually the rug will cover no more. With each sweeping, future fiscal flexibility is curtailed one more notch. Eventually a government has no flexibility to deal with current problems. The same thing occurs for the Federal government, except the rug can be stretched for a while because, after all, the Federal government prints the money.

The Treasury has been publishing accrual statements for certain individual agencies since 1956 and we now plan to do this on a consolidated basis for the Federal government as a whole. Our target date for the first of these publications -- for the Fiscal Year ending September 30, 1977 -- is early in 1978. I would emphasize that the initial publication will focus on significant accruals that have a major impact on the overall financial condition and operating results of the Federal government. The first set of statements are likely to be accompanied by extensive qualifications. As the reporting process and statement preparation procedures are improved, however, these qualifications will diminish.

Not only will the reader obtain a consolidated financial view of the Federal government but an idea of the magnitude of all liabilities, whether they be funded or unfunded and whether they be due for payment in the near future or the distant future. In these consolidated statements, revenues will be recognized only when they are earned and sure to be collected and expenditures will be recognized no later than the time the liability to pay them is firmly established. We believe that this will bring more responsible accounting to government. Financial problems will surface long before a crisis is imminent, thereby reducing unpleasant surprises. I believe this will permit more reasoned judgments on decisions which impact the future fiscal flexibility of our nation. Our children should not bear the albatross of paying for the excesses of this generation, while their government is unable to cope with problems because it lacks fiscal flexibility.

I realize that there has been concern with the cost of installing elaborate accrual accounting systems in agencies where the need is not clearly established. I want to assure you that I am not advocating a slavish application of textbook accounting to every agency and appropriation without regard to benefits. All Federal agencies have accrual accounting of some sort. What we intend to do is to supplement the data we already have with some missing pieces of major proportions, and by major I mean in terms of governmentwide magnitudes, not individual appropriations.

I also want to say that I am not proposing a change in the basis for calculating the official budget surplus or deficit, or in the manner of justifying appropriations. There are some who advocate accrual accounting for both of those purposes, but I do not want to let the controversy over those applications interfere with my objective of giving the American people a clear business-like disclosure of the overall financial condition of their Government.

Longer-Term Policy Issues

Looking at some longer-term policy issues, I am disturbed by the fact that government spending which has been proved to be a cumbersome tool for short-term economic stabilization continues to be used for such purposes. The reason it is so cumbersome is because of the various lags involved. First of all, there usually is a considerable lag between the time a need is identified, or a claim is made by some special interest group, and the time there is a specific response by Congress to the proposal. Then there is another time lag before the expenditures actually occur and begin to spread throughout the economic system. Whereas at the time when the proposal was initially considered there may have been

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underutilization of resources in the economy, by the time the program actually comes on stream resources are often fully employed so that the additional government spending leads to greater inflation. Furthermore, such initiatives take on a life of their own.

If there were some way that old programs could be phased down or eliminated during a period of rapid economic expansion, fiscal policy might be more effective as a tool for stabilization purposes. However, experience has shown that this is not the case. Even programs started in a period of economic slack to stimulate the economy most often become a permanent part of the budget.

We must avoid abrupt and excessive changes in government expenditures. No matter how well intentioned, such sharp swings in spending tend to accentuate rather than stabilize the business cycle and serve to increase the uncertainty of developing policies to meet future needs. In turn, this uncertainty is felt in the consumer markets, in the markets for capital goods, and in financial markets.

In addition to government expenditures, I am concerned with the size of the chronic Federal deficits, particularly the negative impact on financial markets and capital formation. The traditional view of the government's role in the business cycle was that deficits would be recorded in periods of economic slack, but that surpluses would occur in periods of above-average economic activity. As a result, savings would be available to the private sector for the capital formation necessary to sustain the economic advance in real terms. Obviously this has not occurred in recent years where we have had deficits in periods when there is less than full utilization of our resources.

These deficits, of course, need to be financed and such financings in periods of prosperity hurt the economy. They place the U.S. Treasury in a position of preempting private investors. The recent avalanche of Treasury securities has created distortions in the traditional patterns of funds being raised and, in my judgment, this has contributed to making our financial markets less efficient in recent years in channeling the savings of society to investment opportunities. As a result, capital formation is impeded.

Furthermore, deficits cumulate over time. Total Federal debt has increased from $329.5 billion at the end of FY 1966 to an estimated $633.9 billion at the end of FY 1976 -- a rise of 92 percent in only 10 years time. Over the past ten years the average maturity of the debt has

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declined from 5 years, 3 months to 2 years, 5 months. What this means is that the U.S. Treasury must be a more frequent visitor in financial markets simply to roll over outstanding securities let alone to raise funds for current deficits. In this fiscal year (1976) the U.S. Treasury will absorb over 70% of all moneys in the securities markets; government at all levels will absorb over 80%. This percent must be sharply reduced as the economic advance continues or else some private areas will have to go without.

This problem of "crowding out" becomes far more critical of course as the recovery progresses and the financing needs of the private sector intensify. If deficits remain large, the Treasury, by being first in the credit line, will always get its needs financed but in so doing may make it difficult for companies with less than a prime financial rating to obtain the financial resources they need at acceptable interest rates.

Moreover, as annual interest payments grow with increases in the total debt, fiscal flexibility is eroded further. This "uncontrollable" outlay of over $45 billion in FY 1977 is the third largest item in the budget. It puts pressure on the total budget, which in turn means that programs must be displaced or tax reductions foregone. (A more extensive discussion of crowding out is found in Appendix A.)

The size of the deficit also affects the rate of capital formation in the private sector, and this is a matter of great concern. As the recovery progresses, private capital investment needs to increase to sustain the recovery. In the next decade, the need for increased capital formation is extremely large. This need has been carefully documented by the Treasury, by numerous outside studies, and, most recently, in Chapter 1 of the Economic Report of the President. If we are to meet our goals for increased employment and productivity in a non-inflationary environment as well as our environmental, safety and energy goals, we must have an increase in the rate of national savings and private direct investment relative to the total GNP.

The achievement of our capital formation goals depends on the necessary expenditures being financed in the private sector. In turn, the adequacy of capital flows depends on the savings of society being less and less used to finance Federal expenditures and more and more focused on capital formation. This is the only way we can sustain a durable recovery over the long run and bring down the level of inflation. If the private sector is unable to finance capital formation because of the huge demands on savings by the Federal Government and because of the resulting strains and distortions introduced in financial markets, the boom-and-recession sequence of the last decade may be repeated. Therefore, it is imperative that we reduce the Federal deficit and work toward budget surpluses as the recovery progresses.

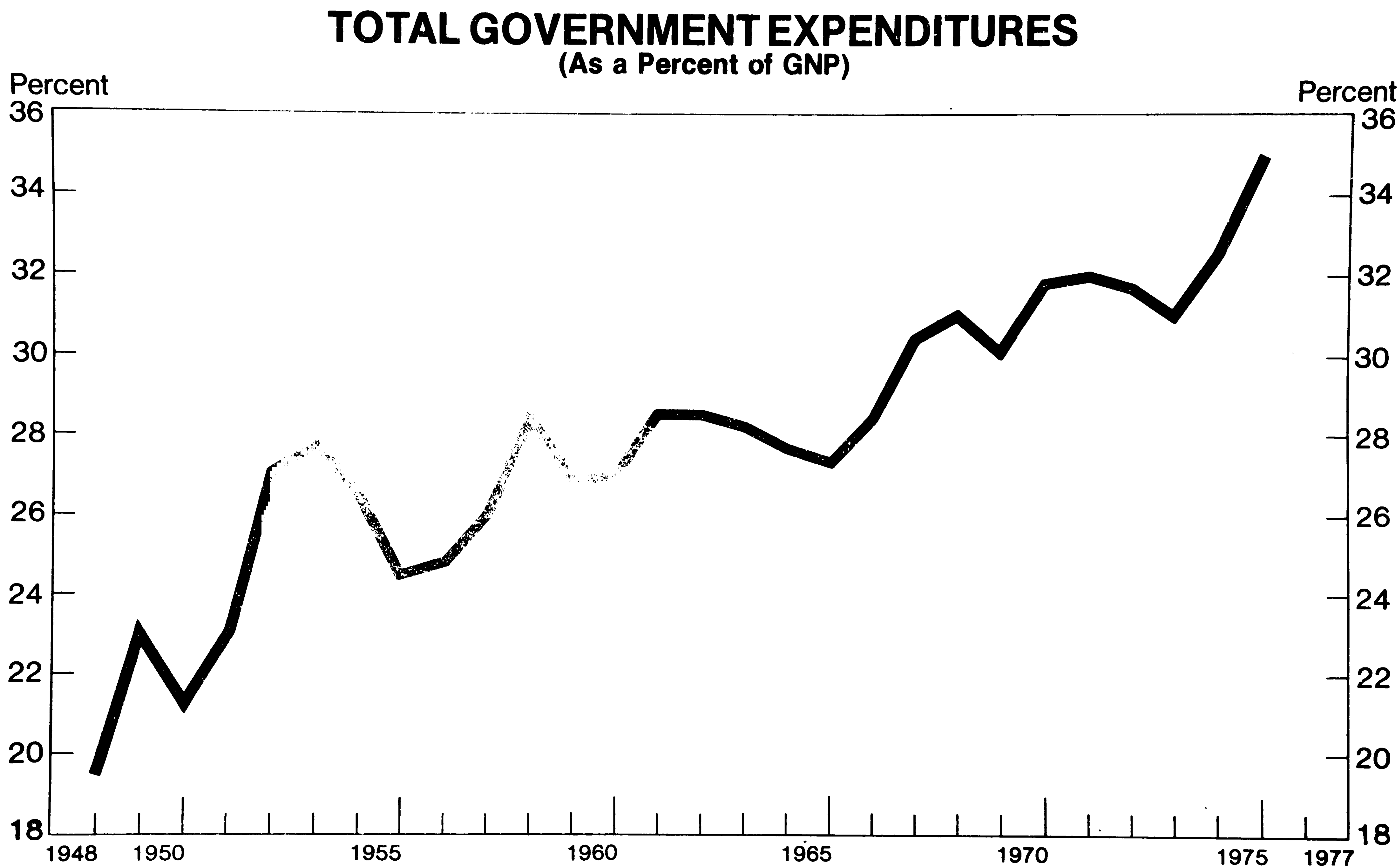
Another aspect of the crowding out problem is the secular deterioration I see in the financial structure of U.S. businesses. Over the past decade there has been a strong trend towards a much more leveraged corporate balance sheet. Debt has roughly tripled; liquid assets have declined relative to liabilities; the debt-equity ratio has about doubled; and the average maturity of debt has shrunk. Just as the Treasury is a more frequent visitor to credit markets, so too will many companies, and if there is an intense competition for funds, it is quite clear that the less than prime rated company will be the loser. Continuing heavy Treasury borrowings will eventually cause difficulties for these companies, small businesses and potential home owners.

For both fiscal and monetary policies, the problem of instability is compounded by the present inflation psychology that permeates our society. All too readily the economy will move to a higher level of prices, but only grudgingly will it move to lower prices despite slack demand. This inflation psychology has been building for a decade and its unwinding will not be easy. The achievement of economic growth without accelerating inflation could be upset by fiscal and monetary policies that are, or even appear to be, overly stimulative.

In addition, such excesses will lead to bottlenecks developing in certain key industries well before the economy as a whole reaches full employment. This occurred in 1973 in such industries as steel, paper, chemicals and fertilizers. The dislocations caused by bottlenecks send inflationary tremors throughout the economy and lead to inefficiencies which ultimately can curtail a recovery in real terms.

We must act wisely and responsibly in bringing stability to our economy. The excesses of the past are not easily undone. Excessive spending, excessive credit creation, excessive stimulation all may provide a short-term palliative, but before long additional inflation and production bottlenecks set in and economic performance declines. The stop-and-go policies of the past fifteen years have led to an instability which now is deeply rooted in our society. To come to grips with this issue we have designed a responsible mix of economic policies that will bring about durable lasting economic prosperity which benefits our nation with sustainable and increasing employment.

Thank you.



Source: Department of Commerce

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TABLE 1

Budget Estimating Errors

Fiscal year	Overestimate (+) or Underestimate (-) as a Percent of the Actual Figure			
	Estimates made 18 months prior to the end of the fiscal year		Estimates made 6 months prior to the end of the fiscal year	
	Outlays	Receipts	Outlays	Receipts
1950 1/	+4.1	+10.3	+7.8	+1.9
1960 1/	-0.3	-1.7	+1.6	+0.2
1970 2/	-0.7	+2.6	+0.7	+2.9
1971 2/	-5.0	+7.3	+0.6	+3.1
1972 2/	-1.1	+4.3	+2.0	-5.2
1973 2/	-0.1	-4.9	+1.3	-3.1
1974 2/	+0.1	-3.4	+2.3	+1.9
1975 2/	-6.2	+5.0	-3.4	-0.8

Office of the Secretary of the Treasury
Office of Tax Analysis

1/23/76

1/ Administrative budget.

2/ Unified budget. The first estimate on a unified budget basis was prepared in January 1968.

TABLE 2

BUDGET RECEIPTS BY SOURCE

(In billions of dollars)

	1975 actual	1976 estimate	TQ estimate	1977 estimate
Individual income taxes-----	122.4	130.8	40.0	153.6
Corporation income taxes----	40.6	40.1	8.4	49.5
Social insurance taxes and contributions------------	86.4	92.6	25.2	113.1
Excise taxes----------------	16.6	16.9	4.4	17.8
Estate and gift taxes-------	4.6	5.1	1.4	5.8
Customs duties--------------	3.7	3.8	1.0	4.3
Miscellaneous receipts------	6.7	8.3	1.5	7.2
Total budget receipts:	281.0	297.5	81.9	351.3

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TABLE 3

CHANGES IN BUDGET RECEIPTS
(In billions of dollars)

	1975 estimate	1976 estimate	TQ estimate	1977 estimate
eipts under tax rates and structure in effect Jan.1,1974---	290.8	310.2	87.2	371.3
rease in import fee on petroleum products by administrative action-----------------	+0.4	+1.7	-	-----
cted legislative changes:				
Social security taxable earnings base increases:				
$13,200 to $14,100 effective Jan.1,1975-------	+.1	+1.6	+.4	+2.1
$14,100 to $15,300 effective Jan.1,1976-------	-----	+.2	+.6	+2.4
$15,300 to $16,500 effective Jan.1,1977 1/------	-----	-----	----	+.8
Tax Reduction Act of 1975--------	-10.2	-9.8	-.2	+.4
Revenue Adjustment Act of 1975---	-----	-6.0	-.5	-1.3
iberalized deduction for individual contributions to pension plans-----------------	-0.2	-.3	-.1	-.5
Reduction in telephone excise tax	-.1	-.4	-.1	-.9
ncrease in SMI (medicare) premium	+.1	+.1	+.1	+.3
Total receipts under existing legislation---------------	281.0	297.3	87.4	374.6
ges due to tax proposals:				
ndividual and corporation income tax reductions, effective July 1, 1976---------	-----	-----	-5.4	-28.1
inancial Institutions Act-------	-----	-----	----	-.3
tock ownership incentives-------	-----	-----	----	-.3
ccelerated depreciation on investment in high unemployment areas-----------------	-----	-*	-*	-.3
ocial security tax rate increase from 11.7% to 12.3% effective January 1, 1977 1/ --	-----	-----	----	+3.3
nemployment tax rate and base increase Jan.1, 1977------	-----	-----	----	+2.1
ther----------------------------	-----	+0.2	-*	+.1
Total receipts under existing and proposed legislation---	281.0	297.5	81.9	351.3

ss than $50 million.

e effect of the taxable earnings base increase is calculated using a tax rate of 11.7%. The effect of the tax rate increase is calculated using a taxable earnings base of $16,500.

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TABLE 4

THE FISCAL OUTLOOK, 1975-81
(In billions of dollars)

	1975	1976	TQ	1977	1978	1979	1980	1981
Outlays under current programs---	324.6	373.7	98.2	391.9	420.4	441.8	465.0	489.2
Outlays under proposed programs--	-----	-.2	-.2	2.3	9.1	13.9	17.5	20.7
Total projected outlays-----	324.6	373.5	98.0	394.2	429.5	455.7	482.5	509.9
Receipts under current law-------	281.0	297.3	87.3	374.1	430.1	491.7	555.1	623.9
Effects of proposed tax changes--	-----	.2	-5.5	-22.8	-23.4	-26.4	-32.0	38.4
Total projected receipts----	281.0	297.5	81.9	351.3	406.7	465.3	523.1	585.4
Budget margin or deficit (-)-----	-43.6	-76.0	-16.1	-43.0	-22.8	9.6	40.6	75.5

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(fiscal years, billions of dollars)

	U.S.Treas. 1/	Federal & sponsored agencies 2/	Total Federal sector	State & local 3/	Corp. & foreign bonds 4/	Total securities	Federal sector as a % of total	Gov't sector as % of total 5/
1960	.8	1.6	2.4	5.7	4.9	13.0	18.6	62.4
1961	2.0	-.2	1.8	4.9	6.3	13.0	14.0	51.8
1962	8.8	2.2	10.9	6.0	5.7	22.6	48.4	74.7
1963	6.4	1.0	7.4	5.5	6.2	19.2	38.7	67.5
1964	2.7	1.5	4.2	5.2	6.4	15.8	26.5	59.6
1965	3.1	2.2	5.3	6.9	7.9	20.1	26.3	60.6
1966	-1.0	6.8	5.8	7.3	10.9	24.0	24.1	54.5
1967	-.6	2.7	2.1	6.0	13.0	21.1	9.8	38.5
1968	18.2	5.6	23.8	7.2	16.4	47.4	50.3	65.5
1969	-1.9	5.8	3.9	12.0	15.9	31.8	12.2	50.0
1970	6.8	8.2	15.0	9.7	16.8	41.5	36.2	59.4
1971	20.5	2.8	23.3	15.0	27.5	65.8	35.3	58.2
1972	19.6	8.7	28.3	15.6	21.7	65.6	43.1	66.9
1973	18.5	14.4	32.9	12.6	15.4	60.9	53.9	74.7
1974	2.1	21.3	23.4	17.0	17.4	57.7	40.5	69.9
1975	51.9	15.8	67.7	16.8	33.5	117.9	57.4	71.6
1976	87.5 (est.)	14.3	101.8	14.0	25.1	140.9	72.2	82.2

Office of the Secretary of the Treasury
Office of Debt Analysis

January 8, 1976

Source: FY 1960-1975 data based on Federal Reserve Flow-of Funds accounts (which show net changes in outstandings).

1/ Net increase in marketable and nonmarketable bills, notes and bonds. (Includes Federal Financing Bank.)
2/ Increase in bills, notes and bonds of budget and sponsored agencies. Includes GNMA pass-throughs.
3/ Increase in notes, bonds and Government loans.
4/ Increase in bonds and notes with original maturities of more than 1 year.
5/ Includes State and local as part of government sector.

TABLE 6

Unified Federal Budget Surplus or Deficit in Relation to GNP
1954-1977

Fiscal Year	Budget Surplus (+) or Deficit (-) ($ billions)	Budget Surplus (+) or Deficit (-) as % of GNP: Annual	Budget Surplus (+) or Deficit (-) as % of GNP: Three-Year Moving Average (Centered)
1954	- 1.2	-0.3	-
1955	- 3.0	-0.8	- .0
1956	+ 4.1	1.0	0.3
1957	+ 3.2	0.7	0.3
1958	- 2.9	-0.7	-0.9
1959	-12.9	-2.7	-1.1
1960	+ 0.3	0.1	-1.1
1961	- 3.4	-0.7	-0.6
1962	- 7.1	-1.3	-0.9
1963	- 4.8	-0.8	-1.0
1964	- 5.9	-1.0	-0.7
1965	- 1.6	-0.2	-0.6
1966	- 3.8	-0.5	-0.6
1967	- 8.7	-1.1	-1.5
1968	-25.2	-3.0	-1.2
1969	+ 3.2	0.4	-1.0
1970	- 2.8	-0.3	-0.7
1971	-23.0	-2.3	-1.6
1972	-23.2	-2.1	-1.9
1973	-14.3	-1.2	-1.2
1974	- 3.5	-0.3	-1.5
1975	-43.6	-3.0	-2.7
1976e	-76.0	-4.8	-3.4
1977e	-43.0	-2.3	-

January 16, 1976

APPENDIX A

CROWDING OUT--SETTING THE RECORD STRAIGHT

There clearly exists some misunderstanding about the meaning and significance of the so-called phenomenon of "crowding out." In essence, there is the idea that since financial collapse has not yet occurred, then the whole issue is misleading. This is wrong. What has occurred is a focussing of attention on short-run improvements in financial markets (associated primarily with the worse recession since the 1930's) and an ignoring of what happens longer-term as the economy moves back toward fuller capacity under conditions of repeated huge sized government budget deficits.

No matter how viewed, the inescapable fact is that with reasonably full use of capacity, more resources claimed by the government must mean less for the private sector. Huge deficits which take the lion share of credit flows will eventually push out the weaker private areas--specifically potential home owners, small businesses and even larger companies who do not have a superior credit rating. This in turn will hurt real growth, deprive our workers of adequate productive tools, frustrate the achievement of our longer-term economic needs, and further misallocate our scarce resources. (This was pointed out repeatedly in prior testimony, e.g., January 25, 1975, before the House Ways and Means Committee.)

1. Interest Rates. Interest rates have declined over the past year or so as would be expected during a recession. High-grade bond rates have fallen from a peak of about 10.5% in mid-1974 to around 8.5% today. Yet this drop cannot be taken as sufficient evidence that credit is ample and more importantly that credit will remain ample to support a lasting business recovery. This cost of long-term funds is still very high historically. (Such interest rates ranged between 2%-6% from 1865-1965--a period containing serious wars, depressions, financial panics, business booms and other assorted economic extremes.) The combination of sustained high Federal government financing, of a growing demand for private financing as the expansion proceeds and of a Federal Reserve policy which must eventually moderate in generosity (to avoid rekindling inflation) points to a level of interest rates and availability of funds for private areas which are not consistent with our long-run needs. Total government borrowings this fiscal year will absorb a record 82% of funds available in the securities market; this percent eventually must be sharply reduced or else some private areas will have to go without.

2. Availability of Credit. Funds are more readily available to more sectors of the economy today, but again this too reflects the cyclical slack in the economy and not the longer-run secular forces at work here. In the first quarter of 1975 about 5% of all new bond issues were Baa-rated or less. By the fourth quarter, it was almost 10%. (This is still below rates close to 20% at times in 1971 and 1972 however.) More lesser-rated companies are

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able to finance today. Unfortunately, a lot of these bonds are for shorter duration--5-7 year maturity as opposed to 20-30 year maturity which was the norm not too long ago. This will raise problems in the future since the companies will have to refinance more frequently (referred to as the "rollover" problem in point 4 below). The most important issue immediately ahead is whether such lesser rated companies will continue to find the necessary funds to sustain the economic advance. When credit markets eventually tighten (as is inevitable), problems of credit availability will occur and their severity will be directly proportional to the relative borrowings of the government.

3. Financing of Deficit. The relative "ease" with which the Federal government financed the deficit in 1975 should not be viewed as a normal state of affairs. The fact is that private needs for credit were low because of the recession but as the recovery gains momentum this year, private credit needs will rise. For example, total short-run business borrowing declined in 1975 by about $14 billion; this year it is expected to rise by about $20 billion which is a swing of almost $35 billion. What this means is that there will be a much higher need for total credit in 1976 than in 1975 and eventually some private areas will be squeezed. This is why it is imperative to take steps now to limit the rise in Federal government spending (up almost 40% in just two years time). Not only is future flexibility lost if this cannot be accomplished but the deficit will remain huge and some private areas will not be financed.

4. Financial Structure. Over the past decade there has been a strong trend towards a much more leveraged and brittle structure of corporate balance sheets. Debt has roughly tripled, liquid assets have declined relative to liabilities, and the debt-equity ratio has about doubled. Sustained high Federal budget deficits will eventually create pressures in financial markets that will cause difficulties for lesser-rated companies (in terms of debt rollover) let alone leave sufficient credit for expansion needs.

5. Capital Formation. Several studies clearly point to a much heavier need for investment over the next several years if there are to be enough jobs for a growing labor force, a healthier environment for our people and a higher degree of energy self sufficiency in the United States. (The share of business investment in GNP must increase from an average of 10.4% over the past 10 years to 12.0% for the rest of this decade--an historically unprecedented change.) Sustained high Federal budget deficits will automatically frustrate the fulfillment of those capital needs by depriving many, many private areas of needed financing to build the new factories and buy the advanced machinery. The real dimension of crowding out becomes much more persuasive and severe the further ahead we look.

Conclusion: Crowding out is a genuine problem whose major economic impacts will occur ahead if something is not done about excessive Federal budget deficits caused by too rapid

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a rise in government spending. The serious nature of this issue should not be masked because of the impacts of a recession. If steps are not taken to exercise better fiscal control, some areas in the private sector will go without needed financing; capital formation will be less than desired; and our serious unemployment and inflation problems will be that much further from a satisfactory resolution. The following excerpts from Professor Paul McCracken's article on the January 8 editorial page of the Wall Street Journal is a well articulated discussion of budget deficits and the phenomenon of "crowding out":

"There is here, however, a more substantive problem. It is the failure of conventional fiscal policy wisdom to face the full implications of the fact that an increase in the federal deficit, from accelerated spending or more tax reduction, must be financed. And the added funds that the Treasury must then borrow are funds not then available to others in the market for financing. . . .

"Markets have, of course, substantial capacity for accommodating to changes in demands, and effects on other borrowers of swings in budget deficits of modest proportions will not be large. When, however, the U.S. government had to raise funds at the rate of $81 billion per year in the first half of 1975, after a $5 billion pace a year earlier, the 22% decline in money for home and commercial mortgages during that period can hardly be assumed to have been an entirely unrelated development.

"The question was never whether a large deficit would cause a disintegration of financial markets, or a collapse of capitalism, or some other catastrophe of draconian proportions, though some have pointed to the absence of such cosmic disaster as evidence that the "crowding out" theory was wrong. The point is the quite common sense one that in financial markets where demands for funds are active, and this is apt to characterize 1976, other claimants for funds will get less than if the large Treasury requirements were not present in the market. The financing "loop" of fiscal policy must be closed.

"This all carries with it some implications for budget strategy in 1976. Within the limits of fiscal discipline that the political process can muster in a quadrennial year, the Congress and the President can continue efforts toward regaining better control of spending without having to worry about the net adverse effect of this fiscal restraint on the economy. Dollars not borrowed by the Treasury will be put to work by other claimants in the money and capital markets. And housing would be a major beneficiary of the easier financial markets that would result. The basic 1976 trend for interest rates, in fact, is more in the hands of those who manage the budget than of the Federal Reserve."

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The Department of the TREASURY NEWS
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STATEMENT BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE
THE HOUSE BUDGET COMMITTEE
SEPTEMBER 29, 1975

Mr. Chairman and members of this distinguished Committee:

I am pleased to appear before you this morning to review current economic conditions and to discuss the Federal budget revenue estimates prepared by the Department of the Treasury. My analysis of economic developments and prospects will hopefully contribute to a broader understanding of the economic recovery now underway and the importance of sustaining responsible policies required for achieving both our near-term goals regarding inflation, unemployment and national output as well as our long-term objective of creating a more stable economy. The discussion of projected Federal budget revenues and the related testimony of James T. Lynn, Director of the Office of Management and Budget, concerning anticipated Federal outlays will provide necessary background for decisions about the future course of fiscal policies.

This Committee has a vital role in developing national economic policies. The past decade has been an unusually difficult period as our policy flexibility has been increasingly restricted by the lagged impact of past decisions. In particular, great concern has developed about the impact of Federal spending and tax policies as outlays have accelerated more rapidly than the overall growth of the economy and chronic Federal deficits have occurred. Your Committee was created to help correct these serious problems. While I do not agree with some of your policy recommendations, I am impressed by your efforts to create a more organized and disciplined approach to making Congressional fiscal decisions. The First Concurrent Resolution to Congress was a constructive step in providing general economic and spending guidelines. However, the real test for the Congressional Budget Committees is yet to come as the specific actions of individual appropriation committees must be adjusted to conform to the targets to be established by your Second Concurrent Resolution to Congress. I look forward to working with you in preparing these important fiscal policy recommendations which will directly affect the current recovery and the future of the U.S. economy.

I. ECONOMIC OVERVIEW

The United States has developed the most productive and creative economic system in the world. Americans have traditionally experienced rising standards of living as real output has increased, inflation pressures have been relatively moderate and employment opportunities have expanded. However, the performance of the U.S. economy during the past decade has been disrupted by recurring booms and recessions caused by inappropriate fiscal and monetary policies. The resulting excessive rates of inflation and unemployment created serious domestic economic distortions and eventually disrupted the balance of the international system. No matter how well-intentioned the original fiscal and monetary actions may have been, the resulting sequence of overheating and accelerating inflation, followed by periods of recession and unemployment, has been a heavy price to pay for temporary economic benefits.

In planning economic policies for 1975 the Administration believed that recovery would begin by midyear if three fundamental adjustments could be accomplished: (1) the unwanted accumulation of inventories could be liquidated and new orders increased; (2) "real incomes" of consumers could be restored by reducing the double-digit level of inflation and initiating tax reductions and rebates which would stimulate personal consumption; and (3) employment would begin to increase rapidly enough to reduce the unemployment rate and strengthen consumer confidence. Fortunately, these adjustments have occurred.

During the first three months of 1975 the real output of goods and services continued to decline at a seasonally adjusted annual rate of 11.4 percent but economic performance was already beginning to shift as personal consumption increased. Most of the recession weakness was concentrated in the private investment sector where residential construction and business investment declined and a large liquidation of inventories occurred. During the last three months of 1974 business inventories accumulated at a seasonally adjusted annual rate of $18 billion. In the first quarter of 1975 the situation was reversed as business inventories were liquidated at a seasonally adjusted annual rate of $19 billion. In the second quarter the pace of liquidation accelerated to a level of $31.0 billion.

As spring progressed other significant economic improvements occurred. The annual rate of consumer price increases dropped from the double-digit level of 1974 to a 6 to 7 percent zone and the Tax Reduction Act of 1975 was passed in March. As a result, real disposable personal income increased during the second quarter following five consecutive quarterly declines. The turnaround of consumer purchasing power further strengthened personal spending and enabled people to improve their financial situations as the savings rate jumped from 7.5 percent during the first quarter to 10.6 percent in the second quarter. As these favorable developments pushed final sales above current levels of production, a runoff of inventories occurred beginning at the retail level and then spreading back through the system into the manufacturing sectors. New orders turned upward in April and inventories have started to rise once again at the retail level.

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As economic conditions improved employment began to rise again in April. The "lay-off" rate has declined steadily each month through 1975 and the average number of hours worked and the amount of overtime have increased. The general measure of industrial production finally bottomed out in April and four consecutive months of expansion have been reported. Exports continued at a strong pace throughout this period and rising government spending has occurred at all levels. The long declines in residential construction and new car sales stopped in the spring and these two basic sectors are no longer dragging the economy down. The seasonally adjusted annual rate of new housing starts rose to 1260 thousand units in August, up from the low annual rate of 980 thousand units in April, and domestic automobile sales have steadily improved for several months. The rate of recovery in these two basic sectors has been sluggish but at least the negative results reported in 1974 and early in 1975 have been reversed.

It is now recognized that the turning point for the U.S. economy was reached sooner than expected -- probably by April or May -- and that the initial pattern of recovery has been somewhat stronger than anticipated. The public's general perception of the improving developments will continue to lag far behind actual events -- by as much as nine months or more according to some public opinion experts -- but the economic recovery does appear to be well underway. Perhaps the best overall measure of the recovery is the swing in "real" GNP -- the total output of goods and services with the effects of price changes removed -- from a sharp decline in the first quarter at an annual rate of 11.4 percent to a positive performance in the second quarter when output increased at an annual rate of 1.9 percent (both figures are seasonally adjusted).

The conclusion that the U.S. economy has started to recover does not mean that our fundamental economic problems have suddenly been solved or that we will not continue to suffer specific economic disappointments during the coming months. The present level of economic activity is still inadequate and we can never be satisfied until the current excessive levels of inflation and unemployment are substantially reduced. Even though some acceleration is likely to occur over the coming months if consumer spending remains strong, corporate profits improve and the stimulative effects of the investment tax credit are felt in 1976, business capital spending remains sluggish. Therefore, the outlook for residential construction and business capital investment suggests that the recovery pattern for the entire economy is likely to be moderate. But I also believe that improvement will be more sustainable if responsible fiscal and monetary policies are supported.

Unfortunately, the hoped-for recovery of residential construction and business investment will be hampered by the disruptive impact of massive Federal debt financing requirements. Although some analysts assume that the financial needs of an economic recovery can be automatically filled, the reality is that mortgages, consumer debt and business spending for fixed investment and inventories must compete against unprecedented Treasury borrowing requirements which will continue throughout this year and into the future. Two weeks ago the Treasury announced that it would need to borrow new money totaling $44 to $47 billion during the second half of Calendar Year 1975. When these anticipated needs are added to the $36.1 billion actually raised during the first half of Calendar Year 1975 the annual total rises to $80 to $83 billion. This excludes new money raised by the issuance of guaranteed securities and Government-sponsored agencies which we estimate at $6.0 billion and $3.0 billion respectively in the current calendar year.

We have substantial refunding requirements this year. Apart from the rollover of the $77 billion of privately-held regular weekly and monthly bills, $23.0 billion of privately-held U. S. Treasury coupon issues will be refunded this year.

The heavy Treasury borrowing requirements have become the dominant factor in the financial markets at the same time that private sector needs are expected to increase. The severity of the recession, particularly the rapid runoff of inventories, has moderated the private demand for credit. enabling the Treasury needs to be met, but there is already clear evidence that some firms have been unable to obtain desired financing and even successful borrowers have had to pay historically-high interest rates. The future pace of the economic recovery will depend upon the availability of credit across the broad spectrum of economic activity. If specific sectors, such as residential construction, or large numbers of businesses who do not have top-level credit ratings, are unable to obtain necessary financing both the strength and sustainability of the recovery will be disappointing. The impact of such large Treasury borrowing needs resulting from the deficits must receive greater attention in preparing general economic forecasts since we can have only as much economic expansion as available financing will support. This was the basis of our warnings about the financial disturbances of restricted access to funds and rising interest rates that would result when private borrowing needs generated by the recovery have to compete against Treasury borrowing. Unfortunately, financial market developments already indicate that these problems are occurring.

We must also be concerned about renewed inflation pressures. The slowdown in the rate of price increases during the first half of 1975 was reversed by the disappointing statistics reported for June and July. While those specific monthly statistics were not an accurate representation of the underlying rate of inflation -- just as the 0.2 percent increase in the CPI for August was an aberration on the low side -- most analysts now anticipate that inflation will persist in the 6 to 8 percent zone. That level of inflation is clearly inconsistent with our Nation's other basic economic goals. Because these inflation pressures have been accumulating for many years actions to correct them will require a sustained effort.

A third problem involves the unacceptable level of current unemployment which is the direct result of the recession. Although large employment gains have occurred since April, the unemployment rate is still in the 8-1/2 percent zone. Further progress in reducing the level of unemployment is expected as the economic recovery moves back to full activity. For several quarters real output will actually exceed the long-term target growth rates.

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During the transition period, it has been necessary to sharply increase the funds allocated to manpower programs, public service employment, unemployment compensation benefits and other social programs to alleviate the recession's impact. But I hope that we will avoid the traditional errors of overheating the entire economy by adopting policies of excessive fiscal and monetary stimulus. That approach might temporarily contribute to the reduction of the unemployment rate but the "stop-go" patterns of the past indicate that excessive stimulus eventually tends to create more problems than solutions.

Considering all of the pluses and minuses, it is clear that we are well into an economic recovery which should accelerate as we move into 1976. However, the strength and durability of this recovery is not certain -- particularly if a renewed surge of price increases or the expectations of inflation disrupt the pattern of economic activity. The amount of actual slack in the economy is uncertain and policy makers should not underestimate the strength of the economic recovery. Extensive stimulus has already been provided by the widespread increase in Federal outlays, the recent tax cut and monetary actions. Monetary policies have been responsive as the money supply (M_1) has increased at an annual rate of 8.6 percent over the past seven months since mid-February. A broader money supply measure, which includes net time deposits (M_2), increased at an annual rate of 11.3 percent over the same time period. Specific money supply growth rates tend to fluctuate widely from week to week but the Federal Reserve System does appear to be following policies which will support the economic recovery. As to fiscal policies, the large tax cut passed in March provided tax relief of $22.8 billion and Federal outlays increased from $268.4 billion in FY 1974 to $324.6 billion in FY 1975, a gain of 21 percent. If outlays in FY 1976 actually rise to the level of $368.2 billion recommended by your Committee in its report of April 14, 1975, that would mean that Federal spending would have increased $100 billion in just two fiscal years, a two-year percentage jump of 37.2 percent. This surge of spending created a huge Federal budget deficit of $43.6 billion in FY 1975 and the shortfall for the current fiscal year will be even larger. In February 1975 the President submitted a budget which called for a FY 1976 Federal deficit of $51.9 billion. The Mid-Session Review of the 1976 Budget published May 30 raised the anticipated deficit to $59.9 billion. In the First Concurrent Resolution on the Budget-Fiscal Year 1976 submitted as a Conference Report to the Congress on May 9, a deficit of $68.8 billion was recommended. Unless the Executive Office and the Congress cooperate in tough and responsible action to control Federal spending the prospective deficit could even escalate to $90 billion and the outlook for future years is for more Federal budget deficits. The challenge is clear.

In addition to the substantial increases in the size of our budget deficits I am particularly concerned about the rapid increase in expenditures. As summarized in Table 1, Federal outlays increased from $97.8 billion in FY 1961 to $324.6 billion in FY 1975, an increase of 232 percent. From 1961 to mid-1975 the entire GNP increased from $520.1 billion to $1440.9 billion, a gain of 177 percent (the mid-1975 figure is the GNP figure reported for the second quarter at a seasonally adjusted annual rate). The Federal budget has clearly grown more rapidly than the total U.S. economy. These budget outlay increases -- including the changes in FY 1976 -- are spread throughout the Government and tend to become permanent. If we are to have the necessary fiscal flexibility to meet our current and future priorities, we must regain control over Federal outlays.

II. FEDERAL REVENUE ESTIMATES

Turning next to the important topic of Federal revenues, I would first like to describe the analytical techniques used by the Department of the Treasury and then discuss our most recent estimates. Within the Treasury the estimating functions are assigned to an Assistant Director of the Office of Tax Analysis and a staff of five professionals whose duties are divided between the preparation of general receipts estimates and the analysis of specific revenue changes that might result from proposed tax legislation initiatives.

The beginning point for our estimates is the preparation of detailed GNP forecasts by the professional staffs of the Treasury, Council of Economic Advisers and Office of Management and Budget. Using these general forecasts of national output and information obtained from various sources the Treasury then prepares monthly collection estimates for several major categories. We also revise the estimates at the beginning of each month to reflect current collection experiences. Finally, the potential impact of any proposed or recently enacted tax legislation is added or subtracted from the basic estimates. Legislative changes are handled directly because the time series information used in the calculations would not include the effects of new tax initiatives.

The tax collection experience of the past five years is summarized in Table 2. Over the five-year period, Fiscal Years 1971 through 1975, individual income taxes accounted for 45 percent of all unified budget revenues, corporate income taxes for 15 percent, social insurance taxes and contributions (consisting of "employment taxes and contributions," "unemployment insurance" and "contributions for other insurance and retirement") accounted for 28 percent and all other sources combined represented the remaining 12 percent. It is also interesting to note the relative stability of each source of revenue as a share of the total even though economic conditions and specific tax legislation change over time.

The methods used for estimating each major source of revenues are as follows:

Individual income taxes -- The individual tax receipts model includes: (1) an equation which estimates current calendar year liabilities, other than capital gains taxes, as a function of personal incomes adjusted to eliminate transfer payments and other labor income and to add the employee payments for social insurance; (2) an equation which estimates current realized capital gains subject to taxation; and (3) an equation which estimates the withheld tax liabilities as a function of quarterly wage and salary figures. The amount of withholding collections must be estimated on a current monthly basis and the income tax withholding must be separated from the social security withholding. There are significant time differences between the tax liability period and the payment date for different payment methods. The model also develops estimates by source of individual tax payments, including refunds, and converts the figures into a monthly and fiscal year collection pattern.

The income tax liability for a given calendar year is estimated by benchmarking on the last actual year. On the basis of past experience, the change from the benchmark year liability is then estimated by correlation with the projected change in personal income (adjusted to a concept of income subject to tax). This gives an estimate of the tax liability excluding the tax on capital gain income. Capital gains, which are not included in the concept of personal income are volatile and often change in opposition to changes in personal income. They are, therefore, treated separately. Even so, estimated capital gains are only approximations for the calendar years in which stock prices and market volume are known. For future years the estimates are subjective.

The estimated total individual income tax liability for the calendar year is then broken down by major method of payment, including refunds, on the basis of historical relationships. Withheld taxes are estimated by means of relationship to salaries and wages by quarters. Refunds are estimated as a percentage of withheld taxes. Payments other than withheld taxes are estimated as a residual after subtracting withheld taxes less refunds from the total liability estimate. This residual is then broken down into estimated tax payments, payments on final tax returns and back taxes, again on the basis of past relationships. All of the past data have to be further adjusted for changes in tax law in order to obtain meaningful relationship. Considerable uncertainty in the relative proportionalities has been introduced in recent years. In the past decade, rarely have there been two years, back to back, in which the methods of payments have not been affected by legislative and administrative changes.

Corporation income taxes -- This model begins with an estimate of calendar year corporate profits before taxes as measured in the national income accounts. The next step is to determine the overall tax rate percentage to apply to the profit estimates. The actual percentage collected will vary according to the mix of economic activity, accounting policies and differences between gross and net tax liabilities. The third step is to determine the "collections lag" which will determine which fiscal year the estimated gross liability will apply to. Finally, the size of corporate income tax refunds must be estimated based on an analysis of the expected tax liabilities and the timing of economic recessions and recoveries. Greater percentage errors occur in preparing corporate income tax collection estimates because the basic variables are more volatile and the availability of information is not as good. Unfortunately, there have been only two or three years in the past twenty-five in which there was no statutory change in the coverage or timing of current estimated payments. In addition, corporations are allowed three methods of computation in determining whether they complied: (1) a current estimate for the year if within 80 percent, (2) annualization as the year progresses if within 80 percent, and (3) the preceding year's tax. This mix results in variations in the pattern apart from the statutory changes and increases in forecasting difficulty. In any event, past collection patterns modified by recent collection experience and expected pattern alterations form the basis for collection forecasts, monthly and for the fiscal year or years. There is a good deal of intuition and judgment in the final result.

Employment taxes and contributions -- This category includes FICA, SECA (for self-employed), deposits by states of their employee-paid portion of social security taxes for covered state employees, Federal employer deposits of employees share of social security taxes for Federal employees not covered by the retirement system, railroad retirement taxes, and premiums for uninsured participants enrolled in the Federal hospital insurance trust fund. The annual estimates of liabilities and receipts, except for railroad retirement taxes, are made by the Social Security Administration and then Treasury produces quarterly and monthly collection estimates.

Unemployment insurance premiums -- The Department of Labor normally prepares estimates of collections although Treasury may occasionally prepare internal revisions based on employment data and historical experience.

Contributions for other insurance and retirement programs -- Various government agencies are responsible for preparing estimates of collections related to programs under their jurisdiction and these figures are collected by the Office of Management and Budget and then given to the Treasury. We then prepare monthly collection estimates based on historical experience.

Excise taxes -- Historical experience is used to forecast excise tax collections with some effort to anticipate future income levels. Annual estimates of the various trust fund excise taxes are jointly prepared by the Treasury and the responsible government agency.

Estate and gift taxes -- Estimates are based on stock prices and historical experience.

Customs duties -- Estimates are based on current levels of GNP results.

Miscellaneous receipts -- Deposited earnings of the Federal Reserve System accounted for nearly 90 percent of the miscellaneous receipts in FY 1975. The only other major source of miscellaneous revenue in FY 1976 is the import fee and tariff on crude oil and petroleum products. This figure is based on estimates of future imports, prices and demand assumptions.

In general, the Treasury is responsible for the overall estimates of revenues but it must obtain necessary economic forecasts and information from a variety of outside sources. This procedure obviously creates the possibility that revenue estimates may turn out to be inaccurate because of errors: (1) in preparing the forecast of GNP; (2) in estimating the mix of economic activity as a basis for predicting personal incomes and expenditures, business spending and profits, unemployment, government transfer payments, etc.; and (3) in applying the equations developed within the Treasury for estimating probable revenues. Unfortunately, the underlying economic conditions constantly change and tax legislation is modified rather frequently. For example, the FY 1975 budget estimated that personal incomes would total $1,135 billion in 1974. The latest figure, which is still subject to further revision, is reported to be $1,150 billion. The $15 billion underestimate would create an error in estimating individual income tax receipts of at least $2 billion. Similarly, the FY 1975 budget forecast for 1974 corporate profits was underestimated by $17 billion, according to the current figures. That underestimate would generate an error of roughly $5 billion in estimating receipts.

Public and private economic forecasters have experienced great difficulty in predicting both the total GNP and major sectors. No matter how sophisticated our forecasts become, they will still be distorted by unexpected economic and political developments. In the final analysis we must recognize that complex mathematical models and careful human judgments must be combined to estimate future results which will ultimately be influenced by many unforseen developments.

It is also true that the tax law is constantly changing. The econometric models used for preparing the estimates attempt to apply equations to a time series of information in order to project future revenues. Unfortunately, it is difficult to develop these historical relationships because the tax law is changed so often and the specific collection and reporting procedures are frequently adjusted. To the extent that proposals in the President's budget prepared each January are modified, rejected or replaced by other actions, the revenue estimates will be disrupted.

The actual historical record for estimating errors in forecasting Federal receipts and outlays is summarized in Table 3. That record indicates that both under- and over-estimates have occurred over the years and that estimating errors persist even as the time horizon of the forecast shortens. For FY 1975 the Federal Budget revenues were overestimated by 5.0 percent in the original publication in January 1974 and outlays were underestimated by 6.2 percent (estimates prepared eighteen months prior to end of FY 1975 on June 30, 1975). In January 1975, at the mid-point of the forecast year, receipts were underestimated by 0.8 percent while outlays were underestimated by 3.5 percent. These errors are attributable to at least three major factors: (1) large changes in the underlying economic forecasts; (2) legislative actions; and (3) internal reestimates of the outlays and receipts as the year progressed. In summary, it is clear that economic forecasting -- including the estimating of Federal Budget revenues -- is far from qualifying as an exact science. The Treasury will continue to work with the best technical methods known to us and we will strive to

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refine our judgments as much as possible but the blunt fact that Federal budget revenue forecasts will continue to be subject to errors should be recognized by everyone.

In the Mid-session review of the 1976 Budget published May 30, revenues for FY 1976 were estimated to be $299.0 billion. Our latest estimates of expected FY 1976 revenues fall within a range of $297.6 to $305.6 billion. In preparing these estimates several key assumptions must be made as to future decisions concerning the Tax Reduction Act of 1975, tax withholding rates and various energy policy issues, including the status of the $2.00 oil import fee and the $0.60 fee applied to products. If the $2.00 oil import fee is continued (but not the product levy) and the tax relief provided by the 1975 Tax Reduction Act is discontinued, the revenue estimates would be at the high end of the range indicated. If the tax relief is extended, along with adjustments to the withholding rates to maintain the amounts of taxes withheld (at current levels), and the $2.00 oil import fee is not continued, then the revenues collected would probably be at the low end of the range. Since the final decisions may combine different variations of several different policies we believe that it is more realistic to estimate a range of possible collection figures.

It should be emphasized that these revenue estimates are still very tentative and contingent upon the basic decisions about tax and energy policies referred to above. In addition to the legislative uncertainties, a number of forecasting problems have complicated our FY 1976 revenue estimates:

1. The underlying forecasts for total GNP, personal income corporate profits, personal consumption, business investment, foreign trade and other important economic sectors are still uncertain at this early stage of the economic recovery. Even a small percentage change in these basic figures has a major impact on the actual taxes collected.

2. Possible inaccuracies in estimating individual capital gains (1974 figures will not be available until late 1975).

3. The potential effects of corporate net losses in calculating refunds is uncertain. It should also be emphasized that corporate accounting practices have frequently changed. For example, many companies have changed their accounting for inventories from a FIFO to a LIFO basis and such adjustments have had a major impact on the timing of tax collection.

4. Uncertainties about the receipts lag in collecting corporate tax liabilities given the flexibility corporations have in paying their taxes and the sharp drop in profits in calendar year 1975 measured on a National Income Accounts basis.

5. Uncertainties about the probable behavior of individuals in adjusting their personal claims for exemptions in order to adjust the amount of taxes currently withheld.

III. SUMMARY

Although the U.S. economy appears to be well into a period of economic recovery a very large Federal deficit will occur in FY 1976 and FY 1977 following the deficit of $43.6 billion in FY 1975. These unusual deficits result from: (1) an erosion of current tax revenues caused by the severe economic recession; (2) a temporary increase in Federal outlays intended to moderate the impact of the recession; (3) a permanent type increase in Federal outlays resulting from past legislative decisions and the initiation of new spending programs; and (4) the tax relief provided by the temporary Tax Reduction Act of 1975. The return to strong economic activity will restore the tax collections to a more normal level and reduce the temporary outlays directly related to the recession but this will not solve the fundamental erosion of fiscal stability caused by the rapid escalation of Federal spending and periodic permanent tax cuts.

Some analysts have claimed that the budget deficits of FY 1975 and FY 1976 are merely aberrations which will disappear once the economy returns to a normal pace. Unfortunately, the historical pattern of Federal budget deficits and the outlook for future fiscal years does not support this optimistic conclusion. At the end of FY 1976 we will record the fifteenth Federal Budget deficit in the last sixteen years. Furthermore, the pattern of increased Federal spending is not concentrated in the "temporary" automatic stabilizers associated with the recession. As summarized in Table 4, large spending increases have occurred throughout the permanent programs of the entire government. Even the emergency programs created for temporary relief tend to become part of the permanent activities of government.

The rapid increase in Federal outlays is not necessarily wrong if one agrees that more functions should be transferred from the private sector to the government. My strong preference is to maximize the role of the private sector because I believe that it is more efficient and responsive to the interests of our people and because I believe this approach provides for more individual freedom. This debate will continue and we cannot hope to resolve it during these hearings. However, one basic consideration is indisputable: When the combination of private and public sector demands exceeds the productive capacity of our economy an inflationary overheating of the economic system occurs. The total productive capability of the entire economy must be identified as a beginning point for ranking and selecting claims against the potential national output. Estimating the total economic capacity of the system and the existing private and public claims would help us avoid the simplistic arguments that additional government programs can be continuously created to meet every claim by simply shifting resources from the private to the public sector. Adding new government commitments is not feasible if the productive capacity of the economy is exceeded. This basic 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, such as occurred in the mid-1960's and again during the early 1970's.

Some analysts have claimed that adding new government spending programs is no threat because of the amount of slack created in the economic system by the severe recession. Beyond the fact that our measures of capacity and excess resources are very uncertain, I believe that this recommendation misses the basic point: The fiscal decision of the past

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have already eroded our fiscal flexibility in responding to the problems of the present and the future. If we accept the recommendations to expand Federal spending even more we will create permanent claims that will further disrupt the allocation of resources in the future. Many government programs now involve an "entitlement authority" which makes the actual outlays open-ended depending upon the eligibility rules and benefits established. There has been a tendency to liberalize both guidelines and many government programs are now indexed so that they rise automatically as inflation occurs. Other outlays are required by specific legislative and contractual agreements. In the future, there should be no such thing as an "uncontrollable" Federal budget commitment because the Congressional Budget Committee discipline will require careful consideration of priorities and the elimination of ineffective programs during the annual appropriations process. We must correct the historical approach of merely continuing existing programs so that any new claims were typically "added on" to current outlays.

I believe that by concentrating on short-term stabilization goals rather than the long-term allocation of resources our fiscal policies have actually become a disruptive force. Too often fiscal policies have lagged economic developments so that the desired stimulus or restraint typically arrives long after the economic situation has changed. The "emergency" spending programs created to pull the economy out of a recession often exaggerate the subsequent overheating of the economy and create additional commitments that last far into the future. A corresponding reduction of such programs during periods of economic expansion is unusual because the Executive Office and the Congress have been unwilling to shift their attention to longer-term goals or to face up to the agonizing experience of saying no.

This country now faces the reality of a strong challenge to our basic fiscal stability. Your Committee is a key factor in determining whether or not this challenge will be met. In preparing your Second Concurrent Resolution to Congress I hope that you will consider the future course of fiscal policies -- particularly the escalating pattern of Federal spending and "off-budget" commitments -- as well as the need to develop guidelines for FY 1976. We need to consider longer-term goals by relating the future impact of current government spending actions. When we consider the total impact of our fiscal decisions we will recognize that individual pieces of legislation cannot simply be added to existing commitments without considering what current claims need to be eliminated or curtailed. Too often we have ignored the economic discipline of allocating scarce resources to different claims according to national priorities which are responsive to the interests of the American public. The economic distortions of the past decade indicate that this was a costly decision. Your Committee has a major opportunity to help correct these distortions and I look forward to working with you as you attempt to achieve that goal. Thank you.

TABLE 1

FEDERAL BUDGETS

CHANGES IN THE UNIFIED BUDGET OUTLAYS

BY FISCAL YEAR, 1961-1976

(dollars in billions)

Fiscal Year over Preceding Year	Federal Outlays	Dollar Increase	Percentage Increase	Surplus or Deficit
1961	$ 97.8	$ 5.6	6.1	-3.4
1962	106.8	9.0	9.2	-7.1
1963	111.3	4.5	4.2	-4.8
1964	118.6	7.3	6.1	-5.9
1965	118.4	-0.2	--	-1.6
1966	134.7	16.3	13.8	-3.8
1967	158.3	23.6	17.5	-8.7
1968	178.8	20.5	13.0	-25.2
1969	184.5	5.7	3.2	+3.2
1970	196.6	12.1	6.6	-2.8
1971	211.4	14.8	7.5	-23.0
1972	231.9	20.5	9.7	-23.2
1973	246.5	14.6	6.3	-14.3
1974	268.4	21.9	8.8	-3.5
1975	324.6	56.2	20.9	-43.6

Source: Economic Report of the President, February 1975, Table C-64, p.324, for years 1961 through 1974; 1975 figure from Final Monthly Treasury Statement of Receipts and Outlays of the United States Government, for period from July 1, 1974 through June 30, 1975.

TABLE 2

Net Unified Budget Receipts, by Source, Percent of Total, and Five-year Average
Fiscal Years 1971-1975

	1971	1972	1973	1974	1975	5-year average
Fiscal Year ($ billions)						
Individual income tax	86.2	94.7	103.2	119.0	122.4	105.1
Corporation income tax	26.8	32.2	36.2	38.6	40.6	34.9
Employment taxes and contributions	41.7	46.1	54.9	65.9	75.2	56.8
Unemployment insurance	3.7	4.4	6.1	6.8	6.8	5.5
Contributions for other insurance and retirement	3.2	3.4	3.6	4.1	4.5	3.8
Excise taxes	16.6	15.5	16.3	16.8	16.6	16.3
Estate and gift taxes	3.7	5.4	4.9	5.0	4.6	4.7
Customs duties	2.6	3.3	3.2	3.3	3.7	3.2
Miscellaneous receipts	3.9	3.6	3.9	5.4	6.7	4.7
Total budget receipts	188.4	208.6	232.2	264.9	281.0	235.0
Fiscal Year - Percent						
Individual income tax	45.8%	45.4%	44.5%	44.9%	43.6%	44.7%
Corporation income tax	14.2	15.4	15.6	14.6	14.5	14.8
Employment taxes and contributions	22.1	22.1	23.6	24.9	26.8	24.1
Unemployment insurance	2.0	2.1	2.6	2.6	2.4	2.4
Contributions for other insurance and retirement	1.7	1.6	1.6	1.5	1.6	1.6
Excise taxes	8.8	7.4	7.0	6.4	5.9	7.0
Estate and gift taxes	2.0	2.6	2.1	1.9	1.6	2.0
Customs duties	1.4	1.6	1.4	1.3	1.3	1.4
Miscellaneous receipts	2.0	1.7	1.7	2.0	2.4	2.0
Total budget receipts	100.0	100.0	100.0	100.0	100.0	100.0

Office of the Secretary of the Treasury
Office of Tax Analysis

September 18, 1975

Note: Figures are rounded and may not add to totals.

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TABLE 3

Budget Estimating Errors

Fiscal year	Overestimate (+) or Underestimate (-) as a Percent of the Actual Figure			
	Estimates made 18 months prior to the end of the fiscal year		Estimates made 6 months prior to the end of the fiscal year	
	Outlays	Receipts	Outlays	Receipts
1950 1/	+4.1	+10.3	+7.8	+1.9
1960 1/	-0.3	-1.7	+1.6	+0.2
1970 2/	-0.7	+2.6	+0.7	+2.9
1971 2/	-5.0	+7.3	+0.6	+3.1
1972 2/	-1.1	+4.3	+2.0	-5.2
1973 2/	-0.1	-4.9	+1.3	-3.1
1974 2/	+0.1	-3.4	+2.3	+1.9
1975 2/	-6.2	+5.0	-3.4	-0.8

Office of the Secretary of the Treasury
Office of Tax Analysis

September 19, 1975

1/ Administrative budget.

2/ Unified budget. The first estimate on a unified budget basis was prepared in January 1968.

TABLE 4

CHANGES IN BUDGET OUTLAYS BY FUNCTION; FY 1976 over FY 1975

(millions of dollars)

Function	FY 1975 (1)	FY 1976 (2)	Change over FY 1975	House Budget Committee Resolution (3) FY 1976	House Budget Committee Resolution (3) Change over FY 1975
National defense	87.4	94.1	+6.7	89.7	+2.3
International affairs	5.0	5.5	+0.5	4.9	-0.1
General science, space, and technology	4.3	4.6	+0.3	4.6	+0.3
Natural resources, environment and energy	9.7	10.3	+0.6	11.5	+1.8
Agriculture	1.8	2.0	+0.2	1.8	--
Commerce and transportation	12.6	15.7	+3.1	19.8	+7.2
Community and regional development	4.6	6.1	+1.5	9.5	+4.9
Education, manpower and social services	15.0	16.8	+1.8	20.4	+5.4
Health	27.6	29.0	+1.4	30.7	+3.1
Income security	109.1	122.8	+13.7	123.9	+14.8
Veterans benefits and services	16.7	17.1	+0.4	17.4	+0.7
Law enforcement and justice	3.0	3.3	+0.3	3.4	+0.4
General government	2.7	3.2	+0.5	3.4	+0.7
Revenue sharing and general purpose fiscal assistance	7.0	7.3	+0.3	7.2	+0.2
Interest	31.2	34.4	+3.2	35.0	+3.8
Allowances	--	6.8	+6.8	1.1	+1.1
Undistributed offsetting receipts	-14.1	-20.0	+5.9	-16.2	+2.1
Total	323.6	358.9	+35.3	368.2	+44.6

(1) *Mid-Session Review of the 1976 Budget*, May 30, 1975, Table 9, p.15.

(2) FY 1976 Administration estimates as published in *Mid-Session Review of the 1976 Budget*.

(3) First Concurrent Resolution on the Budget-Fiscal Year 1976, Report of the Budget, House of Representatives, Appendix A-2, p.49.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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STATEMENT BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE
THE HOUSE SUBCOMMITTEE ON APPROPRIATIONS
FEBRUARY 3, 1976
2:00 P.M.

Mr. Chairman and members of the subcommittee:

I am pleased to be here with you today to consider the Department of the Treasury budget requests for operating appropriations during fiscal year 1977.

Let me introduce my associates - Mr. Donald Alexander, Commissioner of IRS; Mr. David Macdonald, Assistant Secretary for Enforcement, Operations, and Tariff Affairs; Mr. Warren Brecht, Assistant Secretary for Administration; Mr. David Bradford, Deputy Assistant Secretary for Tax Policy; and Mr. Arthur Kallen, Director of my Office of Budget and Finance.

Mr. Chairman, the members of this subcommittee have always worked with the Department in a highly cooperative spirit. I fully intend that I and officials of the Department will continue the same effective and harmonious relationship that has characterized our joint efforts in the past.

As your schedule indicates, the Treasury bureau heads have already appeared before this Committee to justify their individual requests in detail. As a summary of their testimony, I would like to insert for the record a more detailed Treasury bureau addenda. At the conclusion of my statement, I will be pleased to discuss any matters relating to the bureaus which the Committee may wish to review with me.

WS-622

With your permission, Mr. Chairman, I would like to make a short general statement on the overall economic situation and the Administration's total budget, before discussing the Treasury Department's FY 1977 budget. Much more was said earlier on this topic when I testified before the full House Appropriations Committee last week.

Since 1962, Federal Government outlays have roughly quadrupled from $106 billion to the $394 billion proposed for 1977. In fiscal year 1965, outlays in the federal budget accounted for about 18 percent of a $658 billion Gross National Product. For fiscal year 1977, outlays will be over 22 percent of a $1.8 trillion GNP. Government spending has been growing at a faster rate than the underlying economy which supports it. More and more, economic decision-making is being taken out of private hands, where we believe it is most efficiently and responsively handled, and placed in the hands of government. Believing that the path to a truly durable economic recovery lies in the private sector, we hope to redress this trend in fiscal year 1977.

The rise in Federal Government spending not only has outstripped the growth in the economy, but has also surpassed the growth in revenues, thereby causing record budget deficits. In fiscal year 1975 the budget deficit was $43.6 billion, and in FY 1976 it will be almost $76 billion. By FY 1977, we hope to reduce this deficit to $43 billion, and begin the long road back to fiscal responsibility with a budget surplus by FY 1979. These deficits require Treasury financing, which in turn places significant strains on our financial markets and nudges aside many a would-be borrower from the private sector. Over the past 10 years, the Federal Government (including the off-budget agencies) has borrowed over a third of a trillion dollars. In the current fiscal year, over 80 percent of all funds in the securities market will be absorbed by the Federal Government.

The most pressing goal of fiscal policy must be to bring the spiraling growth of government spending under control and to move toward budget balance as the economic recovery gains further momentum. The President's budget, which calls for limiting fiscal year 1977 spending to $394 billion instead of the $423 billion projected, is a positive step toward this goal. Even with this program, outlays will rise by about $21 billion from fiscal year 1976--an increase of 5.5 percent. Thus, the President's program is not a massive or indiscriminate slash in spending, as some allege, but is rather a necessary step in restraining the rapid growth in outlays and bringing about responsible fiscal policy so as to sustain a solid economic recovery in a non-inflationary environment.

I would now like to turn from the broad overall budget environment to the specifics of the Department's request.

Treasury Department Fiscal Year 1977 Overview

The operating accounts budget before you reflects our continuing efforts to strike a reasonable balance between the needs of the Nation's economy and the needs of our Department. In keeping with the President's efforts to prevent a runaway growth of government, minimize inflation, and produce a balanced budget within three years, we have tightened our belts and requested additional resources only where the workload clearly dictates. On the other hand, while we are trying to set an example of efficiency and economy, we have not sought to reduce spending below levels that are essential if the Department is to carry out its responsibilities relating to the financial and economic affairs of the Nation. We have attempted to protect our revenue production capacity and carry out effectively our law enforcement duties. I am sure the testimony of the bureau officials made these points very clear to the Committee.

Our estimates as contained in the President's budget for the new October 1, 1976 to September 30, 1977 fiscal year indicate that Treasury will require a total of $2.6 billion for operating accounts as compared to almost the same amount in FY 1976. (This figure is broken down in detail in Table 1, which I would like to insert for the record.) You will note that this request represents an increase of $14.2 million and a decrease of 2,172 average positions compared to our 1976 levels. The real program level for the Department has been reduced somewhat, partially offset by productivity gains, as part of the tough budgetary decision process. This result is masked, however, by the effects of the October 1975 pay increase, which added costs of $62.7 million to the 1976 budget and a corresponding cost of $90.1 million for a full year in FY 1977. Thus, comparing 1976 with 1977, it is clear that the increase in total proposed outlays is only nominal, and we have reduced our average positions some 2 percent.

Highlights of Expected Program Accomplishments for FY 1977

These funds will enable us to meet the workload generated in our many programs. Here are some brief highlights of the Department's budget for fiscal year 1977:

In the Internal Revenue Service, for example, the funds we are asking for are adequate to permit us to assist 40 million taxpayers, which represents roughly about 47 percent of the individuals filing tax returns. This is 4 percent lower than 1976. In our Collection activities we anticipate being able to collect, in a timely fashion, about $230 million of delinquent returns, although our inventory of unprocessed returns is expected to increase slightly. In the Audit of tax returns, we will be examining approximately 2.39 million returns, which is not far different from last year's program of 2.42 million examinations. The rate of coverage of full examinations will decline from 2.5 percent to 2.4 percent because of a growth in tax return filer population. We are also making in our Service Centers 1.8 million adjustments for items on tax returns, up from 1.4 million in 1976. This increase is due mainly to a higher level of activity in the Information Returns Matching Program. We expect to process 600,000 more tax returns, with 211 less average positions, in the IRS data processing operations.

In our Fiscal Service we anticipate a volume of 666 million checks issued, 777 million paid, and 1.2 million check claims. Savings bonds issues and retirements in 1977 are expected to reach an estimated 289.6 million pieces, an increase of 6 million over 1976. Transactions in other Treasury securities are expected to reach 12.5 million in 1977, which is .5 million above the 1976 level.

We expect a total production of almost 16 billion coins at the Mint, which is an increase of over 1.9 billion from the prior year.

We expect to increase our level of Compliance enforcement in the Office of Revenue Sharing by a modest amount.

In the Bureau of Alcohol, Tobacco and Firearms, we are proposing no new program initiatives, but we do expect to carry out fully the President's Concentrated Urban Enforcement Program which was approved for three cities by the Congress in the 1976 supplemental. This program is a four-pronged approach to significantly reduce the criminal misuse of firearms in all of the Nation's major metropolitan areas.

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The Secret Service will receive and investigate 237,000 cases involving counterfeiting, check and bond forgeries, protective intelligence, and other criminal and non-criminal matters, a 9.8 percent increase over the 215,852 cases in fiscal year 1976.

And, finally, we anticipate that the Customs Service will be handling an increased number of persons entering the country--267 million, up 4 percent from FY 1976--as well as starting their new responsibilities under the generalized system of preference, as provided by the Trade Act of 1974. With 319 less positions, we will need to be vigilant to prevent a denigration in the level of inspection quality or interdiction capability.

1977 Budget Summary

Overall, the President's budget for the Department of the Treasury requests budget authority of $56,335,284,000 for FY 1977--an increase of $5,842,918,000 over 1976. Of this increase, $7,300,000,000 is for interest on the public debt. Incidentally, I might note that the FY 1977 interest payment on the public debt is estimated at $45 billion--a compelling reason to make every effort to stem the rising cost of the Federal Government. $187,500,000 of the increase is for Revenue Sharing, $14,172,000 for operating accounts, with an offsetting reduction of $1,658,754,000 in all other accounts. Funds for the Department's operating programs have been held essentially level at $2,575,797,000, an increase of only $14,172,000 over 1976. As I noted earlier, this apparent increase largely reflects the effect of the October pay raise.

Our net outlays for the Department are estimated at $56,309,963,000, of which $45,000,000,000 is for interest on the public debt; $6,548,504,000 is for Revenue Sharing; and $2,575,356,000 is for the Department's operating programs; and $2,186,103,000 is for all other accounts, such as interest on IRS refunds, Customs collections in Puerto Rico and Virgin Islands, IRS collections in Puerto Rico, Claims, Judgments and Relief Acts, and the expenses for administering the New York City Seasonal Financing Fund.

The budget provides for a reduction of 2,172 average positions for the operating accounts for a FY 1977 total of 110,668 compared with 112,840 in 1976. We have made every effort to economize, in keeping with the need to reduce Federal Government spending; we are convinced that we can increase our productivity, so as to continue to carry out our responsibilities. We expect a minimal reduction in the quality of our service or level of enforcement as compared to FY 1976.

One reason for confidence in our ability to meet the 1977 budget challenge has been the fine support given the Department by this Committee over the past several years. While we are reducing our average positions this year, in the longer run context, I believe the Department has fared well in obtaining the resources needed to meet its workload. For example, the five-year period 1971-1976, Treasury increased average employment from 87,384 to 112,840. With this solid base, I believe this year's budget, combined with careful management attention, will enable us to do our job.

FY 1977 Budget Changes

I would like to insert Table 2 into the record to show the relationship between our average position and dollar requirements, as well as Table 3, which provides the detailed derivation of Treasury's "Proposed Authorized Level for 1976." Also attached is a chart depicting the relative size of the Treasury bureaus for 1977. Following is an outline of the significant increases and decreases for our 1977 request.

Budget Authority - Net +$14,172,000

+$19,884,000 -- to meet workload increases, including such major items as:

- $5.4 million for IRS for processing tax returns and employee plans workload;
- $7.4 million for the Fiscal Service for issuing and paying checks;
- $5.5 million for the Bureau of the Public Debt for costs related to the redemption of public debt securities;

- $.6 million for the Secret Service for protection related to Bicentennial foreign dignitary travel;
- $.2 million for additional coins; and
- $.8 million for all other related workload.

+$13,273,000 -- to provide for full funding by AT&F of the Concentrated Urban Enforcement program.

+$ 2,000,000 -- for payments to state and local governments for protection of permanent foreign diplomatic missions under extraordinary circumstances.

+$ 1,327,000 -- for equipment replacement in Bureaus of the Mint and Alcohol, Tobacco and Firearms.

+$ 500,000 -- for repairs and improvements to Treasury buildings.

+$24,068,000 -- for full-year costs of civilian pay increases authorized by Executive Order 11881.

+$17,568,000 -- to provide full-year cost in 1977 for programs authorized for part of 1976.

+$22,379,000 -- is the remaining cost to maintain current levels of operation offset by nonrecurring costs and savings--within-grade promotions, grade to grade promotions, and annualization of space costs. Included also are the severe effects of inflation reflected in greatly increased prices for such things as printing, communications, utilities, and operating supplies.

These increases are offset by significant decreases:

-$77,142,000 -- a decrease reflecting program reductions in FY 1977 includes such items as:

- Equipment
- Premium Pay
- Audit of Tax Returns
- Taxpayer Service
- Illicit Liquor Program

-$ 9,685,000 -- for productivity savings for most Treasury bureaus.

Employment - Net Decrease of 2,172 Average Positions

\+ 443 average positions of new employees to meet workload increases, including such major items as: 172 average positions for workload related to Employee Plans; 129 average positions for issuing and paying checks; 102 average positions related to the redemption of Public Debt securities; 11 average positions for additional coins; 16 average positions for staff support in Office of the Secretary; and 13 average positions for Office of Revenue Sharing.

\+ 504 average positions to provide for full funding of the Concentrated Urban Enforcement Program (AT&F).

\+ 390 average positions to provide full-year cost in 1977 for programs authorized for part of 1976.

These increases are offset by the following decreases:

-2,119 average positions for program reductions in FY 1977, reflecting the program decreases mentioned previously.

- 720 average positions resulting from lower inventories in the IRS Collection activity.

- 670 average positions for productivity savings.

Mr. Chairman, the budget before you is a lean request. The minor program increases have been substantially offset by program reductions and other cost-saving actions. We have reduced employment by 2,172 average positions and held the line on resource requirements while at the same time providing for the accomplishment of the projected FY 1977 workload increases.

I shall, of course, welcome the opportunity to answer any questions you may have. Thank you.

THE DEPARTMENT OF THE TREASURY
Annual Appropriations for Treasury Department for 1976
and Estimated Requirements for 1977
(In Millions of Dollars)

	1976 Proposed Authorized Level 1/	1977 Budget Estimate	Change over 1976
Regular Operating Appropriations:			
Office of the Secretary	27.7	27.0	-.7
Office of Revenue Sharing	3.0	3.8	.8
Federal Law Enforcement Training Center (Salaries and Expenses)	12.0	8.5	-3.5
Bureau of Government Financial Operations:			
Salaries and Expenses	131.7	147.2	15.5
Government Losses in Shipment	.7	.5	-.2
Eisenhower College Grants	1.0	-	-1.0
Hoover Memorial Fund	7.0	-	-7.0
Bureau of Alcohol, Tobacco and Firearms	109.7	125.3	15.6
U. S. Customs Service	319.1	324.1	5.0
Bureau of the Mint:			
Salaries and Expenses	41.2	43.2	2.0
Construction of Mint Facilities	3.4	-	-3.4
Bureau of the Public Debt	105.6	114.5	8.9
Internal Revenue Service:			
Salaries and Expenses	45.8	46.7	.9
Accounts, Collection and Taxpayer Service	791.7	789.9	-1.8
Compliance	854.0	834.9	-19.1
Total, IRS	1,691.5	1,671.5	-20.0
U.S. Secret Service	108.0	110.3	2.3
TOTAL, Regular Operating Appropriations	$2,561.6	$2,575.8	14.2

NOTE: Amounts are rounded and do not add to total.

1/ Includes pay increases authorized by Executive Order 11881 effective October 1, 1975, and program supplementals for the Bureau of the Public Debt and the Bureau of Government Finanical Operations.

760089
January 13, 1976

THE DEPARTMENT OF THE TREASURY
Comparative Statement of Average Positions
Fiscal Years 1976 and 1977
(Direct Appropriations Only)

	1976 Authorized Level	1977 Estimate	Change over 1976
Regular Annual Operating Appropriations:			
Office of the Secretary	816	839	+23
Office of Revenue Sharing	104	123	+19
Federal Law Enforcement Training Center	256	240	-16
Bureau of Government Financial Operations	2,518	2,557	+39
Bureau of Alcohol, Tobacco and Firearms	4,062	4,573	+511
U. S. Customs Service	13,255	12,936	-319
Bureau of the Mint	1,934	1,925	-9
Bureau of the Public Debt	2,499	2,539	+40
Internal Revenue Service:			
Salaries and Expenses	1,874	1,771	-103
Accounts, Collection and Taxpayer Service	44,248	42,567	-1,681
Compliance	38,042	37,221	-821
Total, IRS	84,164	81,559	-2,605
U. S. Secret Service	3,232	3,377	+145
TOTAL, Regular Annual Operating Appropriations	112,840	110,668	-2,172

760090
January 13, 1976

THE DEPARTMENT OF THE TREASURY

Derivation of "Proposed Authorized Level for 1976"
(in thousands of dollars)

1976 Appropriation		$2,465,859
Supplemental Appropriation (P. L. 94-157) 1/		16,000
Proposed Supplementals:		
1. Pay Increase:		
a. Classified	$62,248	
b. Wage Board	452	
		62,700
2. Program:		
a. Public Debt - Provides for increased reimbursement to the Federal Reserve Banks (3,746), increased reimbursement to paying agents for redemption of savings type securities (276), reimbursement to U. S. Postal Service for increased mailings of securities (1,348), increased cost of space and services (1,123). ----------------------	6,493	
b. Government Financial Operations - to provide for reimbursement to the U. S. Postal Service resulting from the postal rate increase ----------	10,573	17,066
Proposed Authorized Level for 1976------------------------------		2,561,625

1/ Includes $5.5 million for the Bureau of Alcohol, Tobacco and Firearms (Concentrated Urban Enforcement) and $10.5 million for Secret Service (Protection of Foreign Dignitaries).

760091
January 13, 1976

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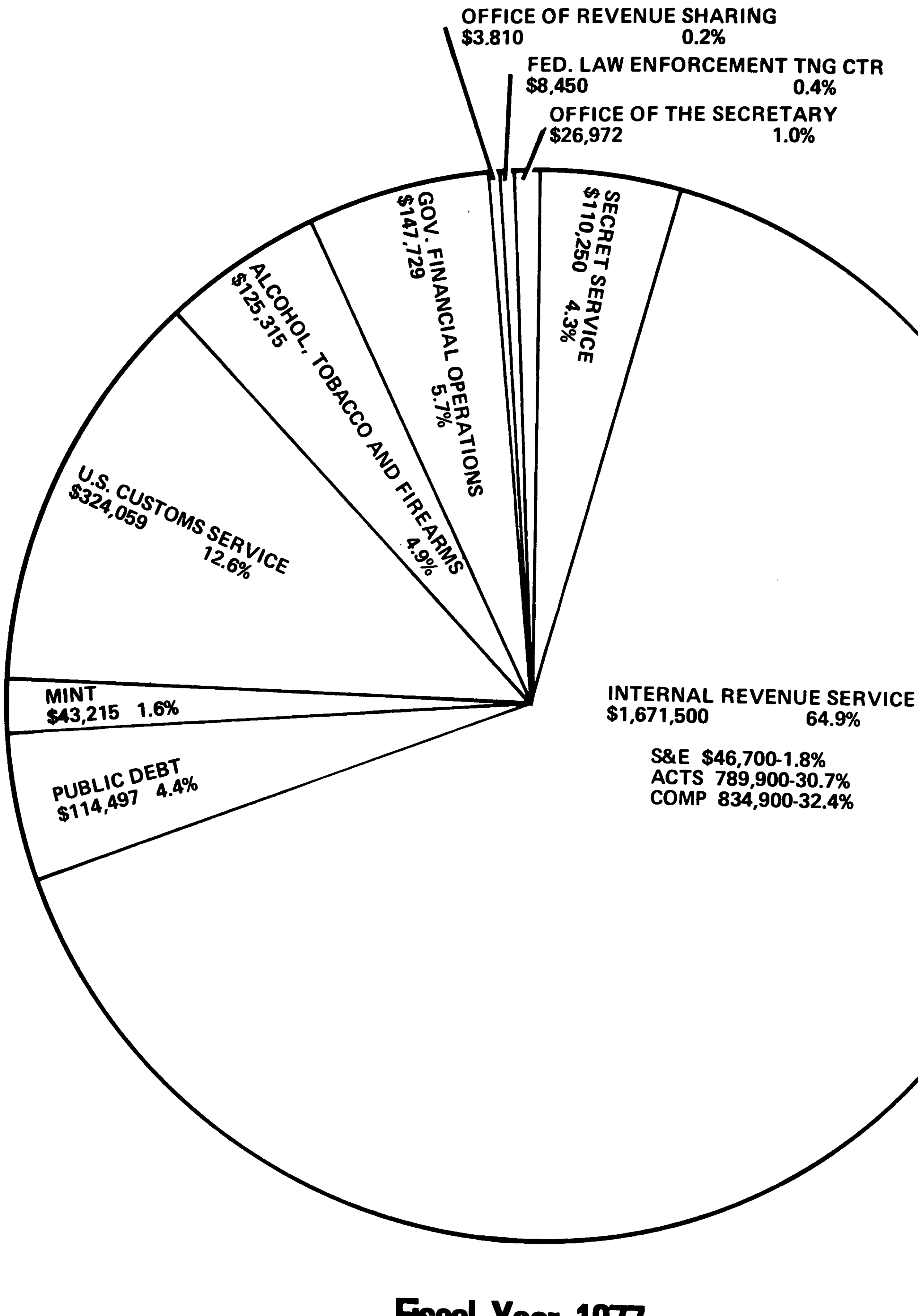
Department of the Treasury
Operating Appropriation Levels
Total $2,575,797 (thousands)



Fiscal Year 1977

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ADDENDUM

BUREAU STATEMENTS

Office of the Secretary

The Office of the Secretary provides for functions that are directly attributable to the Secretary of the Treasury as a major policy advisor to the President and for executive direction of the Department. The Office assumes primary responsibility for the direction and coordination of all Treasury activities, and direct responsibility for formulating and recommending domestic and international economic, tax, fiscal and monetary policies. The appropriation also funds general maintenance, and major repairs and improvements to the Main Treasury and Annex Buildings.

The appropriation request for fiscal year 1977 is $27 million and 839 average positions. The estimate is $.7 million less and 23 average positions more than the authorized level for fiscal year 1976. The major elements which comprise this change are $.5 million for repair and improvements to the Main Teasury and Annex Buildings, $.4 million and 16 average positions for new and increased program responsibilities, 7 average positions and $1.9 million for increases to maintain the 1976 level of operations in 1977, offset by a reduction in the repairs and improvements program and other nonrecurring equipment costs and savings of $3.6 million.

A total of 21 new positions is being requested for the staffs in the various supporting organizations of the Office of the Secretary. These include six positions in the Office of Debt Analysis, one position in the Office of Tax Analysis, two positions in the Office of the Assistant Secretary (EO&TA), eight positions in the Office of Equal Opportunity Program, one position in the Office of the General Counsel, one position in the Office of Personnel, and two positions in the Office of Administrative Programs. This request represents the minimum needs necessary to accomplish our mission of providing guidance, direction, and overall supervision for the many functions of the Department.

Office of Revenue Sharing

The Office of Revenue Sharing was established to implement the General Revenue Sharing Program as authorized by Title I of the State and Local Fiscal Assistance Act of 1972 (P.L. 92-512). Through General Revenue Sharing, $30.2 billion from federally - collected individual income tax receipts is being returned over a five-year period to nearly 39,000 recipient governments. The Office of Revenue Sharing assumes responsibility for the distribution of revenue sharing monies, maintaining detailed accounting records, insuring compliance with the requirements and provisions of the law, and reporting at regular intervals to Congress, recipient governments, and the general public on the revenue sharing program.

The appropriation request for fiscal year 1977 is $3.8 million and 123 average positions. The estimate for fiscal year 1977 is $.8 million and 19 average positions higher than the authorized level for fiscal year 1976. The major elements that comprise this increase are $.4 million and 13 average positions for increased program responsibilities, and $.4 million and six average positions to maintain the 1976 level of operations in 1977.

A total of 21 new positions is being requested for the Compliance Division, and will improve the civil rights and financial compliance programs as required by the General Revenue Sharing Act.

Federal Law Enforcement Training Center

Salaries and Expenses

The request for the Federal Law Enforcement Training Center for FY 1977 is $8.5 million, a decrease of $3.5 million and 16 average positions from the FY 1976 appropriation. This is net of the following items: an increase of $115 thousand for plant operations; an increase of $1.0 million for increases to maintain the current level (within-grades, annualization of pay costs, etc.); and a decrease of $4.7 million for one-time costs related to the move to Glynco, Georgia; decreases in training projections; and other nonrecurring costs.

The eight-week Criminal Investigator School (C.I.S.) will continue to provide basic training for new agents of the 24 participating agencies and, on a space-available basis, to personnel from other Federal organizations. It is estimated that the C.I.S. will train 659 students in FY 1977.

The Police School (PS) will continue to provide basic training in police techniques and enforcement law for recruits from ten Federal law enforcement agencies. The full course for recruits attending the Police School is a 12-week program. In addition, the staff of the Police School conducts some special 8-week and 5-week classes.

The Center conducts full-time driver training on a temporary course which will be used until the permanent course is constructed.

Advanced, In-Service, Refresher and Specialized (AIRS) driving training is also conducted for requesting agencies, and the Center is moving further into this area. The curriculum includes training in high-speed driving, defensive driving, and skid recovery techniques. In addition, firearms training is also conducted on behalf of the Center with 1,562 students to be trained in FY 1977.

Construction

No appropriation is requested for this account. The Center has been authorized to spend $28 million for permanent construction at Glynco, Georgia. These funds will come from amounts previously appropriated by the Congress.

The Master Plan for the Glynco facility is currently being finalized. It will call for utilizing **some or all of the** permanent buildings and facilities now in use at Glynco, as well as construction of new facilities. The first priorities for additional construction under the Master Plan are the completion of dormitories begun, but not completed, by the Navy; and the construction of a modern, up-to-date, indoor firing range. New construction to house additional classrooms and training support activities is also planned as part of the Master Plan -- as well as a permanent driving range facility for our Driver Training program. In addition, other renovation, demolition and upgrading of the facility will be undertaken consistent with our approved Master Plan.

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Bureau of Government Financial Operations

Salaries and Expenses

The 1977 estimate for the Bureau of Government Financial Operations is $147.2 million -- a net increase of $15.5 million above the 1976 level. Of this increment, $9.2 million is for the annualization of the recent postal rate increase. Outlays for equipment which will provide service and benefits in future years total $2.8 million -- $1.6 million for the purchase of equipment and $1.2 million for the rental of equipment with a purchase option.

Other increases totaling $6.2 million are necessary for financing incremental workloads, additional functions and those increases necessary to maintain in 1977 the current levels of employment and operations. Offsetting reductions for nonrecurring equipment purchases, compensation for one less workday, and management savings other than those reflected in the workload areas, amount to $2.7 million.

An increase of 18 million brings the total volume of issuances, primarily checks, to 666 million for 1977. The Bureau expects to pay 777 million Government checks and to reconcile such payments against issues reported by disbursing officers. In addition, an increase of 107 thousand check claims over the 1976 level will bring total claims for lost, stolen and forged checks to 1.2 million. Productivity increases of over 2% are anticipated in all work volume areas.

Government losses in shipment

This self insurance account covers losses in shipment of government property such as coins, currency, securities and losses in connection with the redemption of savings bonds. An appropriation of $500 thousand is requested in 1977 to cover these losses.

Bureau of Alcohol, Tobacco and Firearms

The appropriation request for the Bureau of Alcohol, Tobacco and Firearms for fiscal year 1977 totals $125.3 million, an increase of $15.6 million over the proposed authorized level for fiscal 1976. Of this increase, $13.3 million is for program increases, $9.7 million is for maintenance of current operating levels with a $7.4 million offset for nonrecurring costs.

The program increase of $13.3 million is requested to fund the balance of the Concentrated Urban Enforcement (CUE) program to combat illegal traffic in firearms and explosives. This program was requested by the President in his June 1975 message on crime and was authorized by Congress in Public Law 94-157, which provided funds to implement the program in three of the eleven cities contemplated. This program has four basic objectives. The first is to trace guns seized in crimes to determine the channel of illegal gun commerce. Second is the investigation and elimination of major illegal sources of weapons. **Third**, is the use of concentrated enforcement techniques to perfect cases against persons using firearms and explosives in criminal activities. **Four**, expanded dealer compliance efforts will be made to assure stricter conformity to Federal firearms and explosives laws.

An intensive effort will also be undertaken to deny terrorists and organized criminals access to explosives through a nine point enforcement program.

The bureau regulation of the legal alcohol and tobacco industries will assure collection of proper taxes which are projected at nearly $8.2 billion in fiscal 1977.

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U. S. Customs Service

The budget request for the Customs Service is $324.1 million. This level reflects a net increase of $5.0 million over the FY 1976 proposed authorized level. No program increases have been requested; however, the Service is requesting $16.0 million to maintain current levels, offset by a reduction of $11.0 million for nonrecurring one-time costs, equipment, and program reductions.

The Customs Service is continuing their intensified efforts in all areas of their enforcement responsibility. In fiscal year 1975, Customs expended 240 more work-years on special enforcement than the previous year. This includes the areas of general enforcement, smuggling, fraud, cargo surveillance, added inspections of vessels, cargo and persons, and a wide range of laws and regulations of other Government agencies.

In the area of drugs, Customs is facing the worst smuggling problem since the days of prohibition. We are in the midst of a resurgence in drug usage, especially heroin abuse. Reflecting this increase is an increase of 416 percent in heroin sezied to date in fiscal year 1976. The President in his statement of December 26, 1975, said, "Drug abuse is a tragic national problem which saps our Nation's vitality. It is also a major contributor to our growing crime rate. All of us must redouble our efforts to combat this problem". The Customs Service is the interdiction force at our borders, and, as such, will play a major role in this new Presidential initiative. The Customs Service is meeting the challenge of processing on-going workload, increasing responsibilities and limited resources, with many improved procedures: selectivity in inspection of passengers, and in technological assists through the use of X-ray equipment, communications systems, computers, aircraft, helicopters, boats and other devices.

The economic downturn beginning in fiscal year 1974 has caused reductions in the traditional workload indices of the Customs Service. However, in fiscal year 1976 Customs workloads are again on the rise, reflecting improved economic factors.

The Customs Service continues to experience increases in workload that are not captured by traditional workload measures. Tasks mandated by Congress through recent legislation, such as the Trade Act, and by the President through the Executive Order process, have placed additional burdens on the Customs Service. The tasks I refer to include the Trade Act, the Freedom of Information and Privacy Acts, and the Executive Orders dealing with labor management relations and oil importations.

In line with the Administration's policy of reducing Federal employment and expenditures, some Customs programs in fiscal year 1977 will decrease. However, the Service will make every effort to hold the program effect to a minimum.

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Bureau of Engraving and Printing

The Bureau of Engraving and Printing designs and produces United States currency, postage stamps, Public Debt securities, and miscellaneous financial and security documents.

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 incidental to work and services performed, including administrative expenses.

For fiscal year 1977 the bureau estimated a delivery requirement of approximately 2.9 billion Federal Reserve Notes. Actual production for the current fiscal year will approximate 3.1 billion notes, as compared with 2.8 billion notes delivered in fiscal year 1975. Savings to the Federal Reserve System, estimated at $27 million in the next 5 years, led to the announcement by the Secretary of the Treasury on November 3, 1975, that the Bureau of Engraving and Printing would commence production of $2 Federal Reserve Notes and that the first day of issue would be April 13, 1976, the anniversary of Thomas Jefferson's birth.

Accordingly, the Bureau started production of a new $2 Federal Reserve Note on November 18, 1975. The design of the $2 note features a portrait of Thomas Jefferson on its face and a rendition of the painting, "The Signing of the Declaration of Independence", by John Trumbull, on its back.

Current plans call for production of 400 million notes by June 30, 1976, with 225 million available for issuance on April 13, 1976. It is anticipated that 400 million notes will approximate annual requirements.

Bureau of the Mint

Salaries and Expenses

The appropriation request of the Bureau of the Mint for fiscal year 1977 is $43.2 million, an increase of $2 million over the authorized level for fiscal year 1976. This increase will provide additional production of 1.9 billion coins raising the total annual production to 15.8 billion. Included in our 1977 coin production is a reserve inventory to prevent recurrence of the just ended one-cent shortage which has been with us for the last two years.

In fiscal year 1977 the Philadelphia Mint will produce coinage strip. The Denver Mint has been converted to a coining operation only. Denver's strip fabrication equipment was removed and replaced by coining equipment, enabling us to increase coin production.

Construction of Mint Facilities

To assure the coinage capability needed to meet the increasing coin needs of the Nation, it is essential that we replace the Mint at Denver with a new and modern facility. The new Mint will be needed by no later than 1980 if we are to meet anticipated demand of the future.

Under the terms of the Act of Congress of August 20, 1963, authority for the appropriation of Mint construction funds expired June 30, 1973. In the 93rd Congress, the Department proposed

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legislation authorizing the appropriation of the funds needed for the new Mint and extending the time during which funds could be appropriated to September 30, 1983. However, the legislation had to be resubmitted to the 94th Congress.

Requests for additional funds to begin construction of a new Mint has been postponed until authorizing legislation is enacted.

Bureau of the Public Debt

The request for the appropriation "Administering the Public Debt" for fiscal year 1977 is $114.5 million, an increase of $8.9 million above the authorized level proposed for fiscal year 1976. This appropriation finances operations of the Bureau of the Public Debt, estimated at $102.3 million, and the U. S. Savings Bonds Division, estimated at $12.2 million.

The workload of the Bureau of the Public Debt is expected to remain at a high level in 1977. Savings bond issues and retirements are expected to reach 289.6 million pieces, an increase of 6 million over projected 1976 totals. Transactions in other Treasury securities have continued to rise and are expected to increase in 1977.

The major program increases requested for the Bureau relate to these projected workload increases and would provide for additional personnel, supplies, and security stock, and for increased reimbursements to the Federal Reserve Banks, the Postal Service, and paying agents. It is also necessary to further automate the registered accounts operation in order to keep pace with increases in registered security activity. Other program increases are requested to enable the Bureau to increase productivity in future years.

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Internal Revenue Service

The Internal Revenue Service budget request for fiscal year 1977 totals about 81,500 average positions and $1.671 billion. These are decreases of approximately 2,600 average positions and $20 million from the adjusted fiscal year 1976 levels. The total decreases are net of program and cost increases offset by program reductions.

The proposed decreases are a direct response to the President's program to reduce federal expenditures, and does not signal a decrease in workload or responsibilities for the tax administration system.

Taxpayer Service

The fiscal year 1977 request for Taxpayer Service totals over 4,000 average positions and $122.8 million, a decrease of some 150 average positions and $1 million. This funding will permit assistance to over 40 million taxpayers.

Collection

The fiscal year 1977 budget for Collection proposes a level of some 11,400 average positions and about $230 million, a decrease of over 1,200 average positions and $13.2 million. Prior experience indicates application of these resources should permit the collection of approximately $2.9 billion in overdue taxes.

Audit

The proposed FY 1977 Audit program totals about 27,600 average positions and some $591 million, a reduction of some 520 average positions and some $13 million. This level of funding should permit a total Audit program of some 4.2 million[1/] returns, with a coverage rate under current

1/ 2.4 million is used in calculating audit coverage and 1.8 million is additional Service Center contacts for the unallowable deduction program.

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plans of about 2.4 percent, a decrease from the 2.5 percent expected for fiscal 1976. Experience suggests that approximately $5.3 billion in additional tax should be recommended and some $4.5 billion in additional tax and interest should be assessed.

Employee Plans

The Employee Plans activity, created as a result of the Employee Retirement Income Security Act (ERISA) of 1974, is budgeted for more than 1,350 average positions and almost $30.5 million, an increase of about 170 average positions and $2.7 million. These resources should enable the Service to process approximately 160,000 of an estimated 350,000 determination requests expected to be filed under ERISA in FY 1977 as well as operate a small examination program and a delinquent returns program. The issuance of standard plans and paragraphs and model plans should help applicants in securing plan approvals.

U. S. Secret Service

The appropriation request for the U. S. Secret Service for fiscal year 1977 is $110.3 million, a $2.3 million increase over the proposed authorized level for fiscal 1976. Essentially, the request maintains fiscal 1976 level of activities, but does provide for two program increases. One is for travel associated with expanded foreign dignitary protection during the Bicentennial, and the second is $2 million for payments to state and local governments for protection under extraordinary circumstances of Foreign Diplomatic Missions and places of temporary domicile, as recently authorized by Public Law 94-196.

The number of counterfeit, forged check and bond, protective intelligence, and other criminal cases to be investigated is expected to grow from 215,852 in fiscal 1976 to 237,000 in 1977, an increase of nearly 10 percent. The number of these cases to be closed is expected to increase by nearly 6 percent, from 138,852 in fiscal 1976 to 146,500 in 1977. The Service made 9,318 arrests in connection with these types of cases in fiscal 1975, a 21 percent increase over 1974.

The Service's protection of foreign dignitaries visiting this country is expected to increase in 1977. The number and frequency of such visits is expected to be at least 25 percent higher than 1976.

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

FOR RELEASE AT 4:00 P.M. February 3, 1976 93

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $7,000,000,000, or thereabouts, to be issued February 13, 1976, as follows:

90-day bills (to maturity date) in the amount of $3,100,000,000, or thereabouts, representing an additional amount of bills dated November 13, 1975, and to mature May 13, 1976 (CUSIP No.912793 ZG 4), originally issued in the amount of $3,301,815,000, the additional and original bills to be freely interchangeable.

181-day bills, for $3,900,000,000, or thereabouts, to be dated February 13, 1976, and to mature August 12, 1976 (CUSIP No.912793 A4 8).

The bills will be issued for cash and in exchange for Treasury bills maturing February 13, 1976 outstanding in the amount of $6,303,960,000, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $3,222,405,000. 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 non-competitive 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 Standard time, Monday, February 9, 1976. 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

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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 February 13, 1976, in cash or other immediately available funds or in a like face amount of Treasury bills maturing February 13, 1976. 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.

Department of the TREASURY NEWS
INGTON, D.C. 20220 TELEPHONE 964-2041

FOR IMMEDIATE RELEASE February 4, 1976 95

SIMON NAMES PARSKY TO HEAD
TREASURY INTERNATIONAL AFFAIRS

Treasury Secretary William E. Simon announced today that Assistant Secretary Gerald L. Parsky will assume greater responsibility for assisting the Secretary and other senior departmental officials in the formulation and execution of the department's policies and programs in the international economic field. Mr. Parsky will assume the title of Assistant Secretary for International Affairs.

Since June 1974, Mr. Parsky has been in charge of Treasury's policy in the trade, energy, commodities and financial resource areas as well as economic relations with the Middle East. In addition to these duties, he will now supervise Treasury policy in the other international economic, financial and monetary areas, including investment, policy with respect to the industrial and developing nations, and policy with respect to international financial institutions.

In naming Mr. Parsky, Secretary Simon noted, "placing the Treasury's international staffs under one Assistant Secretary will greatly strengthen Treasury operations in the international area." Mr. Simon further stated, "I believe in allowing people to take on additional duties as soon as they are willing and able. Gerald Parsky has done an outstanding job in the areas in which he has been involved, and I am sure he will approach his new tasks with the same diligence and competence."

Last year, Mr. Parsky was chosen as one of America's Ten Outstanding Young Men by the United States Jaycees. He came to the Treasury Department in 1971 as Special Assistant to Edwin S. Cohen, Assistant Secretary for Tax Policy, and later Under Secretary of the Treasury. He then served as Executive Assistant to William Simon when he was Deputy Secretary of the Treasury and head of the Federal Energy Office.

Mr. Parsky, 33, received his A.B. degree (cum laude) from Princeton University in 1964, and his J.D. degree, with honors from the University of Virginia Law School in 1968. He resides in Washington, D.C.

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Department of the TREASURY NEWS
INGTON, D.C. 20220 TELEPHONE 964-2041

FOR RELEASE UPON DELIVERY

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STATEMENT OF THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE THE JOINT ECONOMIC COMMITTEE
WEDNESDAY, FEBRUARY 4, 1976, 10:00 A.M.

Mr. Chairman and Members of this Distinguished Committee:

I am pleased to appear before you to discuss the current economic situation and, more importantly, to consider some of our longer-term economic goals and policies. The importance of economic issues in shaping the future gives the Joint Economic Committee a basic role in determining these goals and policies. I hope that my analysis of the current economic outlook and of the policies needed to provide permanent prosperity and employment will contribute to a calm, reasoned, and perhaps, dispassionate discussion of these issues.

The Nation's economic goals were summarized in the Employment Act of 1946: "To promote maximum employment, production, and purchasing power" through actions consistent with "other essential considerations of national policy" in ways "calculated to foster and promote free competitive enterprise and the general welfare..." It is obvious that we all support the same basic goals of sustaining the current output and employment gains, of further moderating the still unsatisfactory rate of inflation, of reducing the unacceptable rate of unemployment, and of correcting the monetary, trade and investment problems which have periodically disrupted the international economic system. But there can be disagreement about what tradeoffs will be required to achieve simultaneous progress toward all of these goals, about the best mix and timing of fiscal and monetary actions and about the proper time horizon for planning current policies.

A year ago at this time, we were concerned with an economy in the midst of a serious recession. Fortunately, the turning point in the U.S. economy occurred somewhat earlier than anticipated and the pace of recovery during the transition period has been stronger than expected. Economic historians will likely identify last April as the low point

Economic Forecasts for 1976

	Forecast Published February 1975	Forecast Published January 1976
Gross National Product (current dollars)---------------------	12.6%	12.4%
Gross National Product (constant dollars)---------------------	4.8	6.2
GNP price deflator (yearly average)---------------------	7.5	5.9
Consumer Price Index (yearly average)---------------------	7.8	6.3
Unemployment rate (yearly average)---------------------	7.9	7.7

The basic turning point in the U.S. economy occurred during the second quarter of 1975 when real output rose at an annual rate of 3.3 percent following five consecutive quarterly declines. Then in the third quarter real GNP increased at an unusually high annual rate of 12.0 percent. However, over one half of the gain reflected a massive swing in inventories toward less liquidation. During the last three months of 1975, preliminary figures indicate that real output expanded at an annual pace of 5.4 percent as the liquidation of inventories effect was largely over. Real final sales increased at a 5.0 percent annual rate, compared with 4.7 percent in the third quarter of 1975.

The forecast for real economic growth in 1976 is now 6.2 percent with the pattern of recovery continuing throughout the year and into 1977. The major strength of the U.S. economy will continue to be personal spending, which represents approximately two-thirds of our GNP. Real personal consumption expenditures are expected to increase 5 percent this year, compared to a rise of about 1 percent in 1975 and to a decline of almost 1 percent in 1974. As consumers increased their spending in early 1975 and continued to purchase a variety of durable and nondurable goods throughout the year, this fundamental shift has proven to be a crucial element in the recovery to date. Personal incomes are expected to rise strongly in 1976, and real purchasing power should continue to improve if inflation does not accelerate. After falling 1-1/2 percent in 1974, real disposable personal income increased approximately 2 percent in 1975.

Furthermore, consumers increased their savings as a percentage of disposable income to the unusually high level of 8.3 percent in 1975 compared to an average annual rate of 6.4 percent from 1960 through 1974. Our 1976 forecast anticipates a continued high savings rate of about 8 percent, which affords the consumer a cushion to sustain the rise in spending. The improvement in household balance sheets -- resulting from the rapid accumulation of savings, liquidation of personal installment debts last year and the increase in the value of financial assets -- the reduced pace of inflation, further improvement in employment, and general economic recovery all should work to strengthen consumer confidence and spending in 1976.

While personal consumption expenditures will provide a necessary foundation for the economic recovery, the incremental thrust for growth will need to be provided by accelerated private domestic investment. Business spending for new plant and equipment tends to lag behind other sectors during an economic recovery and such real outlays actually fell 11.8 percent in 1975. Fortunately, that decline bottomed out in the third quarter of 1975 and business fixed investment should show good growth in 1976. The quarterly pattern of business spending is expected to accelerate throughout the year as rising corporate profits provide additional incentives, as increased retained earnings provide financing, and as improved corporate financial positions enable managers to plan more confidently for meeting future demands for goods and services. Long-term interest rates, though they have declined, still remain at historically high levels. However, a record amount of long-term financing was consummated last year (primarily in the high grade area). The sharp improvement in the stock market will likely encourage more equity financing which is badly needed to offset the heavy reliance on debt during recent years. The combination of these things would lead me personally to believe that real capital spending will rise in the neighborhood of 3 percent this year.

The liquidation of inventories is now largely completed -- except for a few manufacturing sectors -- and modest additions to inventory stocks should add to the general recovery in 1976. During the first and second quarters of 1975, inventories were liquidated at annual rates of $24.8 billion and $29.6 billion respectively in current dollars. During the third quarter, only a small decline was reported and in the fourth quarter inventories were essentially unchanged. Businessmen naturally are being very careful about replenishing their inventories following the problems caused by excessive purchases and the drop in sales in 1974, which piled up unwanted stocks that had to be liquidated in 1975. The expectation of a moderate acceleration in inventory accumulation as the year progresses is consistent with the overall economic outlook.

Residential construction is also expected to continue the pattern of gradual recovery begun in 1975. By the fourth quarter of 1975 new housing starts had reached an annual rate of 1.37 million units compared to a level of 1.07 million new starts at an annual rate reported during the second quarter. By yearend 1976 new housing starts will likely reach an annual rate of 1.75 million units which while still be below the peak levels of 1971 through 1973 will contribute to the total economic expansion. The availability of mortgage financing has greatly improved but new building activity continues to be constrained by the large backlog of unsold housing units, the jump in average prices for new homes from $38,900 in 1974 to $42,300 last year, the high rates of interest still required on mortgage loans as well as by the general uncertainties associated with the sharp increase in unemployment during the recent recession. The housing sector will benefit from the improvement in personal incomes as the economy strengthens, but a variety of serious structural problems must be corrected. In particular, a more stable economy would help reduce the disruptive swings in home building that have badly hurt this industry over the years.

The surplus in our balance of international trade will likely decline in 1976 from last year's record surplus of around $11 billion. As the U.S. economy continues its economic expansion, imports of raw materials and some finished goods will rise more rapidly than exports to our major trading partners, who generally are not recovering as rapidly. Fortunately, the reduced surplus will not curtail the domestic level of output and employment because exports will continue to grow.

Combining the major private sectors of the U.S. economy and the government into a total GNP forecast indicates that 1976 will be a good year with real output gains of about 6 percent and real final sales of 4-1/2 to 5 percent. Personal consumption expenditures should provide a solid base for continued growth and business spending for plant and equipment should accelerate as the year progresses, which will provide much of the additional thrust to sustain the recovery. Solid gains in residential construction and inventory investment are also expected to add to the total growth. If the economy could be judged only on the basis of output and consumption the forecast for 1976 would seem most satisfying. However, the serious problems of inflation and unemployment will require continued attention.

The rate of price increases in 1976 will probably continue at about the level reported in late 1975, although the figures reported for individual months may swing widely.

In 1975, the GNP price deflator increased 8.7 percent. The 1976 figure is expected to be 5.9 percent.

The expected moderation of inflation on a year-over-year basis is, of course, a welcome development but it must be recognized that there is considerable uncertainty surrounding this outcome. It is clear that: (1) inflation at the present level will continue to distort personal consumption and business investment decisions; (2) price increases in the high single- and double-digit categories are disruptive to the allocation of resources in our economy as well as to the stability of existing institutions and they threaten our entire economic system; and (3) while inflation pressures tend to moderate and intensify over the course of a business cycle, each time we start an economic recovery it is from a higher level. The last point is particularly troublesome at this time, for it points to the difficulty of reducing the near-term level of inflation.

The near-term outlook for unemployment is also a matter of great concern. From 1960 through 1975 the unemployment rate averaged 5.2 percent. On a yearly average basis, the low point of 3.5 percent was reported in 1969 and the highest yearly average level was 8.5 percent during 1975 when a postwar record was set. Over this extended time period there have been significant changes in the composition of the civilian labor force and in the development of various government programs to minimize the social costs of unemployment which may be causing some disincentives for returning to work. Despite these structural changes, it still is clear that unemployment is far too high today. In fact, after each bout of stop-go policies, there is a worrisome tendency to start the next economic advance from successively higher levels of unemployment and inflation.

There were several encouraging developments in the labor market during 1975: (1) the gain in employment of 1.1 million workers since the recovery got under way in April; (2) the turnaround in the average hours worked each week which are now almost back to the pre-recession level; (3) the gradual improvement in overtime hours worked; (4) the improvement in the "lay-off rate" from 3.1 per 100 employees in January 1975 to 1.3 in December; and (5) the drop in the unemployment rate from the peak of around 9 percent. While these developments are encouraging, specific effort must be committed to reducing the existing level of excessive unemployment if all Americans are to share in the benefits of recovery.

II. ECONOMIC POLICY BACKGROUND

Although the prospects for near-term economic performance are favorable, several basic trends require further analysis. Without question, this country has developed the most efficient and creative economic system the world has ever known. It has been particularly responsive in satisfying the consumption demands of our large population and the real standard of living for most Americans has risen sharply during the postwar era. Real disposible per capita income has increased by about 50 percent in the past 15 years -- after inflation. Over the same 15 years, the percent of persons in families below the poverty line has been cut in half -- to approximately 10 percent. The median family income now is approximately $13,000. Personal consumption expenditures now account for almost two-thirds of our Gross National Product and Americans spend around 92 percent of their disposable income.

Yet, as I take soundings of people throughout our country, I sense a growing concern about the long-term outlook for continued economic development. America seems to be on a path that may not hold the same promise for the future. There appears to be declining recognition of the fundamental importance of markets and a narrowing of the boundaries in which individual Americans can make personal economic decisions. Of course the market system adapts to change. The population has grown, the availability of resources has fluctuated, concerns about the environment have increased and the United States has become a major part of an increasingly integrated world economy. As our economy has become more complex, new approaches to difficult problems have been needed to achieve our general economic goals, to prevent specific abuses, and to stimulate and preserve competition in the markets. I believe that free, competitive markets are the most effective way to provide for increased output and the equitable distribution of the results of economic activity.

We do need government regulations and other safeguards to protect the public interest. But I am disturbed by my discussions with individual consumers and businessmen which indicate that the government at all levels is increasingly constraining innovation, entrepreneurship, and individual spending decisions. In particular, the small businessman attempting to create a new enterprise today, in which you, Mr. Chairman, have expressed such justifiable concern, is curtailed at most every turn.

He must comply with thousands of government regulations on health, safety, pollution control, hiring practices, product liability, tax reporting, employee pensions and compensation, advertising, distribution practices and other requirements too numerous to list. This compliance burden is costly to large and small businesses alike. These costs ultimately must be passed on to consumers in the form of higher prices. Moreover, such costs are particularly heavy for the smaller businessman because of the fixed-cost nature of many of the regulations. If profits are earned, and that is obviously the basic reason for creating most new businesses, they are taxed by the Federal Government, usually by the States, and increasingly by local governments, to support the enormous growth of government spending at all levels.

Just the paperwork burden of government regulation is staggering. Individuals and business firms spend over 130 million person-hours a year filling out over 5,000 government forms. Even more costly is the paperwork burden within government itself. The Commission on Federal Paperwork estimates that Federal spending to process forms totals an incredible $15 billion a year. In fact, just the cost for forms themselves runs to a billion dollars annually, and one department -- Agriculture -- maintains nearly a million cubic feet of records and spends $150 million yearly on reporting systems. When government and businesses are so burdened, it is not just they who pay the penalty. Everyone pays -- the taxpayer and the consumer alike.

Small businessmen are increasingly questioning the desirablility of working so hard and bearing so much risk when others are able to claim virtually the same financial rewards in our society with shorter hours, far fewer headaches, much less responsibility, and little risk. Is it any wonder that the entrepreneurial spirit in this country is fading? Employees also have growing concerns about the future as they see an increasing share of their financial resources eroded by personal income taxes paid to several layers of government, payroll taxes, property taxes, sales taxes on most of the goods and services they purchase and many other indirect taxes. Although earnings continue to rise rapidly, the real purchasing power of these higher incomes is quickly erased by higher taxes and inflation.

These personal concerns raise fundamental questions about the proper allocation of resources and decison making between the public and private sectors. Determining the proper functions of government and the means of financing those activities is a critical issue facing our society. The key, of course, is what is the appropriate balance? If the balance is almost entirely in the private sector, the public's interest may not be properly safeguarded. There would be little or no national defense, national parks or other public goods of this sort, and we would still have the difficult challenge of providing a basic level of income and services for those Americans who are currently not able to pay for their basic needs. Clearly, there is an important role for government.

However, when resource allocation and other economic decisions become dominated by a government bureaucracy, innovation and productivity are too often restricted. Moreover, the individual finds he has less freedom of economic choice as greater portions of his pay check go to support growing government outlays at all levels, as prices rise, and as the total economy becomes less productive. As an economy becomes increasingly dominated by the government, individual initiatives fade away. The potential entrepreneur considering a new business because he has an idea he thinks is really good finds himself stymied at almost every turn. The danger of all of this is that in many cases he concludes that the risks and inconvenience far outweigh the potential rewards and he drops the idea. At the extreme, economic decision making by people in the market is supplanted by people in government, individual incentives evaporate, and the economy deteriorates into conditions of stagflation.

Reasonable people will agree that we do not want either extreme. Too little government results in an absence of public goods and safeguards of the public interest. Too much government, on the other hand, stymies the workings of efficient and competitive markets and reduces the individual's freedom of economic choice. We obviously must have a balance. But what is the appropriate mix of public and private decison making? There is no exact answer to this question, but I do believe that we can make a reasoned assessment.

We must recognize that the resources of this great country -- the number of people, their education and skills, the amount and types of capital goods, the abundance of raw materials, and the infrastructure of transportation, communicatio utility, and other services -- are limited, particularly in the short run. Yet as we all know there are numerous claims on these resources. Each special interest group assumes that its claim is somehow unique and deserves satisfaction. When we total all of the worthwhile claims, we find that they far exceed our ability as a Nation to satisfy them particularly in the unrealistically short time frames that are sometimes expected. Obviously hard choices must be made.

In trying to respond to the claims before it, governments at all levels attempt to satisfy as many claims as possible. That is a natural response to the desire to attract future electoral support. However, this response has resulted in the increasing intervention of govenment at all levels into our economic system and into our individual affairs. In my judgment, the efficiency of our economic system has been unnecessarily distorted by bureaucratic infringemnts and by stop-and-go policies which have produced an atmosphere of instability.

The growth in government spending (Federal, State and local) has far exceeded the rate of expansion of the economy. Total government spending averaged about 35 percent of our GNP in 1975, compared with 27 percent in 1960 and 21 percent in 1950 (see Chart 1). In 1975, 1 out of 6 workers was a government employee; in 1950 this ratio was only 1 out of 10. In absolute terms, total government spending at all levels -- Federal, State and local -- has gone from $61 billion in 1950 to $136 billion in 1960 and to $525 billion in 1975 (see Table 1). Increasingly, a greater portion of our ability to produce goods and services is being taken over by government. Each new inroad has implications for the efficiency of the private sector, to which we must look for productivity gains and resulting increases in the total amount of goods and services produced.

I believe that the balance has tipped too far in the direction of bigger and bigger govenment at the relative expense of the private sector. The American people are beginning to resent this growth, for many of them know that ultimately it must be paid for directly with their taxes and/or indirectly by accelerating inflation.

We must redress this imbalance and restore to the American people greater discretion over personal spending decisions. They are usually able to decide what is best for them and, within limits, competitive markets are able to respond to these desires in the most efficient and responsive manner. I am not talking about a reduction in the absolute level of government expenditures. What I am advocating is a slowdown in the upward momentum of government spending that began to accelerate in the mid-1960's so that the relative portion of resource allocation decisions made by the private sector increases. In this way, the overall efficiency of our economic system can increase and we can bring about higher economic growth.

It cannot be emphasized often enough that the true wealth of a Nation is in its ability to produce goods and services. Improvements in this ability come mainly from the private sector. We can debate how the total pie should be divided, but we should not lose sight of the fact that we are no better off as a Nation unless the pie continues to increase in real terms. To do so and realize a durable prosperity, we should restore incentives to the private sector by tipping the scales toward a somewhat greater relative growth of the private sector.

However, government spending is only one part of the picture. Resource allocation also is affected by the myriad of regulations the private sector faces. Regulatory agencies have come to exercise direct control over transportation, energy, communications and the securities market -- industries that account for almost 10 percent of the value of everything made and sold -- and to exercise indirect control over much of the rest of our private economy. Business activities have become more controlled in areas of environmental protection, job safety, consumer requirements, hiring practices and information reporting and much more.

To be sure, many of these regulations are necessary and important in safeguarding the public interest. For example, regulations to prevent monopolistic pricing, to assure product safety, to provide reasonable and effective standards for environmental protection and worker safety, to make possible fair employment and other things of this sort are important to us all. However, too many regulations are overlapping, inefficiently administered with long delays, or obsolete. Others are actually anti-competitive. Regulators regulate with a frenzy and in so doing hamper the basic efficiency of competitive markets.

An underlying problem is that many regulations have never been subjected to a true cost-benefit type of analysis. The benefits are always cited, but very seldom are they documented by evidence showing that the regulation proposed is really going to make a difference. In other words, is there going to be a measurable and significant benefit which will exceed the combined cost of administering the regulations and the costs resulting from reduced efficiency of the U.S. economic system -- costs which ultimately must be borne by the consumer? In cases where the benefits are less than the total costs, we should consider changing or eliminating the government regulations and administrative actions that have caused the problems. Many regulations designed to cope with yesterday's problems are obsolete today. Frequently these regulations impede innovation by creating barriers to entry which preserve the status quo and limit competition. Other regulations simply are ineffectively administered creating needless red tape and delays.

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In those relatively few areas where there is an identifiable need to safeguard the public interest, Government regulation and administrative direction should be used but normally economic decisions should be left to the marketplace. By eliminating unnecessary regulations and streamlining others, the negative impact of government actions that restrain the economic decision making ability of the private sector would be reduced. The consumer would benefit in being able to purchase the product or service at a lower price and/or with less inconvenience than would otherwise be the case. The reform of government regulation is a principal goal of the Administration and many members of Congress as well. I know of no issue that has the agreement of so many people -- from liberals to conservatives, from business to labor. Yet the special interest groups are vociferous and tenacious. Witness the reactions of airline and trucking executives to the President's reform proposals for these industries. We should all recognize that we have an enormous stake in restoring competition to the marketplace.

Turning next to the question of economic stabilization, there is certainly an important role to be played by fiscal and monetary policies in evening out extreme moves in the economy. There have unquestionably been times, however, when such moves and policies have been counter productive. For example, additional government stimulus frequently takes effect at times when the total productive capacity of the economy cannot absorb the increased demand for goods and services. The result is inflation, dislocations in the economy, and, eventually, unemployment. Increased government spending programs have proven to be a cumbersome tool for short-term economic stabilization purposes. There usually is a considerable lag between the time a need is identified, or a claim is made by a special interest group, and the time there is a specific response by Congress to the proposal. Then there is another time lag before the expenditures actually occur and begin to spread throughout the economic system. At the time a proposal was initially considered there may have been underutilization of resources in the economy, but by the time the program actually comes on stream resources are often fully employed so that the additional government spending leads to greater inflation.

If there were some way that old programs could be phased down or eliminated during a period of rapid economic expansion, fiscal policy might be more effective as a tool for stabilization purposes. However, experience has shown that this is not the case and that programs initiated in a period of economic slack tend to become a permanent part of the budget. It is extremely difficult to reduce or eliminate even the obviously ineffective or obsolete programs; to scale down existing programs for countercyclical purposes has been, for all practical purposes, impossible. This is particularly true when the sizable outlays of the many State and local governments are added to the total.

This implies that we must avoid abrupt and excessive changes in government expenditures. No matter how well intentioned, such sharp swings in spending tend to accentuate rather than stabilize the business cycle and serve to increase the uncertainty of developing policies to meet future needs. In turn, this uncertainty is felt in the consumer markets, in the markets for capital goods, and in financial markets.

In addition to government expenditures, I am concerned with the size of the chronic Federal deficits, particularly the negative impact on financial markets and capital formation. The rise in Federal expenditures has exceeded the growth in revenues resulting in Federal budget deficits in sixteen out of the last seventeen years. The traditional view of the Government's role in the business cycle was that deficits would be recorded in periods of economic slack, but that surpluses would occur in periods of high economic activity. As a result, savings would be available to the private sector for the capital formation necessary to sustain the economic advance in real terms. This has not occurred in recent years. We not only have had deficits in periods of economic boom but even larger deficits in periods when there is less than full utilization of our resources.

These deficits, of course, need to be financed and such financing in periods of prosperity harm the economy in a number of ways. Over the past ten years, the Federal Government will have borrowed in the capital markets a total of nearly one-third of a trillion dollars on a net basis. The national debt now is climbing at a rate of more than $1 billion a week. During the last ten years, the interest on the debt has more than tripled to almost $38 billion in the current fiscal year and will go to $45 billion in FY 1977, (Interest is now the third largest Federal budget item, after income maintenance and defense.) As annual interest payments grow, fiscal flexibility is constrained. This "uncontrollable" outlay puts pressure on the total budget, which in turn means that programs must be displaced or tax reductions foregone.

Moreover, the deficits place the U.S. Treasury in a position of competing with private investors. The recent avalanche of Treasury securities has created distoritons in the traditional patterns of funds being raised by various sectors in the capital markets as well as in the sheer magnitude of total funds raised (see Table 2). In my judgment, this has contributed to making our financial markets less efficient in recent years in channeling the savings of society to investment opportunities. As a result, capital formation is impeded.

Furthermore, deficits cumulate over time. Total Federal debt has increased from $329.5 billion at the end of Fiscal Year 1966, to an estimated $633.9 billion at the end of FY 1976 -- a rise of 92 percent in only 10 years time. Over the last ten years the average maturity of the debt has declined from 5 years, 3 months to 2 years, 5 months. What this means is that the U.S. Treasury must be a more frequent visitor in financial markets simply to roll over outstanding securities let alone raising funds for current deficits. In this fiscal year (1976) the U.S. Treasury will absorb over 70% of all moneys in the securities markets; government at all levels will absorb over 80%. This percent must be sharply reduced as the economic advance continues or else some private areas will have to go without.

The problem becomes far more critical as the recovery progresses and the financing needs of the private sector intensify. If deficits remain large, the Treasury, by being first in the credit line, will always get its needs financed but in so doing will make it difficult for companies with less than prime financial ratings to obtain the financial resources they need at acceptable interest rates.

This problem of "crowding out" does not imply a dollar-for-dolar displacement of Treasury for private borrowing, but rather describes strains in the financial markets. These strains result in certain private borrowers not being satisfied and in the financial markets as a whole being less efficient in their function of channeling savings in our society to investment opportunities.

Another aspect of the crowding out problem is the secular deterioration I see in the financial structure of U.S. businesses. Over the past decade there has been a strong trend towards a much more leveraged corporate balance sheet. Debt has roughly tripled; liquid assets have declined relative to liabilities; the debt-equity ratio has about doubled; and the average maturity of debt has shrunk. Just as the Treasury is a more frequent visitor to credit markets, so too will many companies, and if there is a competition for funds, it is quite clear that the less than prime rated company will be the loser. Continuing heavy Treasury borrowings will eventually cause difficulties for these companies, small businesses and potential home owners. (In the Appendix, crowding out is discussed in greater detail.)

The size of the deficit also affects the rate of capital formation in the private sector, and this is a matter of great concern. As the recovery progresses, private capital investment must rise to sustain the recovery. In the longer run, the need for increased capital formation has been carefully documented by the Treasury, by numerous outside studies, and most recently, in Chapter 1 of the Economic Report of the President. If we are to meet our goals for increased employment and productivity in a noninflationary environment as well as our environmental, safety and energy goals, we must have an increase in the rate of national savings and private direct investment relative to the total GNP. More specifically, we must increase the percentage of business fixed investment from the average figures of 10.3 percent of our gross national product the last decade to approximately 11-1/2 percent over the next decade. In another sense, total investment, including residential construction, must increase from approximately 14-1/2 percent to 16 percent.

The achievement of our capital formation goals depends on the necessary expenditures being financed in the private sector. In turn, the adequacy of capital flows depends on the savings of society being less and less used to finance Federal expenditures and more and more focused on capital formation. This is the only way we can sustain a durable recovery over the long run and bring down the level of inflation. If the private sector is unable to finance capital formation because of the huge demands on savings by the Federal Government and because of the resulting inefficiencies introduced in financial markets, the boom-and recession sequence of the last decade will be repeated. Therefore, it is imperative that we reduce the Federal deficit and work toward a budget surplus as the recovery progresses.

Excessive monetary stimulus must also be avoided to prevent renewed inflationary pressures and uncertainty. No one wants to see an explosion of the money supply. On the other hand, it is important that the monetary growth be adequate to support the increase in nominal GNP necessary to sustain the recovery. With the surge in the economy in the last half of 1975, velocity increased dramatically; that is, the turnover of the money stock rose indicating people and business used money more efficiently. This growth rate in velocity is not sustainable over the longer run, but still the average rate of growth of velocity may well be higher than in years gone by. If this occurs, the money supply need not grow at as fast a rate to sustain a given level of nominal GNP as it would need to do if there were only a modest growth in velocity. Given the fact that monetary growth in 1975 was moderate, the Federal Reserve has considerable flexibility in managing monetary growth in the months ahead and still be within its target range on a cumulative basis. Given the anticipated velocity increase and this flexibility in near-term policies, the Federal Reserve's target range of 5 to 7-1/2 percent for growth in the money supply is consistent with the sustained recovery we anticipate for 1976. However, over the longer run, this range is not compatible with bringing down the level of inflation. Therefore, the monetary targets will need to be reduced in the future as the recovery proceeds.

For both fiscal and monetary policies, the problem of instability is compounded by the present inflation psychology that permeates our society. All too readily the economy will move to a higher level of prices, but only grudgingly will it move to lower prices despite slack demand. This inflation psychology has been building for a decade and its unwinding will not be easy. The achievement of economic growth without accelerating inflation could be upset by fiscal and monetary policies that are, or even appear to be, overly stimulative.

In addition, such excesses will lead to bottlenecks developing in certain key industries well before the economy as a whole reaches full employment. This occurred in 1973 in such industries as chemicals, steel, paper and fertilizers. The dislocations caused by bottlenecks send inflationary tremors throughout the economy and lead to inefficiencies which ultimately can curtail a recovery in real terms.

I believe that by excessively concentrating on short-term economic stabilization goals rather than on the long-term allocation of resources, stop-go fiscal and monetary policies in the past have been a disruptive influence which has accentuated the business cycle. Too often fiscal policies and, to a lesser extent, monetary policies have lagged economic developments so that when the stimulus or restraint arrives the business cycle has changed. As a result, these policies accentuate rather than dampen the ups and downs in the economy -- just the opposite of the intended purpose of these changes.

We must act wisely and responsibly in bringing stability to our economy. The excesses of the past are not easily undone. Excessive spending, excessive credit creation, excessive stimulation all may provide a short-term palliative, but before long additional inflation and production bottlenecks set in and economic performance declines. The stop-and-go policies of the past fifteen years have led to an instability which now is deeply rooted in our society. We can undo this problem only through a moderate and steady economic recovery which restores confidence in the prospect for longer run prosperity in a noninflationary environment.

There can be confusion about what is necessary to deal with a current problem and the effect of that action on future fiscal flexibility. Too often we in government are prone to make decisions without proper consideration of the cumulative impact of those decisions on the future. To deal with this problem, I am proposing that government accounting be placed on an accrual basis where unfunded liabilities are fully recognized. This would thwart the natural tendency for those at all levels of government to want to claim revenues too early and expenditures too late, thereby postponing the day of reckoning. We have had recent examples of the sharp and painful adjustments that must occur to a local government when things are continually swept under the rug until eventually the rug will cover no more. With each sweeping, future fiscal flexibility is curtailed one more notch. Eventually a government has no flexibility to deal with current problems. The same thing occurs for the Federal government, except the rug can be stretched for a while because, after all, the Federal government prints the money.

The Treasury has been publishing accrual statements for certain individual agencies since 1956 and we now plan to do this on a consolidated basis for the Federal government as a whole. Our target date for the first of these publications -- for the Fiscal Year ending September 30, 1977 -- is early in 1978. I would emphasize that the initial publication will focus on significant accruals that have a major impact on the overall financial condition and operating results of the Federal government. The first set of statements are likely to be accompanied by extensive qualifications. As the reporting process and statement preparation procedures are improved, however, these qualifications will diminish.

Not only will the reader obtain a consolidated financial view of the Federal government but an idea of the magnitude of all liabilities, whether they be funded or unfunded and whether they be due for payment in the near future or the distant future. In these consolidated statements, revenues will be recognized only when they are earned and sure to be collected and expenditures will be recognized no later than the time the liability to pay them is firmly established. We believe that this will bring more responsible accounting to government. Financial problems will surface long before a crisis is imminent, thereby reducing unpleasant surprises. I believe this will permit more reasoned judgments on decisions which impact the future fiscal flexibility of our nation. Our children should not bear the albatross of paying for the excesses of this generation, while their government is unable to cope with problems because it lacks fiscal flexibility.

I realize that there has been concern with the cost of installing elaborate accrual accounting systems in agencies where the need is not clearly established. I want to assure you that I am not advocating a slavish application of textbook accounting to every agency and appropriation without regard to benefits. All Federal agencies have accrual accounting of some sort. What we intend to do is to supplement the data we already have with some missing pieces of major proportions, and by major I mean in terms of governmentwide magnitudes, not individual appropriations.

I also want to say that I am not proposing a change in the basis for calculating the official budget surplus or deficit, or in the manner of justifying appropriations. There are some who advocate accrual accounting for both of those purposes, but I do not want to let the controversy over those applications interfere with my objective of giving the American people a clear business-like disclosure of the overall financial condition of their Government.

III. SUMMARY

This country has developed the most efficient and prosperous economic system the world has ever known. Over the past fifteen years the U.S. economy has increased the real output of goods and services by 60 percent; the real income of the average American has increased by over 50 percent; the number of Americans living in families with incomes below the poverty level has declined from 20.7 to 10.2 percent (1974) of the population; and 20 million new jobs have been created. Unfortunately, that impressive performance was marred by: (1) a sharp increase in inflation beginning in the mid-1960's; (2) continued unemployment in excess of 5 percent throughout the first half of the 1960's and again in the 1970's, and a sizable GNP "gap" between actual and potential output during those same time frames; and (3) occasional disruption of international trade and investment. While we clearly are justified in having a great deal of pride in our economic system, there also are sufficient reasons to have concern about the future pattern of economic progress.

Throughout much of this period the concept that the government must continuously intervene to stabilize the U.S.

economy has dominated policy decisions. The repeated use of fiscal and monetary stimulus too often has turned out to be counter-productive because of the lagged impact of such actions. The "temporary" programs created to respond to current problems have frequently become a permanent government activity with the result that fiscal flexibility and control have been continuously eroded.

This is not to say that governments do not have an important role in promoting economic development. The Federal budget has become a major factor in determining the allocation of national resources. In addition, the Federal Government has an important role in providing temporary assistance to moderate the negative impact of economic recessions. During the 1974-75 recession public employment programs were expanded, unemployment insurance coverage was liberalized, various transfer payments were increased and considerable personal and corporate income tax relief was provided. Federal spending increased dramatically -- up approximately 40 percent from FY 1974 to FY 1976 -- and part of this increase was the responsiveness of existing programs to economic slack. Government policies clearly have a major impact on the total economy, particularly during periods of recession.

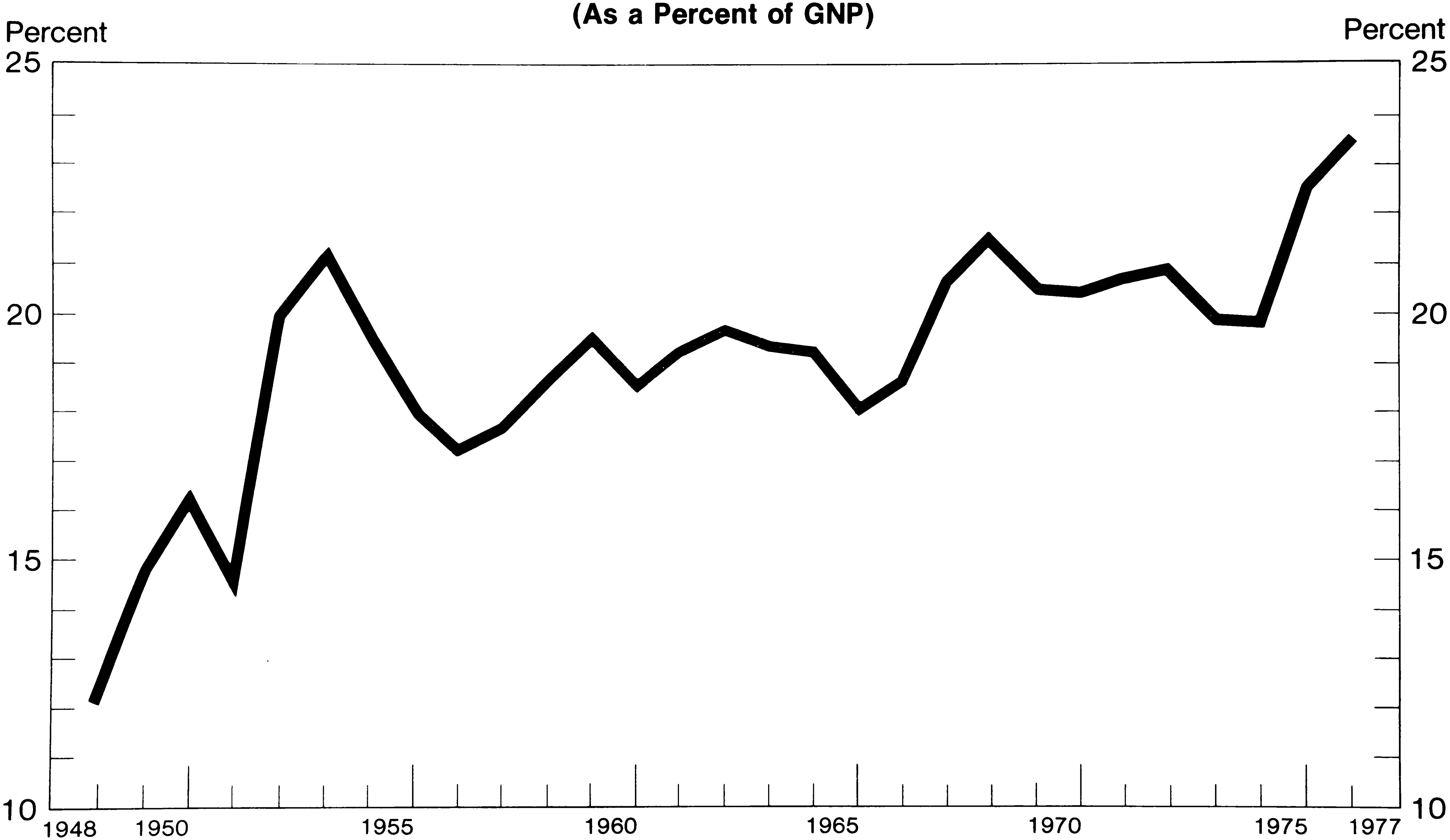
The debate over the proper role of the government in the total economy will continue. But there is an even more fundamental issue involving the total size and growth of government spending which has led to chronic deficits and periodic disruption of the entire economy. Merely ranking priorities within the Federal budget is not enough. We must expand the analysis to evaluate total government outlays as they relate to the priorities of the entire economy. I emphasized the need for considering the combined private and public demand for goods and services in my testimony before the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee on April 3, 1975.

The second basic requirement is to lengthen the time horizon of policy planning. There is a natural tendency to concentrate too much on short-run needs without adequate consideration for the cumulative impact of decisions into the future. This point is particularly important at this time because of the short-term benefits claimed for rapidly stimulating the economy with the slack that still remains at this stage of the recovery. However, because of the painful inflation recently experienced there must be greater concern about the reactions in the private sector to actual and potential government polcies. Employees are anxious to restore their real wage gains and business wants to restore profit margins which have been eroded by inflation. If the real growth in the economy is accelerated too rapidly, both real and perceived inflation pressures could quickly escalate because of concerns about the future. Another repetition of inflation and recession would result in even more unemployment and lost output. Lower rates of unemployment and inflation are obviously the desired goal, but we must consider the prospects over the next few years not the next few months. A mix of policies designed to provide temporary relief at the expense of higher rates of inflation and unemployment in future years is inappropriate.

It is particularly important to consider the longer-run government spending trends. The amount of adjustment in any specific Federal budget may appear to be relatively limited because of the legislative decisions of the past. However, decisions to better control Federal spending today will have major significance on the levels of outlays in 1978, 1979 and beyond as existing programs continue to expand. It will never be easy to make these fundamental shifts and there is a tendency to wait for a more "convenient" time to begin the painful process of regaining fiscal control, but I am convinced that the longer we permit the existing trends to continue the more difficult the ultimate correction process will be. To come to grips with this issue we have designed a responsible mix of economic policies that will bring about durable, lasting economic prosperity which will benefit our nation with sustainable and increasing employment.

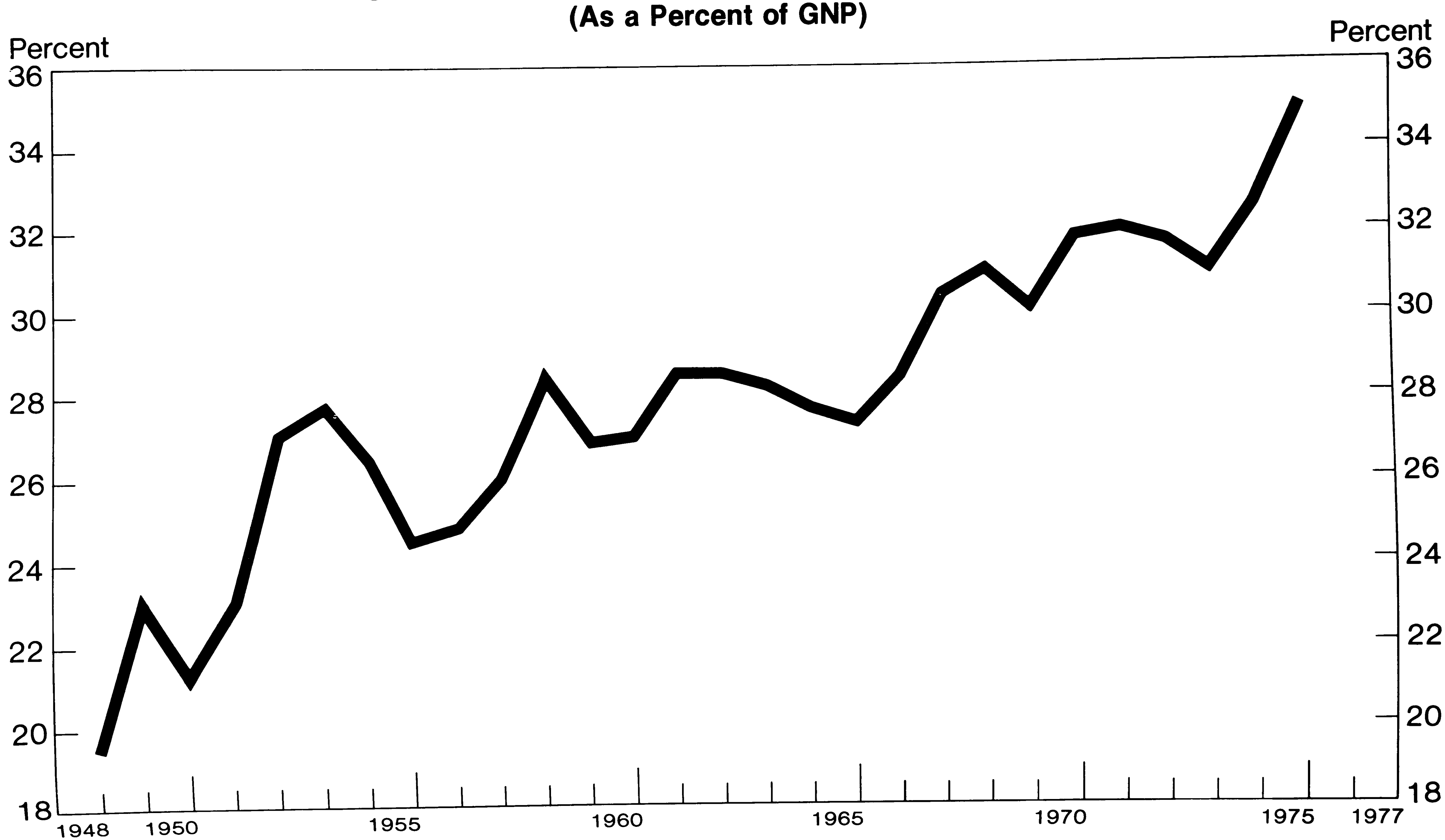
Thank you.

FEDERAL BUDGET OUTLAYS
(As a Percent of GNP)



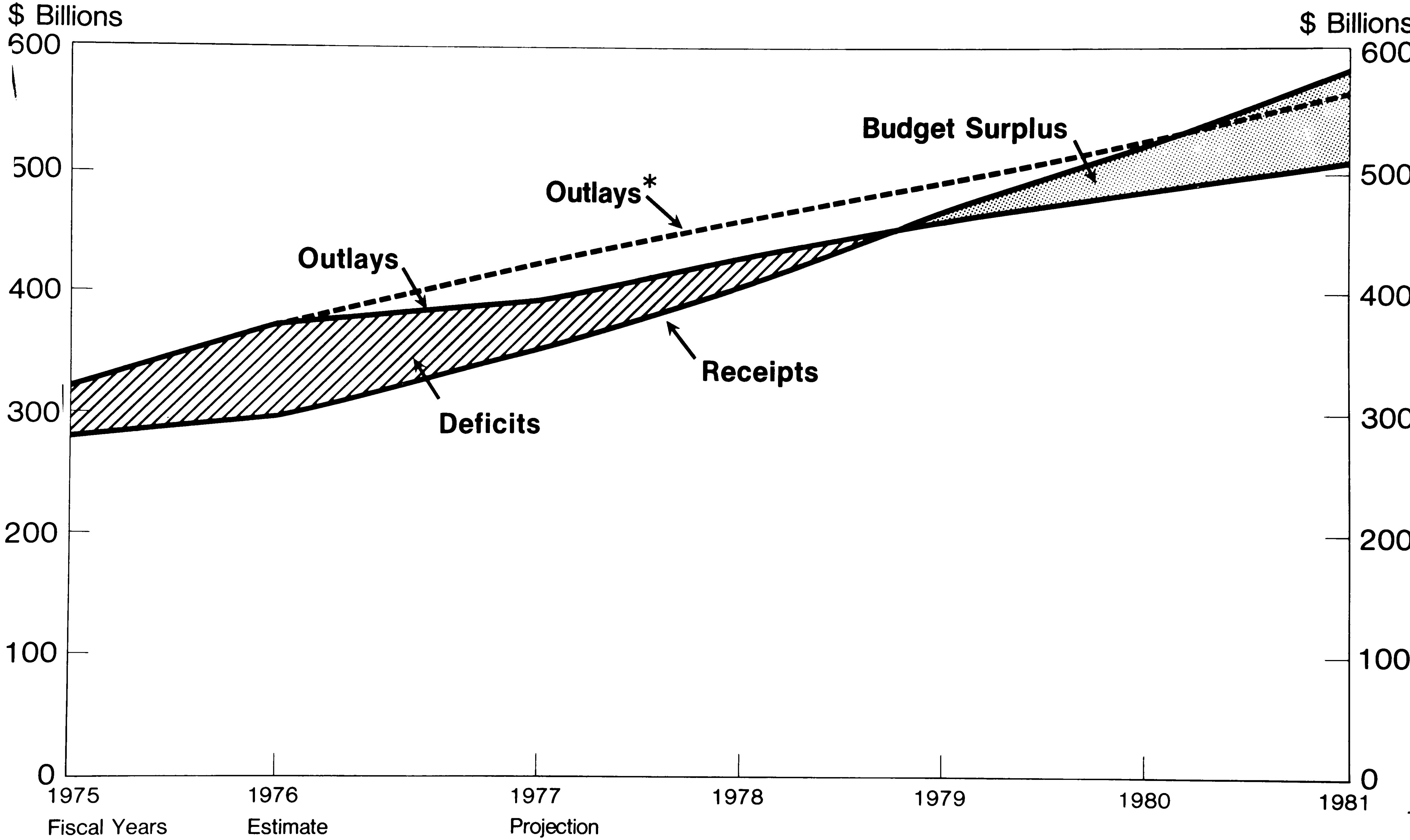
Source: OMB and Department of Commerce

TOTAL GOVERNMENT EXPENDITURES
(As a Percent of GNP)



Source: Department of Commerce

THE FISCAL OUTLOOK TO 1981



* Current Services—no restraint.

TABLE 1
TOTAL GOVERNMENT EXPENDITURES
(billions of dollars)

Calendar Year	Federal	State & Local	Grants In Aid	Total	GNP	Percent of GNP: Federal	Percent of GNP: State & Local	Percent of GNP: Total
1948	34.9	17.6	2.0	50.5	259.1	12.7	6.8	19.5
1949	41.3	20.2	2.2	59.3	258.0	15.2	7.8	23.0
1950	40.8	22.5	2.3	61.0	286.2	13.4	7.9	21.3
1951	57.8	23.9	2.5	79.2	330.2	16.7	7.2	24.0
1952	71.1	25.5	2.6	93.9	347.2	19.7	7.3	27.0
1953	77.1	27.3	2.8	101.6	366.1	20.3	7.5	27.7
1954	69.8	30.2	2.9	97.0	366.3	18.2	8.2	26.5
1955	68.1	32.9	3.1	98.0	399.3	16.3	8.2	24.5
1956	71.9	35.9	3.3	104.5	420.7	16.3	8.5	24.8
1957	79.6	39.8	4.2	115.3	442.8	17.0	9.0	26.0
1958	88.9	44.3	5.6	127.6	448.9	18.6	9.9	28.4
1959	91.0	46.9	6.8	131.0	486.5	17.3	9.6	26.9
1960	93.1	49.8	6.5	136.4	506.0	17.1	9.8	27.0
1961	101.9	54.4	7.2	149.1	523.3	18.1	10.4	28.5
1962	110.4	58.0	8.0	160.5	563.8	18.2	10.3	28.5
1963	114.2	62.8	9.1	167.8	594.7	17.7	10.6	28.2
1964	118.2	68.5	10.4	176.3	635.7	16.9	10.8	27.7
1965	123.8	75.1	11.1	187.8	688.1	16.4	10.9	27.3
1966	143.6	84.3	14.4	213.6	753.0	17.2	11.2	28.4
1967	163.7	94.7	15.9	242.4	796.3	18.6	11.9	30.4
1968	180.6	106.9	18.6	268.9	868.5	18.7	12.3	31.0
1969	188.4	117.6	20.3	285.6	935.5	18.0	12.6	30.5
1970	204.2	132.2	24.4	311.9	982.4	18.3	13.5	31.8
1971	220.6	148.9	29.0	340.5	1,063.4	18.0	14.0	32.0
1972	244.7	163.7	37.5	370.9	1,171.1	17.7	14.0	31.7
1973	264.8	180.9	40.6	405.1	1,306.3	17.2	13.8	31.0
1974	300.1	201.3	43.9	457.5	1,406.9	18.2	14.3	32.5
1975	356.9	222.4	54.2	525.1	1,499.0	20.2	14.8	35.0

Note: Federal grants-in-aid to State and local governments are reflected in Federal and State and local expenditures. Total government expenditures have been adjusted to eliminate this duplication. The ratio of Federal expenditures to GNP excludes grants-in-aid.

January 28, 1976

TABLE 2

Net Funds Raised in the Securities Markets by Major Sector
(fiscal years, billions of dollars)

	U.S.Treas. 1/	Federal & sponsored agencies 2/	Total Federal sector	State & local 3/	Corp. & foreign bonds 4/	Total securities	Federal sector as a % of total	Gov't sector as % of total 5/
1960	.8	1.6	2.4	5.7	4.9	13.0	18.6	62.4
1961	2.0	-.2	1.8	4.9	6.3	13.0	14.0	51.8
1962	8.8	2.2	10.9	6.0	5.7	22.6	48.4	74.7
1963	6.4	1.0	7.4	5.5	6.2	19.2	38.7	67.5
1964	2.7	1.5	4.2	5.2	6.4	15.8	26.5	59.6
1965	3.1	2.2	5.3	6.9	7.9	20.1	26.3	60.6
1966	-1.0	6.8	5.8	7.3	10.9	24.0	24.1	54.5
1967	-.6	2.7	2.1	6.0	13.0	21.1	9.8	38.5
1968	18.2	5.6	23.8	7.2	16.4	47.4	50.3	65.5
1969	-1.9	5.8	3.9	12.0	15.9	31.8	12.2	50.0
1970	6.8	8.2	15.0	9.7	16.8	41.5	36.2	59.4
1971	20.5	2.8	23.3	15.0	27.5	65.8	35.3	58.2
1972	19.6	8.7	28.3	15.6	21.7	65.6	43.1	66.9
1973	18.5	14.4	32.9	12.6	15.4	60.9	53.9	74.7
1974	2.1	21.3	23.4	17.0	17.4	57.7	40.5	69.9
1975	51.9	15.8	67.7	16.8	33.5	117.9	57.4	71.6
1976	87,5 (est.)	14.3	101.8	14.0	25.1	140.9	72.2	82.2

Office of the Secretary of the Treasury
Office of Debt Analysis

January 8, 1976

Source: FY 1960-1975 data based on Federal Reserve Flow-of Funds accounts (which show net changes in outstandings).

1 Net increase in marketable and nonmarketable bills, notes and bonds. (Includes Federal Financing Bank.)

2 Increase in bills, notes and bonds of budget and sponsored agencies. Includes GNMA pass-throughs.

3 Increase in notes, bonds and Government loans.

4 Increase in bonds and notes with original maturities of more than 1 year.

5 Includes State and local as part of government sector.

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TABLE 3

Unified Federal Budget Surplus or Deficit in Relation to GNP
1954-1977

Fiscal Year	Budget Surplus (+) or Deficit (-) ($ billions)	Budget Surplus (+) or Deficit (-) as % of GNP: Annual	Budget Surplus (+) or Deficit (-) as % of GNP: Three-Year Moving Average (Centered)
1954	- 1.2	-0.3	-
1955	- 3.0	-0.8	- .0
1956	+ 4.1	1.0	0.3
1957	+ 3.2	0.7	0.3
1958	- 2.9	-0.7	-0.9
1959	-12.9	-2.7	-1.1
1960	+ 0.3	0.1	-1.1
1961	- 3.4	-0.7	-0.6
1962	- 7.1	-1.3	-0.9
1963	- 4.8	-0.8	-1.0
1964	- 5.9	-1.0	-0.7
1965	- 1.6	-0.2	-0.6
1966	- 3.8	-0.5	-0.6
1967	- 8.7	-1.1	-1.5
1968	-25.2	-3.0	-1.2
1969	+ 3.2	0.4	-1.0
1970	- 2.8	-0.3	-0.7
1971	-23.0	-2.3	-1.6
1972	-23.2	-2.1	-1.9
1973	-14.3	-1.2	-1.2
1974	- 3.5	-0.3	-1.5
1975	-43.6	-3.0	-2.7
1976e	-76.0	-4.8	-3.4
1977e	-43.0	-2.3	-

January 16, 1976

APPENDIX A

CROWDING OUT--SETTING THE RECORD STRAIGHT

There clearly exists some misunderstanding about the meaning and significance of the so-called phenomenon of "crowding out." In essence, there is the idea that since financial collapse has not yet occurred, then the whole issue is misleading. This is wrong. What has occurred is a focussing of attention on short-run improvements in financial markets (associated primarily with the worse recession since the 1930's) and an ignoring of what happens longer-term as the economy moves back toward fuller capacity under conditions of repeated huge sized government budget deficits.

No matter how viewed, the inescapable fact is that with reasonably full use of capacity, more resources claimed by the government <u>must</u> mean less for the private sector. Huge deficits which take the lion share of credit flows will eventually push out the weaker private areas--specifically potential home owners, small businesses and even larger companies who do not have a superior credit rating. This in turn will hurt real growth, deprive our workers of adequate productive tools, frustrate the achievement of our longer-term economic needs, and further misallocate our scarce resources. (This was pointed out repeatedly in prior testimony, e.g., January 25, 1975, before the House Ways and Means Committee.)

1. <u>Interest Rates</u>. Interest rates have declined over the past year or so as would be expected during a recession. High-grade bond rates have fallen from a peak of about 10.5% in mid-1974 to around 8.5% today. Yet this drop cannot be taken as sufficient evidence that credit is ample and more importantly that credit will remain ample to support a lasting business recovery. This cost of long-term funds is still very high historically. (Such interest rates ranged between 2%-6% from 1865-1965--a period containing serious wars, depressions, financial panics, business booms and other assorted economic extremes.) The combination of sustained high Federal government financing, of a growing demand for private financing as the expansion proceeds and of a Federal Reserve policy which must eventually moderate in generosity (to avoid rekindling inflation) points to a level of interest rates and availability of funds for private areas which are not consistent with our long-run needs. Total government borrowings this fiscal year will absorb a record 82% of funds available in the securities market; this percent eventually must be sharply reduced or else some private areas will have to go without.

2. <u>Availability of Credit</u>. Funds are more readily available to more sectors of the economy today, but again this too reflects the cyclical slack in the economy and not the longer-run secular forces at work here. In the first quarter of 1975 about 5% of all new bond issues were Baa-rated or less. By the fourth quarter, it was almost 10%. (This is still below rates close to 20% at times in 1971 and 1972 however.) More lesser-rated companies are

able to finance today. Unfortunately, a lot of these bonds are for shorter duration--5-7 year maturity as opposed to 20-30 year maturity which was the norm not too long ago. This will raise problems in the future since the companies will have to refinance more frequently (referred to as the "rollover" problem in point 4 below). The most important issue immediately ahead is whether such lesser rated companies will continue to find the necessary funds to sustain the economic advance. When credit markets eventually tighten (as is inevitable), problems of credit availability will occur and their severity will be directly proportional to the relative borrowings of the government.

3. Financing of Deficit. The relative "ease" with which the Federal government financed the deficit in 1975 should not be viewed as a normal state of affairs. The fact is that private needs for credit were low because of the recession but as the recovery gains momentum this year, private credit needs will rise. For example, total short-run business borrowing declined in 1975 by about $14 billion; this year it is expected to rise by about $20 billion which is a swing of almost $35 billion. What this means is that there will be a much higher need for total credit in 1976 than in 1975 and eventually some private areas will be squeezed. This is why it is imperative to take steps now to limit the rise in Federal government spending (up almost 40% in just two years time). Not only is future flexibility lost if this cannot be accomplished but the deficit will remain huge and some private areas will not be financed.

4. Financial Structure. Over the past decade there has been a strong trend towards a much more leveraged and brittle structure of corporate balance sheets. Debt has roughly tripled, liquid assets have declined relative to liabilities, and the debt-equity ratio has about doubled. Sustained high Federal budget deficits will eventually create pressures in financial markets that will cause difficulties for lesser-rated companies (in terms of debt rollover) let alone leave sufficient credit for expansion needs.

5. Capital Formation. Several studies clearly point to a much heavier need for investment over the next several years if there are to be enough jobs for a growing labor force, a healthier environment for our people and a higher degree of energy self sufficiency in the United States. (The share of business investment in GNP must increase from an average of 10.4% over the past 10 years to 12.0% for the rest of this decade--an historically unprecedented change.) Sustained high Federal budget deficits will automatically frustrate the fulfillment of those capital needs by depriving many, many private areas of needed financing to build the new factories and buy the advanced machinery. The real dimension of crowding out becomes much more persuasive and severe the further ahead we look.

Conclusion: Crowding out is a genuine problem whose major economic impacts will occur ahead if something is not done about excessive Federal budget deficits caused by too rapid

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FOR IMMEDIATE RELEASE February 4, 1976

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $2,160,000,000 of 52-week Treasury bills to be issued to the public, to be dated February 10, 1976, and to mature February 8, 1977, were opened at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS: (Excepting 1 tender of $655,000)

	Price	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)
High -	94.439	5.500%	5.84%
Low -	94.342	5.596%	5.94%
Average -	94.366	5.572%	5.92%

TOTAL TENDERS FROM THE PUBLIC RECEIVED AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Received	Accepted
Boston	$ 23,975,000	$ 15,975,000
New York	3,368,525,000	
Philadelphia	26,880,000	
Cleveland	79,425,000	
Richmond	27,905,000	
Atlanta	9,205,000	
Chicago	309,845,000	
St. Louis	42,075,000	
Minneapolis	10,680,000	
Kansas City	7,435,000	
Dallas	14,920,000	
San Francisco	224,060,000	
TOTAL	$4,144,930,000	

Last month 5.578

High since 12/10/75 6.439

The $2,160,765,000 of accepted tenders includ bills bid for at the low price and $ 48,390,000 of noncompetitive tenders from the public accepted at the average price.

In addition, $ 767,985,000 of tenders were accepted at the average price from Government accounts and from Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities.

WS-626

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FOR IMMEDIATE RELEASE February 5, 1976

The Secretary of the Treasury, William E. Simon, stated today that the Commissioner and other senior officials of the Internal Revenue Service will voluntarily appear before a sitting Grand Jury in Washington, D.C., next week at the invitation of the Justice Department. In commenting on this prospective appearance, the Secretary reaffirmed his complete confidence in the Commissioner and his integrity and the Internal Revenue Service.

The Secretary said that this investigation into the allegations made against the Commissioner and the Service is an old matter that has been dragging on for months, and it is important that the allegations be pursued to a conclusion or laid to rest. The Secretary pointed out that the use of a Grand Jury by the Justice Department is a routine investigative procedure, and he is unaware of any other purpose for this particular inquiry. He emphasized that the Treasury and the Internal Revenue Service are cooperating in every way with the Justice Department. He added that the Treasury has previously investigated a number of the allegations and shared the results of its investigation with the appropriate committees of Congress, and the Justice Department. He said he hoped that the Justice Department investigation would conclude the matter.

Secretary Simon said:

"The whole purpose for this is to expedite the process of investigation. We cannot allow this investigation to drag on while Don Alexander and his senior associates are subjected to leaks, innuendos and vilification by a mindless, invisible bureaucracy. Through these unsavory tactics, men such as Don Alexander are subjected to calumnious attacks on their character and integrity. We must remember that the overriding principle in this great country remains that a man is innocent until proven guilty."

oOo

WS-629

The Treasury expects to announce the results of the 7-year 8 percent note due 1983 on Thursday, February 5 at 10:00 a.m.

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FOR 10:00 A.M. RELEASE FEBRUARY 5, 1976

RESULTS OF OFFERING OF 8 PERCENT 7-YEAR TREASURY NOTES

Preliminary figures indicate that approximately 106,000 subscriptions totalling $29.2 billion were received for the offering of $3.5 billion of 8 percent, 7-year Treasury Notes of Series A-1983.

Due to the overwhelming response to the offering, the Secretary of the Treasury has found it necessary to exercise his authority to reduce the amount of notes to be allotted on subscriptions in amounts over $200,000. Accordingly, all subscriptions for $200,000 or less will be alloted in full and subscriptions over that amount will be allotted $200,000.

Approximately $6.0 billion of the notes will be allotted to the public. In addition, $1.9 billion of the notes have been allotted to Government accounts and Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities.

3-year note
today 7.05

38-month note
10/7/75 8.14

29 1/4 year bond
today 8.09

24 3/4 year bond
10/30/75 8.23

25 year bond
7/31/75 8.44

30-year bond
5/8/75 8.30

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RESULTS OF AUCTIONS OF 3-YEAR NOTES AND 29-1/4-YEAR BONDS

The Treasury has accepted $3.0 billion of the $4.4 billion of tenders for the 3-year notes, Series H-1979, and $0.4 billion of the $0.7 billion of tenders for the 29-1/4-year 8-1/4% bonds maturing May 15, 2005, received from the public for the notes and bonds auctioned today.

The range of accepted competitive bids for the notes was as follows:

Lowest yield	7.00% 1/
Highest yield	7.09%
Average yield	7.05%

The interest rate on the notes will be 7%. At that rate, the above yields result in the following prices:

Low-yield price	100.000
High-yield price	99.761
Average-yield price	99.867

The range of accepted competitive bids for the bonds was as follows:

	Price	Approximate Yield To First Callable Date	Approximate Yield To Maturity
High	102.14	8.04%	8.05%
Low	101.42	8.11%	8.12%
Average	101.75	8.08%	8.09%

The $3.0 billion of accepted tenders for the notes includes 15 % of the amount of notes bid for at the highest yield and $0.5 billion of noncompetitive tenders from the public accepted at the average yield.

The $0.4 billion of accepted tenders for the bonds includes 68 % of the amount of bonds bid for at the low price and $25 million of noncompetitive tenders from the public accepted at the average price.

In addition, $ 1.7 billion of tenders for the notes and $0.2 billion of tenders for the bonds were accepted at the average yields/prices from Government accounts and from Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities.

1/ Excepting 4 tenders totalling $2,510,000

WS-631

The Department of the TREASURY NEWS
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FOR RELEASE UPON DELIVERY

STATEMENT BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE THE SENATE COMMITTEE ON THE BUDGET
FEBRUARY 5, 1976

Mr. Chairman and members of this distinguished committee:

I am pleased to be with you this morning to discuss the President's economic program. Your Committee plays a key role in the budget process and in bringing an organized and responsible approach to Congressional legislation. Because Federal expenditures now have such an important impact on the allocation of resources in our society and on the stability of our economic system, the decisions reached will have significant implications for our future economy.

As Mr. Lynn was with you earlier this week to discuss the details of the President's budget and Mr. Greenspan is with me this morning, I will focus my remarks on Federal revenue estimates and on certain concepts which underlie a durable, orderly and sustained economic recovery. It is obvious that we all share such basic goals as achieving greater economic growth, reducing the unacceptable rate of unemployment and of moderating the rate of inflation. However, there can be disagreement about what tradeoffs will be required to achieve simultaneous progress toward all of these goals, about the best mix and timing of economic policies and about the proper time horizon for planning purposes. In our discussion today, I hope that we can come to a better understanding of these issues and of the need for responsible budgetary policies.

We begin this important budget planning session with significant and solid improvement in the U.S. economy during 1975. As we know, the turning point in the economy came around April ending the most severe recession since World War II. Final sales, real gross national product and industrial production have shown solid gains and give us all considerable optimism for further progress in output growth. Significant improvement also has been made in reducing the rate of inflation and expanding employment opportunities. This is an impressive turnaround from the situation which prevailed one year ago.

Despite this progress, we must not become complacent. Inflation and unemployment remain serious problems. Embedded in the present recovery are risks which must be watched closely. If inflation should escalate, it will bring on severe problems that ultimately could halt the recovery. We then would repeat the pattern of inflation-recession-unemployment of the last several years, but with even more serious consequences.

Throughout much of the past fifteen years, the concept that the U.S. Government must continually intervene to stabilize the economy has come to dominate policy decisions. However, because of the lagged impact of fiscal and to a lesser extent, monetary stimulus, such actions have often been counter-productive and have accentuated rather than stabilized fluctuations in the business cycle.

The proper role of government is to create an environment for sustained, orderly and durable economic growth through its fiscal, monetary, and regulatory policies. With respect to fiscal policy, the beginning is the budget. As you know, proposed Federal expenditures total $394.2 billion under the Administration's plan, and Mr. Lynn already has discussed the details with you. The other side of the picture, of course, is Federal revenues which I wish to take a few minutes to discuss.

Federal Revenue Estimates

The Department of the Treasury is responsible for estimating Federal revenues as a basis for planning fiscal policies. The beginning point for our estimates is the preparation of detailed GNP forecasts by a trio of the Treasury, the Council of Economic Advisers and the Office of Management and Budget. Using these general forecasts and specific revenue information obtained from a variety of sources, the Treasury prepares monthly collection estimates. I might add that in my testimony of September 29, 1975, before the House Budget Committee, the detailed estimating procedures for revenues were described. Attached is a copy of that testimony.

The estimating process obviously depends upon several factors: (1) the accuracy of the GNP forecasts; (2) changes in the mix of economic results which cause adjustments in estimates of personal income and expenditures, business spending and profits, unemployment, government transfer payments, etc.; (3) the refinement of statistical estimating procedures; and (4) the frequent revision of tax legislation which can be anticipated only in part. As a result, actual receipts always vary from those which are forecast. However, the discrepancy usually is relatively small. In fact, it is amazing to me that with all the uncertainty involved our revenue estimates are as accurate as they are. Budget estimating errors over the past six years together with 1950 and 1960 are summarized in Table 1.

As shown in Table 2, Federal Budget receipts are estimated at $351.3 billion for FY 1977. These estimates take into account the Tax Reduction Act, enacted on March 29, 1975, and the Revenue Adjustment Act, enacted on December 23, 1975. The President has proposed additional tax reductions to become effective July 1, 1976, if spending is properly controlled. His recommendation would make permanent the six-month extension of the Revenue Adjustment Act of 1975 and add about $10 billion of additional tax relief. He also has asked for some special tax incentives in order: (1) to stimulate construction in areas of particularly high unemployment; (2) to encourage broader ownership of common stock; (3) to ease the burden of estate and gift taxes on farms and small businesses; (4) to take initial steps to integrate individual and corporate taxes so as to stimulate investment; (5) to bring about more investment in the hard pressed utility area; and (6) to encourage residential construction. Recommended also is an increase in social security and unemployment trust fund taxes, and these would increase revenues in FY 1977. The details of these proposals and their impact on Federal revenues for FY 1977 are summarized in Table 3.

Looking five years into the future, receipts are projected to increase from $351.3 billion in FY 1977 to $585.4 billion in FY 1981. These projections, shown in Table 4, are based on the legislative initiatives recommended by the President and they also are based on the integration of individual and corporate income taxes, as outlined in my testimony before the House Ways and Means Committee last July. The assumption embodied in the projections is that such integration will begin January 1, 1978. The revenue projections are consistent with the economic assumptions and legislative initiatives proposed by the President in his budget message. Those assumptions should not be interpreted as forecasts for years beyond 1976, since they do not include the potential impact of policy decisions made between now and the end of the 5-year period, 1981. Nor are the projections to be considered recommendations for policy actions. The figures merely represent extrapolations of conditions beyond next year. Nevertheless, the projections indicate that a balance in the Federal budget will be achieved by FY 1979 if current assumptions are correct and the recommendations in the President's budget message are adopted.

The Need for Responsible Accounting

The balance of the Federal budget by FY 1979 would have a favorable impact on the future development of the U.S. economy. Because of the cumulative nature of government spending programs over the years, decisions made during this budget-planning period will largely determine whether or not we will achieve responsible fiscal policy goals in the future. Thus, the long-term impact of current policy decisions should be the basis for all of our economic planning.

There can be confusion about what is necessary to deal with a current problem and the effect of that action on future fiscal flexibility. Too often we in government are prone to make decisions without proper consideration of the cumulative impact of those decisions on the future. To deal with this problem, I am proposing that government accounting be placed on an accrual basis where unfunded liabilities are fully recognized. This would thwart the natural tendency for those at all levels of government to want to claim revenues too early and expenditures too late, thereby postponing the day of reckoning. We have had recent examples of the sharp and painful adjustments that must occur to a local government when things are continually swept under the rug until eventually the rug will cover no more. With each sweeping, future fiscal flexibility is curtailed one more notch. Eventually a government has no flexibility to deal with current problems. The same thing occurs for the Federal government, except the rug can be stretched for a while because, after all, the Federal government prints the money.

The Treasury has been publishing accrual statements for certain individual agencies since 1956 and we now plan to do this on a consolidated basis for the Federal government as a whole. Our target date for the first of these publications -- for the Fiscal Year ending September 30, 1977 -- is early in 1978. I would emphasize that the initial publication will focus on significant accruals that have a major impact on the overall financial condition and operating results of the Federal government. The first set of statements are likely to be accompanied by extensive qualifications. As the reporting process and statement preparation procedures are improved, however, these qualifications will diminish.

Not only will the reader obtain a consolidated financial view of the Federal government but an idea of the magnitude of all liabilities, whether they be funded or unfunded and whether they be due for payment in the near future or the distant future. In these consolidated statements, revenues will be recognized only when they are earned and sure to be collected and expenditures will be recognized no later than the time the liability to pay them is firmly established. We believe that this will bring more responsible accounting to government. Financial problems will surface long before a crisis is imminent, thereby reducing unpleasant surprises. I believe this will permit more reasoned judgments on decisions which impact the future fiscal flexibility of our nation. Our children should not bear the albatross of paying for the excesses of this generation, while their government is unable to cope with problems because it lacks fiscal flexibility.

I realize that there has been concern with the cost of installing elaborate accrual accounting systems in agencies where the need is not clearly established. I want to assure you that I am not advocating a slavish application of textbook accounting to every agency and appropriation without regard to benefits. All Federal agencies have accrual accounting of some sort. What we intend to do is to supplement the data we already have with some missing pieces of major proportions, and by major I mean in terms of governmentwide magnitudes, not individual appropriations.

I also want to say that I am not proposing a change in the basis for calculating the official budget surplus or deficit, or in the manner of justifying appropriations. There are some who advocate accrual accounting for both of those purposes, but I do not want to let the controversy over those applications interfere with my objective of giving the American people a clear business-like disclosure of the overall financial condition of their Government.

Longer-Term Policy Issues

Looking at some longer-term policy issues, I am disturbed by the fact that government spending which has been proved to be a cumbersome tool for short-term economic stabilization continues to be used for such purposes. The reason it is so cumbersome is because of the various lags involved. First of all, there usually is a considerable lag between the time a need is identified, or a claim is made by some special interest group, and the time there is a specific response by Congress to the proposal. Then there is another time lag before the expenditures actually occur and begin to spread throughout the economic system. Whereas at the time when the proposal was initially considered there may have been underutilization of resources in the economy, by the time the program actually comes on stream resources are often fully employed so that the additional government spending leads to greater inflation. Furthermore, such initiatives take on a life of their own.

If there were some way that old programs could be phased down or eliminated during a period of rapid economic expansion, fiscal policy might be more effective as a tool for stabilization purposes. However, experience has shown that this is not the case. Even programs started in a period of economic slack to stimulate the economy most often become a permanent part of the budget.

We must avoid abrupt and excessive changes in government expenditures. No matter how well intentioned, such sharp swings in spending tend to accentuate rather than stabilize the business cycle and serve to increase the uncertainty of developing policies to meet future needs. In turn, this uncertainty is felt in the consumer markets, in the markets for capital goods, and in financial markets.

In addition to government expenditures, I am concerned with the size of the chronic Federal deficits, particularly the negative impact on financial markets and capital formation. The traditional view of the government's role in the business cycle was that deficits would be recorded in periods of economic slack, but that surpluses would occur in periods of above-average economic activity. As a result, savings would be available to the private sector for the capital formation necessary to sustain the economic advance in real terms. Obviously this has not occurred in recent years where we have had deficits in periods when there is less than full utilization of our resources.

These deficits, of course, need to be financed and such financings in periods of prosperity hurt the economy. They place the U.S. Treasury in a position of preempting private investors. The recent avalanche of Treasury securities has created distortions in the traditional patterns of funds being raised and, in my judgment, this has contributed to making our financial markets less efficient in recent years in channeling the savings of society to investment opportunities. As a result, capital formation is impeded.

Furthermore, deficits cumulate over time. Total Federal debt has increased from $329.5 billion at the end of FY 1966 to an estimated $633.9 billion at the end of FY 1976 -- a rise of 92 percent in only 10 years time. Over the past ten years the average maturity of the debt has declined from 5 years, 3 months to 2 years, 5 months. What this means is that the U.S. Treasury must be a more frequent visitor in financial markets simply to roll over outstanding securities let alone to raise funds for current deficits. In this fiscal year (1976) the U.S. Treasury will absorb over 70% of all moneys in the securities markets; government at all levels will absorb over 80%. This percent must be sharply reduced as the economic advance continues or else some private areas will have to go without.

This problem of "crowding out" becomes far more critical of course as the recovery progresses and the financing needs of the private sector intensify. If deficits remain large, the Treasury, by being first in the credit line, will always get its needs financed but in so doing may make it difficult for companies with less than a prime financial rating to obtain the financial resources they need at acceptable interest rates.

Moreover, as annual interest payments grow with increases in the total debt, fiscal flexibility is eroded further. This "uncontrollable" outlay of over $45 billion in FY 1977 is the third largest item in the budget. It puts pressure on the total budget, which in turn means that programs must be displaced or tax reductions foregone. (A more extensive discussion of crowding out is found in Appendix A.)

The size of the deficit also affects the rate of capital formation in the private sector, and this is a matter of great concern. As the recovery progresses, private capital investment needs to increase to sustain the recovery. In the next decade, the need for increased capital formation is extremely large. This need has been carefully documented by the Treasury, by numerous outside studies, and, most recently, in Chapter 1 of the Economic Report of the President. If we are to meet our goals for increased employment and productivity in a non-inflationary environment as well as our environmental, safety and energy goals, we must have an increase in the rate of national savings and private direct investment relative to the total GNP.

The achievement of our capital formation goals depends on the necessary expenditures being financed in the private sector. In turn, the adequacy of capital flows depends on the savings of society being less and less used to finance Federal expenditures and more and more focused on capital formation. This is the only way we can sustain a durable recovery over the long run and bring down the level of inflation. If the private sector is unable to finance capital formation because of the huge demands on savings by the Federal Government and because of the resulting strains and distortions introduced in financial markets, the boom-and-recession sequence of the last decade may be repeated. Therefore, it is imperative that we reduce the Federal deficit and work toward budget surpluses as the recovery progresses.

Another aspect of the crowding out problem is the secular deterioration I see in the financial structure of U.S. businesses. Over the past decade there has been a strong trend towards a much more leveraged corporate balance sheet. Debt has roughly tripled; liquid assets have declined relative to liabilities; the debt-equity ratio has about doubled; and the average maturity of debt has shrunk. Just as the Treasury is a more frequent visitor to credit markets, so too will many companies, and if there is an intense competition for funds, it is quite clear that the less than prime rated company will be the loser. Continuing heavy Treasury borrowings will eventually cause difficulties for these companies, small businesses and potential home owners.

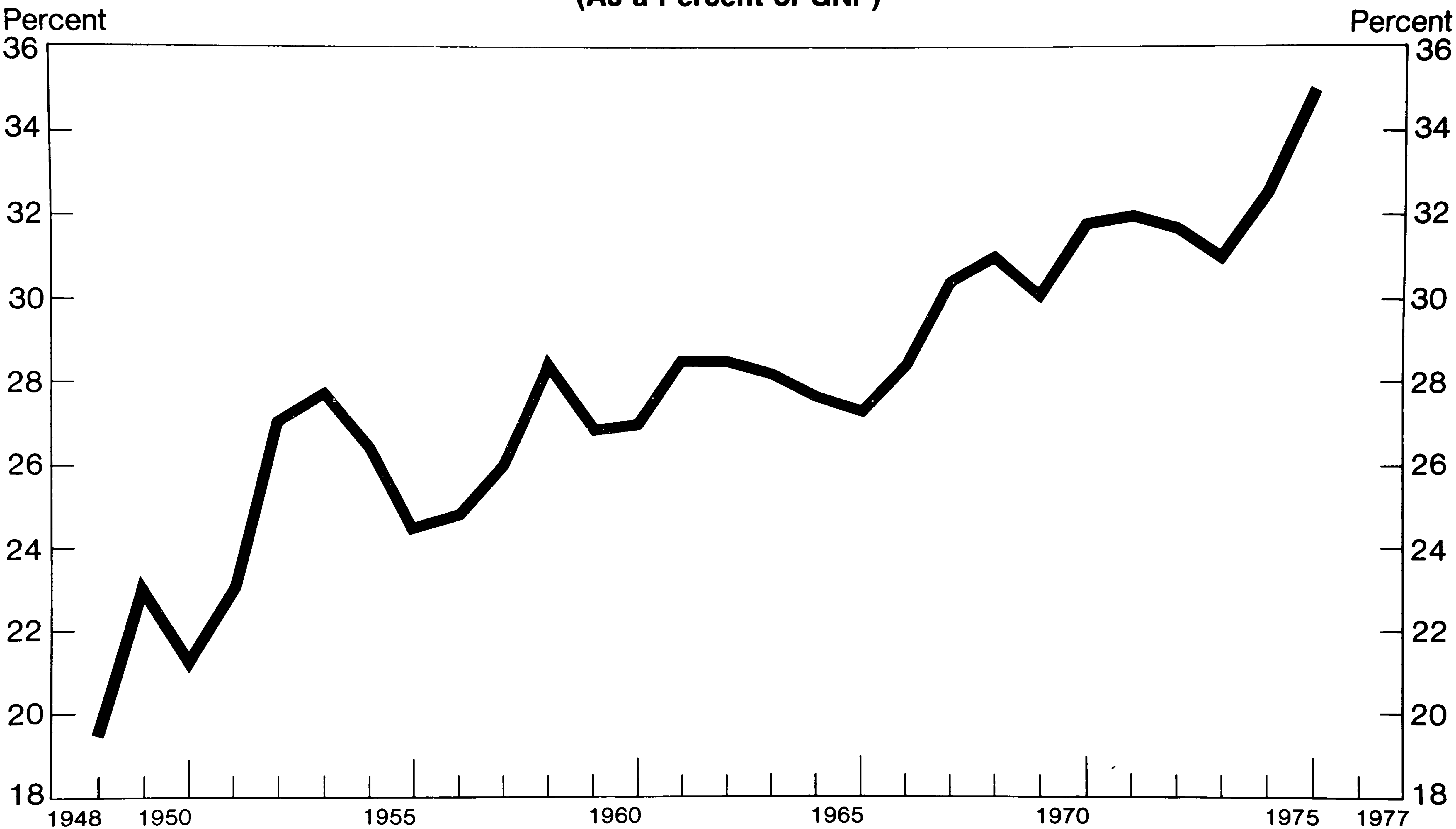
For both fiscal and monetary policies, the problem of instability is compounded by the present inflation psychology that permeates our society. All too readily the economy will move to a higher level of prices, but only grudgingly will it move to lower prices despite slack demand. This inflation psychology has been building for a decade and its unwinding will not be easy. The achievement of economic growth without accelerating inflation could be upset by fiscal and monetary policies that are, or even appear to be, overly stimulative.

In addition, such excesses will lead to bottlenecks developing in certain key industries well before the economy as a whole reaches full employment. This occurred in 1973 in such industries as steel, paper, chemicals and fertilizers. The dislocations caused by bottlenecks send inflationary tremors throughout the economy and lead to inefficiencies which ultimately can curtail a recovery in real terms.

We must act wisely and responsibly in bringing stability to our economy. The excesses of the past are not easily undone. Excessive spending, excessive credit creation, excessive stimulation all may provide a short-term palliative, but before long additional inflation and production bottlenecks set in and economic performance declines. The stop-and-go policies of the past fifteen years have led to an instability which now is deeply rooted in our society. To come to grips with this issue we have designed a responsible mix of economic policies that will bring about durable lasting economic prosperity which benefits our nation with sustainable and increasing employment.

Thank you.

TOTAL GOVERNMENT EXPENDITURES
(As a Percent of GNP)



Source: Department of Commerce

TABLE 1

Budget Estimating Errors

Fiscal year	Overestimate (+) or Underestimate (-) as a Percent of the Actual Figure			
	Estimates made 18 months prior to the end of the fiscal year		Estimates made 6 months prior to the end of the fiscal year	
	Outlays	Receipts	Outlays	Receipts
1950 1/	+4.1	+10.3	+7.8	+1.9
1960 1/	-0.3	-1.7	+1.6	+0.2
1970 2/	-0.7	+2.6	+0.7	+2.9
1971 2/	-5.0	+7.3	+0.6	+3.1
1972 2/	-1.1	+4.3	+2.0	-5.2
1973 2/	-0.1	-4.9	+1.3	-3.1
1974 2/	+0.1	-3.4	+2.3	+1.9
1975 2/	-6.2	+5.0	-3.4	-0.8

Office of the Secretary of the Treasury
Office of Tax Analysis
1/23/76

1/ Administrative budget.

2/ Unified budget. The first estimate on a unified budget basis was prepared in January 1968.

TABLE 2

BUDGET RECEIPTS BY SOURCE

(In billions of dollars)

	1975 actual	1976 estimate	TQ estimate	1977 estimate
Individual income taxes-----	122.4	130.8	40.0	153.6
Corporation income taxes----	40.6	40.1	8.4	49.5
Social insurance taxes and contributions------------	86.4	92.6	25.2	113.1
Excise taxes----------------	16.6	16.9	4.4	17.8
Estate and gift taxes-------	4.6	5.1	1.4	5.8
Customs duties--------------	3.7	3.8	1.0	4.3
Miscellaneous receipts------	6.7	8.3	1.5	7.2
Total budget receipts:	281.0	297.5	81.9	351.3

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TABLE 3

CHANGES IN BUDGET RECEIPTS
(In billions of dollars)

	1975 estimate	1976 estimate	TQ estimate	1977 estimate
ceipts under tax rates and structure in effect Jan.1,1974---	290.8	310.2	87.2	371.3
crease in import fee on petroleum products by administrative action-----------------	+0.4	+1.7	-	-----
acted legislative changes:				
Social security taxable earnings base increases:				
$13,200 to $14,100 effective Jan.1,1975-------	+.1	+1.6	+.4	+2.1
$14,100 to $15,300 effective Jan.1,1976-------	-----	+.2	+.6	+2.4
$15,300 to $16,500 effective Jan.1,1977 1/------	-----	-----	----	+.8
Tax Reduction Act of 1975--------	-10.2	-9.8	-.2	+.4
Revenue Adjustment Act of 1975---	-----	-6.0	-.5	-1.3
Liberalized deduction for individual contributions to pension plans-----------------	-0.2	-.3	-.1	-.5
Reduction in telephone excise tax	-.1	-.4	-.1	-.9
Increase in SMI (medicare) premium	+.1	+.1	+.1	+.3
Total receipts under existing legislation----------------	281.0	297.3	87.4	374.6
anges due to tax proposals:				
Individual and corporation income tax reductions, effective July 1, 1976---------	-----	-----	-5.4	-28.1
Financial Institutions Act-------	-----	-----	----	-.3
Stock ownership incentives-------	-----	-----	----	-.3
Accelerated depreciation on investment in high unemployment areas-----------------	-----	-*	-*	-.3
Social security tax rate increase from 11.7% to 12.3% effective January 1, 1977 1/ --	-----	-----	----	+3.3
Unemployment tax rate and base increase Jan.1, 1977------	-----	-----	----	+2.1
Other-------------------------	-----	+0.2	-*	+.1
Total receipts under existing and proposed legislation---	281.0	297.5	81.9	351.3

ess than $50 million.

The effect of the taxable earnings base increase is calculated using a tax rate of 11.7%. The effect of the tax rate increase is calculated using a taxable earnings base of $16,500.

23/76

TABLE 4

THE FISCAL OUTLOOK, 1975-81
(In billions of dollars)

	1975	1976	TQ	1977	1978	1979	1980	1981
Outlays under current programs---	324.6	373.7	98.2	391.9	420.4	441.8	465.0	489.2
Outlays under proposed programs--	-----	-.2	-.2	2.3	9.1	13.9	17.5	20.7
Total projected outlays-----	324.6	373.5	98.0	394.2	429.5	455.7	482.5	509.9
Receipts under current law-------	281.0	297.3	87.3	374.1	430.1	491.7	555.1	623.9
Effects of proposed tax changes--	-----	.2	-5.5	-22.8	-23.4	-26.4	-32.0	38.4
Total projected receipts----	281.0	297.5	81.9	351.3	406.7	465.3	523.1	585.4
Budget margin or deficit (-)-----	-43.6	-76.0	-16.1	-43.0	-22.8	9.6	40.6	75.5

1/23/76

TABLE 5

Net Funds Raised in the Securities Markets by Major Sector
(fiscal years, billions of dollars)

	U.S.Treas. 1/	Federal & sponsored agencies 2/	Total Federal sector	State & local 3/	Corp. & foreign bonds 4/	Total securities	Federal sector as a % of total	Gov't sector as % of total 5/
1960	.8	1.6	2.4	5.7	4.9	13.0	18.6	62.4
1961	2.0	-.2	1.8	4.9	6.3	13.0	14.0	51.8
1962	8.8	2.2	10.9	6.0	5.7	22.6	48.4	74.7
1963	6.4	1.0	7.4	5.5	6.2	19.2	38.7	67.5
1964	2.7	1.5	4.2	5.2	6.4	15.8	26.5	59.6
1965	3.1	2.2	5.3	6.9	7.9	20.1	26.3	60.6
1966	-1.0	6.8	5.8	7.3	10.9	24.0	24.1	54.5
1967	-.6	2.7	2.1	6.0	13.0	21.1	9.8	38.5
1968	18.2	5.6	23.8	7.2	16.4	47.4	50.3	65.5
1969	-1.9	5.8	3.9	12.0	15.9	31.8	12.2	50.0
1970	6.8	8.2	15.0	9.7	16.8	41.5	36.2	59.4
1971	20.5	2.8	23.3	15.0	27.5	65.8	35.3	58.2
1972	19.6	8.7	28.3	15.6	21.7	65.6	43.1	66.9
1973	18.5	14.4	32.9	12.6	15.4	60.9	53.9	74.7
1974	2.1	21.3	23.4	17.0	17.4	57.7	40.5	69.9
1975	51.9	15.8	67.7	16.8	33.5	117.9	57.4	71.6
1976	87,5 (est.)	14.3	101.8	14.0	25.1	140.9	72.2	82.2

Office of the Secretary of the Treasury
Office of Debt Analysis

January 8, 1976

Source: FY 1960-1975 data based on Federal Reserve Flow-of-Funds accounts (which show net changes in outstandings).

1/ Net increase in marketable and nonmarketable bills, notes and bonds. (Includes Federal Financing Bank.)
2/ Increase in bills, notes and bonds of budget and sponsored agencies. Includes GNMA pass-throughs.
3/ Increase in notes, bonds and Government loans.
4/ Increase in bonds and notes with original maturities of more than 1 year.
5/ Includes State and local as part of government sector.

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TABLE 6

Unified Federal Budget Surplus or Deficit in Relation to GNP
1954-1977

Fiscal Year	Budget Surplus (+) or Deficit (-) ($ billions)	Budget Surplus (+) or Deficit (-) as % of GNP: Annual	Budget Surplus (+) or Deficit (-) as % of GNP: Three-Year Moving Average (Centered)
1954	- 1.2	-0.3	-
1955	- 3.0	-0.8	- .0
1956	+ 4.1	1.0	0.3
1957	+ 3.2	0.7	0.3
1958	- 2.9	-0.7	-0.9
1959	-12.9	-2.7	-1.1
1960	+ 0.3	0.1	-1.1
1961	- 3.4	-0.7	-0.6
1962	- 7.1	-1.3	-0.9
1963	- 4.8	-0.8	-1.0
1964	- 5.9	-1.0	-0.7
1965	- 1.6	-0.2	-0.6
1966	- 3.8	-0.5	-0.6
1967	- 8.7	-1.1	-1.5
1968	-25.2	-3.0	-1.2
1969	+ 3.2	0.4	-1.0
1970	- 2.8	-0.3	-0.7
1971	-23.0	-2.3	-1.6
1972	-23.2	-2.1	-1.9
1973	-14.3	-1.2	-1.2
1974	- 3.5	-0.3	-1.5
1975	-43.6	-3.0	-2.7
1976e	-76.0	-4.8	-3.4
1977e	-43.0	-2.3	-

January 16, 1976

APPENDIX A

CROWDING OUT--SETTING THE RECORD STRAIGHT

There clearly exists some misunderstanding about the meaning and significance of the so-called phenomenon of "crowding out." In essence, there is the idea that since financial collapse has not yet occurred, then the whole issue is misleading. This is wrong. What has occurred is a focussing of attention on short-run improvements in financial markets (associated primarily with the worse recession since the 1930's) and an ignoring of what happens longer-term as the economy moves back toward fuller capacity under conditions of repeated huge sized government budget deficits.

No matter how viewed, the inescapable fact is that with reasonably full use of capacity, more resources claimed by the government must mean less for the private sector. Huge deficits which take the lion share of credit flows will eventually push out the weaker private areas--specifically potential home owners, small businesses and even larger companies who do not have a superior credit rating. This in turn will hurt real growth, deprive our workers of adequate productive tools, frustrate the achievement of our longer-term economic needs, and further misallocate our scarce resources. (This was pointed out repeatedly in prior testimony, e.g., January 25, 1975, before the House Ways and Means Committee.)

1. Interest Rates. Interest rates have declined over the past year or so as would be expected during a recession. High-grade bond rates have fallen from a peak of about 10.5% in mid-1974 to around 8.5% today. Yet this drop cannot be taken as sufficient evidence that credit is ample and more importantly that credit will remain ample to support a lasting business recovery. This cost of long-term funds is still very high historically. (Such interest rates ranged between 2%-6% from 1865-1965--a period containing serious wars, depressions, financial panics, business booms and other assorted economic extremes.) The combination of sustained high Federal government financing, of a growing demand for private financing as the expansion proceeds and of a Federal Reserve policy which must eventually moderate in generosity (to avoid rekindling inflation) points to a level of interest rates and availability of funds for private areas which are not consistent with our long-run needs. Total government borrowings this fiscal year will absorb a record 82% of funds available in the securities market; this percent eventually must be sharply reduced or else some private areas will have to go without.

2. Availability of Credit. Funds are more readily available to more sectors of the economy today, but again this too reflects the cyclical slack in the economy and not the longer-run secular forces at work here. In the first quarter of 1975 about 5% of all new bond issues were Baa-rated or less. By the fourth quarter, it was almost 10%. (This is still below rates close to 20% at times in 1971 and 1972 however.) More lesser-rated companies are

able to finance today. Unfortunately, a lot of these bonds are for shorter duration--5-7 year maturity as opposed to 20-30 year maturity which was the norm not too long ago. This will raise problems in the future since the companies will have to refinance more frequently (referred to as the "rollover" problem in point 4 below). The most important issue immediately ahead is whether such lesser rated companies will continue to find the necessary funds to sustain the economic advance. When credit markets eventually tighten (as is inevitable), problems of credit availability will occur and their severity will be directly proportional to the relative borrowings of the government.

3. Financing of Deficit. The relative "ease" with which the Federal government financed the deficit in 1975 should not be viewed as a normal state of affairs. The fact is that private needs for credit were low because of the recession but as the recovery gains momentum this year, private credit needs will rise. For example, total short-run business borrowing declined in 1975 by about $14 billion; this year it is expected to rise by about $20 billion which is a swing of almost $35 billion. What this means is that there will be a much higher need for total credit in 1976 than in 1975 and eventually some private areas will be squeezed. This is why it is imperative to take steps now to limit the rise in Federal government spending (up almost 40% in just two years time). Not only is future flexibility lost if this cannot be accomplished but the deficit will remain huge and some private areas will not be financed.

4. Financial Structure. Over the past decade there has been a strong trend towards a much more leveraged and brittle structure of corporate balance sheets. Debt has roughly tripled, liquid assets have declined relative to liabilities, and the debt-equity ratio has about doubled. Sustained high Federal budget deficits will eventually create pressures in financial markets that will cause difficulties for lesser-rated companies (in terms of debt rollover) let alone leave sufficient credit for expansion needs.

5. Capital Formation. Several studies clearly point to a much heavier need for investment over the next several years if there are to be enough jobs for a growing labor force, a healthier environment for our people and a higher degree of energy self sufficiency in the United States. (The share of business investment in GNP must increase from an average of 10.4% over the past 10 years to 12.0% for the rest of this decade--an historically unprecedented change.) Sustained high Federal budget deficits will automatically frustrate the fulfillment of those capital needs by depriving many, many private areas of needed financing to build the new factories and buy the advanced machinery. The real dimension of crowding out becomes much more persuasive and severe the further ahead we look.

Conclusion: Crowding out is a genuine problem whose major economic impacts will occur ahead if something is not done about excessive Federal budget deficits caused by too rapid

a rise in government spending. The serious nature of this issue should not be masked because of the impacts of a recession. If steps are not taken to exercise better fiscal control, some areas in the private sector will go without needed financing; capital formation will be less than desired; and our serious unemployment and inflation problems will be that much further from a satisfactory resolution. The following excerpts from Professor Paul McCracken's article on the January 8 editorial page of the Wall Street Journal is a well articulated discussion of budget deficits and the phenomenon of "crowding out":

"There is here, however, a more substantive problem. It is the failure of conventional fiscal policy wisdom to face the full implications of the fact that an increase in the federal deficit, from accelerated spending or more tax reduction, must be financed. And the added funds that the Treasury must then borrow are funds not then available to others in the market for financing. . . .

"Markets have, of course, substantial capacity for accommodating to changes in demands, and effects on other borrowers of swings in budget deficits of modest proportions will not be large. When, however, the U.S. government had to raise funds at the rate of $81 billion per year in the first half of 1975, after a $5 billion pace a year earlier, the 22% decline in money for home and commercial mortgages during that period can hardly be assumed to have been an entirely unrelated development.

"The question was never whether a large deficit would cause a disintegration of financial markets, or a collapse of capitalism, or some other catastrophe of draconian proportions, though some have pointed to the absence of such cosmic disaster as evidence that the "crowding out" theory was wrong. The point is the quite common sense one that in financial markets where demands for funds are active, and this is apt to characterize 1976, other claimants for funds will get less than if the large Treasury requirements were not present in the market. The financing "loop" of fiscal policy must be closed.

"This all carries with it some implications for budget strategy in 1976. Within the limits of fiscal discipline that the political process can muster in a quadrennial year, the Congress and the President can continue efforts toward regaining better control of spending without having to worry about the net adverse effect of this fiscal restraint on the economy. Dollars not borrowed by the Treasury will be put to work by other claimants in the money and capital markets. And housing would be a major beneficiary of the easier financial markets that would result. The basic 1976 trend for interest rates, in fact, is more in the hands of those who manage the budget than of the Federal Reserve."

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STATEMENT BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE
THE HOUSE BUDGET COMMITTEE
SEPTEMBER 29, 1975

Mr. Chairman and members of this distinguished Committee:

I am pleased to appear before you this morning to review current economic conditions and to discuss the Federal budget revenue estimates prepared by the Department of the Treasury. My analysis of economic developments and prospects will hopefully contribute to a broader understanding of the economic recovery now underway and the importance of sustaining responsible policies required for achieving both our near-term goals regarding inflation, unemployment and national output as well as our long-term objective of creating a more stable economy. The discussion of projected Federal budget revenues and the related testimony of James T. Lynn, Director of the Office of Management and Budget, concerning anticipated Federal outlays will provide necessary background for decisions about the future course of fiscal policies.

This Committee has a vital role in developing national economic policies. The past decade has been an unusually difficult period as our policy flexibility has been increasingly restricted by the lagged impact of past decisions. In particular, great concern has developed about the impact of Federal spending and tax policies as outlays have accelerated more rapidly than the overall growth of the economy and

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chronic Federal deficits have occurred. Your Committee was created to help correct these serious problems. While I do not agree with some of your policy recommendations, I am impressed by your efforts to create a more organized and disciplined approach to making Congressional fiscal decisions. The First Concurrent Resolution to Congress was a constructive step in providing general economic and spending guidelines. However, the real test for the Congressional Budget Committees is yet to come as the specific actions of individual appropriation committees must be adjusted to conform to the targets to be established by your Second Concurrent Resolution to Congress. I look forward to working with you in preparing these important fiscal policy recommendations which will directly affect the current recovery and the future of the U.S. economy.

I. ECONOMIC OVERVIEW

The United States has developed the most productive and creative economic system in the world. Americans have traditionally experienced rising standards of living as real output has increased, inflation pressures have been relatively moderate and employment opportunities have expanded. However, the performance of the U.S. economy during the past decade has been disrupted by recurring booms and recessions caused by inappropriate fiscal and monetary policies. The resulting excessive rates of inflation and unemployment created serious domestic economic distortions and eventually disrupted the balance of the international system. No matter how well-intentioned the original fiscal and monetary actions may have been, the resulting sequence of overheating and accelerating inflation, followed by periods of recession and unemployment, has been a heavy price to pay for temporary economic benefits.

In planning economic policies for 1975 the Administration believed that recovery would begin by midyear if three fundamental adjustments could be accomplished: (1) the unwanted accumulation of inventories could be liquidated and new orders increased; (2) "real incomes" of consumers could be restored by reducing the double-digit level of inflation and initiating tax reductions and rebates which would stimulate personal consumption; and (3) employment would begin to increase rapidly enough to reduce the unemployment rate and strengthen consumer confidence. Fortunately, these adjustments have occurred.

During the first three months of 1975 the real output of goods and services continued to decline at a seasonally adjusted annual rate of 11.4 percent but economic performance was already beginning to shift as personal consumption increased. Most of the recession weakness was concentrated in the private investment sector where residential construction and business investment declined and a large liquidation of inventories occurred. During the last three months of 1974 business inventories accumulated at a seasonally adjusted annual rate of $18 billion. In the first quarter of 1975 the situation was reversed as business inventories were liquidated at a seasonally adjusted annual rate of $19 billion. In the second quarter the pace of liquidation accelerated to a level of $31.0 billion.

As spring progressed other significant economic improvements occurred. The annual rate of consumer price increases dropped from the double-digit level of 1974 to a 6 to 7 percent zone and the Tax Reduction Act of 1975 was passed in March. As a result, real disposable personal income increased during the second quarter following five consecutive quarterly declines. The turnaround of consumer purchasing power further strengthened personal spending and enabled people to improve their financial situations as the savings rate jumped from 7.5 percent during the first quarter to 10.6 percent in the second quarter. As these favorable developments pushed final sales above current levels of production, a runoff of inventories occurred beginning at the retail level and then spreading back through the system into the manufacturing sectors. New orders turned upward in April and inventories have started to rise once again at the retail level.

As economic conditions improved employment began to rise again in April. The "lay-off" rate has declined steadily each month through 1975 and the average number of hours worked and the amount of overtime have increased. The general measure of industrial production finally bottomed out in April and four consecutive months of expansion have been reported. Exports continued at a strong pace throughout this period and rising government spending has occurred at all levels. The long declines in residential construction and new car sales stopped in the spring and these two basic sectors are no longer dragging the economy down. The seasonally adjusted annual rate of new housing starts rose to 1260 thousand units in August, up from the low annual rate of 980 thousand units in April, and domestic automobile sales have steadily improved for several months. The rate of recovery in these two basic sectors has been sluggish but at least the negative results reported in 1974 and early in 1975 have been reversed.

It is now recognized that the turning point for the U.S. economy was reached sooner than expected -- probably by April or May -- and that the initial pattern of recovery has been somewhat stronger than anticipated. The public's general perception of the improving developments will continue to lag far behind actual events -- by as much as nine months or more according to some public opinion experts -- but the economic recovery does appear to be well underway. Perhaps the best overall measure of the recovery is the swing in "real" GNP -- the total output of goods and services with the effects of price changes removed -- from a sharp decline in the first quarter at an annual rate of 11.4 percent to a positive performance in the second quarter when output increased at an annual rate of 1.9 percent (both figures are seasonally adjusted).

The conclusion that the U.S. economy has started to recover does not mean that our fundamental economic problems have suddenly been solved or that we will not continue to suffer specific economic disappointments during the coming months. The present level of economic activity is still inadequate and we can never be satisfied until the current excessive levels of inflation and unemployment are substantially reduced. Even though some acceleration is likely to occur over the coming months if consumer spending remains strong, corporate profits improve and the stimulative effects of the investment tax credit are felt in 1976, business capital spending remains sluggish. Therefore, the outlook for residential construction and business capital investment suggests that the recovery pattern for the entire economy is likely to be moderate. But I also believe that improvement will be more sustainable if responsible fiscal and monetary policies are supported.

Unfortunately, the hoped-for recovery of residential construction and business investment will be hampered by the disruptive impact of massive Federal debt financing requirements. Although some analysts assume that the financial needs of an economic recovery can be automatically filled, the reality is that mortgages, consumer debt and business spending for fixed investment and inventories must compete against unprecedented Treasury borrowing requirements which will continue throughout this year and into the future. Two weeks ago the Treasury announced that it would need to borrow new money totaling $44 to $47 billion during the second half of Calendar Year 1975. When these anticipated needs are added to the $36.1 billion actually raised during the first half of Calendar Year 1975 the annual total rises to $80 to $83 billion. This excludes new money raised by the issuance of guaranteed securities and Government-sponsored agencies which we estimate at $6.0 billion and $3.0 billion respectively in the current calendar year.

We have substantial refunding requirements this year. Apart from the rollover of the $77 billion of privately-held regular weekly and monthly bills, $23.0 billion of privately-held U. S. Treasury coupon issues will be refunded this year.

The heavy Treasury borrowing requirements have become the dominant factor in the financial markets at the same time that private sector needs are expected to increase. The severity of the recession, particularly the rapid runoff of inventories, has moderated the private demand for credit. enabling the Treasury needs to be met, but there is already clear evidence that some firms have been unable to obtain desired financing and even successful borrowers have had to pay historically-high interest rates. The future pace of the economic recovery will depend upon the availability of credit across the broad spectrum of economic activity. If specific sectors, such as residential construction, or large numbers of businesses who do not have top-level credit ratings, are unable to obtain necessary financing both the strength and sustainability of the recovery will be disappointing. The impact of such large Treasury borrowing needs resulting from the deficits must receive greater attention in preparing general economic forecasts since we can have only as much economic expansion as available financing will support. This was the basis of our warnings about the financial disturbances of restricted access to funds and rising interest rates that would result when private borrowing needs generated by the recovery have to compete against Treasury borrowing. Unfortunately, financial market developments already indicate that these problems are occurring.

We must also be concerned about renewed inflation pressures. The slowdown in the rate of price increases during the first half of 1975 was reversed by the disappointing statistics reported for June and July. While those specific monthly statistics were not an accurate representation of the underlying rate of inflation -- just as the 0.2 percent increase in the CPI for August was an aberration on the low side -- most analysts now anticipate that inflation will persist in the 6 to 8 percent zone. That level of inflation is clearly inconsistent with our Nation's other basic economic goals. Because these inflation pressures have been accumulating for many years actions to correct them will require a sustained effort.

A third problem involves the unacceptable level of current unemployment which is the direct result of the recession. Although large employment gains have occurred since April, the unemployment rate is still in the 8-1/2 percent zone. Further progress in reducing the level of unemployment is expected as the economic recovery moves back to full activity. For several quarters real output will actually exceed the long-term target growth rates.

During the transition period, it has been necessary to sharply increase the funds allocated to manpower programs, public service employment, unemployment compensation benefits and other social programs to alleviate the recession's impact. But I hope that we will avoid the traditional errors of overheating the entire economy by adopting policies of excessive fiscal and monetary stimulus. That approach might temporarily contribute to the reduction of the unemployment rate but the "stop-go" patterns of the past indicate that excessive stimulus eventually tends to create more problems than solutions.

Considering all of the pluses and minuses, it is clear that we are well into an economic recovery which should accelerate as we move into 1976. However, the strength and durability of this recovery is not certain -- particularly if a renewed surge of price increases or the expectations of inflation disrupt the pattern of economic activity. The amount of actual slack in the economy is uncertain and policy makers should not underestimate the strength of the economic recovery. Extensive stimulus has already been provided by the widespread increase in Federal outlays, the recent tax cut and monetary actions. Monetary policies have been responsive as the money supply (M_1) has increased at an annual rate of 8.6 percent over the past seven months since mid-February. A broader money supply measure, which includes net time deposits (M_2), increased at an annual rate of 11.3 percent over the same time period. Specific money supply growth rates tend to fluctuate widely from week to week but the Federal Reserve System does appear to be following policies which will support the economic recovery. As to fiscal policies, the large tax cut passed in March provided tax relief of $22.8 billion and Federal outlays increased from $268.4 billion in FY 1974 to $324.6 billion in FY 1975, a gain of 21 percent. If outlays in FY 1976 actually rise to the level of $368.2 billion recommended by your Committee in its report of April 14, 1975, that would mean that Federal spending would have increased $100 billion in just two fiscal years, a two-year percentage jump of 37.2 percent. This surge of spending created a huge Federal budget deficit of $43.6 billion in FY 1975 and the shortfall for the current fiscal year will be even larger. In February 1975 the President submitted a budget which called for a FY 1976 Federal deficit of $51.9 billion. The Mid-Session Review of the 1976 Budget published May 30 raised the anticipated deficit to $59.9 billion. In the First Concurrent Resolution on the Budget-Fiscal Year 1976 submitted as a Conference Report to the Congress on May 9, a deficit of $68.8 billion was recommended. Unless the Executive Office and the Congress cooperate in tough and responsible action to control Federal spending the prospective deficit could even escalate to $90 billion and the outlook for future years is for more Federal budget deficits. The challenge is clear.

In addition to the substantial increases in the size of our budget deficits I am particularly concerned about the rapid increase in expenditures. As summarized in Table 1, Federal outlays increased from $97.8 billion in FY 1961 to $324.6 billion in FY 1975, an increase of 232 percent. From 1961 to mid-1975 the entire GNP increased from $520.1 billion to $1440.9 billion, a gain of 177 percent (the mid-1975 figure is the GNP figure reported for the second quarter at a seasonally adjusted annual rate). The Federal budget has clearly grown more rapidly than the total U.S. economy. These budget outlay increases -- including the changes in FY 1976 -- are spread throughout the Government and tend to become permanent. If we are to have the necessary fiscal flexibility to meet our current and future priorities, we must regain control over Federal outlays.

II. FEDERAL REVENUE ESTIMATES

Turning next to the important topic of Federal revenues, I would first like to describe the analytical techniques used by the Department of the Treasury and then discuss our most recent estimates. Within the Treasury the estimating functions are assigned to an Assistant Director of the Office of Tax Analysis and a staff of five professionals whose duties are divided between the preparation of general receipts estimates and the analysis of specific revenue changes that might result from proposed tax legislation initiatives.

The beginning point for our estimates is the preparation of detailed GNP forecasts by the professional staffs of the Treasury, Council of Economic Advisers and Office of Management and Budget. Using these general forecasts of national output and information obtained from various sources the Treasury then prepares monthly collection estimates for several major categories. We also revise the estimates at the beginning of each month to reflect current collection experiences. Finally, the potential impact of any proposed or recently enacted tax legislation is added or subtracted from the basic estimates. Legislative changes are handled directly because the time series information used in the calculations would not include the effects of new tax initiatives.

The tax collection experience of the past five years is summarized in Table 2. Over the five-year period, Fiscal Years 1971 through 1975, individual income taxes accounted for 45 percent of all unified budget revenues, corporate income taxes for 15 percent, social insurance taxes and contributions (consisting of "employment taxes and contributions," "unemployment insurance" and "contributions for other insurance and retirement") accounted for 28 percent and all other sources combined represented the remaining 12 percent. It is also interesting to note the relative stability of each source of revenue as a share of the total even though economic conditions and specific tax legislation change over time.

The methods used for estimating each major source of revenues are as follows:

Individual income taxes -- The individual tax receipts model includes: (1) an equation which estimates current calendar year liabilities, other than capital gains taxes, as a function of personal incomes adjusted to eliminate transfer payments and other labor income and to add the employee payments for social insurance; (2) an equation which estimates current realized capital gains subject to taxation; and (3) an equation which estimates the withheld tax liabilities as a function of quarterly wage and salary figures. The amount of withholding collections must be estimated on a current monthly basis and the income tax withholding must be separated from the social security withholding. There are significant time differences between the tax liability period and the payment date for different payment methods. The model also develops estimates by source of individual tax payments, including refunds, and converts the figures into a monthly and fiscal year collection pattern.

The income tax liability for a given calendar year is estimated by benchmarking on the last actual year. On the basis of past experience, the change from the benchmark year liability is then estimated by correlation with the projected change in personal income (adjusted to a concept of income subject to tax). This gives an estimate of the tax liability excluding the tax on capital gain income. Capital gains, which are not included in the concept of personal income are volatile and often change in opposition to changes in personal income. They are, therefore, treated separately. Even so, estimated capital gains are only approximations for the calendar years in which stock prices and market volume are known. For future years the estimates are subjective.

The estimated total individual income tax liability for the calendar year is then broken down by major method of payment, including refunds, on the basis of historical relationships. Withheld taxes are estimated by means of relationship to salaries and wages by quarters. Refunds are estimated as a percentage of withheld taxes. Payments other than withheld taxes are estimated as a residual after subtracting withheld taxes less refunds from the total liability estimate. This residual is then broken down into estimated tax payments, payments on final tax returns and back taxes, again on the basis of past relationships. All of the past data have to be further adjusted for changes in tax law in order to obtain meaningful relationship. Considerable uncertainty in the relative proportionalities has been introduced in recent years. In the past decade, rarely have there been two years, back to back, in which the methods of payments have not been affected by legislative and administrative changes.

Corporation income taxes -- This model begins with an estimate of calendar year corporate profits before taxes as measured in the national income accounts. The next step is to determine the overall tax rate percentage to apply to the profit estimates. The actual percentage collected will vary according to the mix of economic activity, accounting policies and differences between gross and net tax liabilities. The third step is to determine the "collections lag" which will determine which fiscal year the estimated gross liability will apply to. Finally, the size of corporate income tax refunds must be estimated based on an analysis of the expected tax liabilities and the timing of economic recessions and recoveries. Greater percentage errors occur in preparing corporate income tax collection estimates because the basic variables are more volatile and the availability of information is not as good. Unfortunately, there have been only two or three years in the past twenty-five in which there was no statutory change in the coverage or timing of current estimated payments. In addition, corporations are allowed three methods of computation in determining whether they complied: (1) a current estimate for the year if within 80 percent, (2) annualization as the year progresses if within 80 percent, and (3) the preceding year's tax. This mix results in variations in the pattern apart from the statutory changes and increases in forecasting difficulty. In any event, past collection patterns modified by recent collection experience and expected pattern alterations form the basis for collection forecasts, monthly and for the fiscal year or years. There is a good deal of intuition and judgment in the final result.

Employment taxes and contributions -- This category includes FICA, SECA (for self-employed), deposits by states of their employee-paid portion of social security taxes for covered state employees, Federal employer deposits of employees share of social security taxes for Federal employees not covered by the retirement system, railroad retirement taxes, and premiums for uninsured participants enrolled in the Federal hospital insurance trust fund. The annual estimates of liabilities and receipts, except for railroad retirement taxes, are made by the Social Security Administration and then Treasury produces quarterly and monthly collection estimates.

Unemployment insurance premiums -- The Department of Labor normally prepares estimates of collections although Treasury may occasionally prepare internal revisions based on employment data and historical experience.

Contributions for other insurance and retirement programs -- Various government agencies are responsible for preparing estimates of collections related to programs under their jurisdiction and these figures are collected by the Office of Management and Budget and then given to the Treasury. We then prepare monthly collection estimates based on historical experience.

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<u>Excise taxes</u> -- Historical experience is used to forecast excise tax collections with some effort to anticipate future income levels. Annual estimates of the various trust fund excise taxes are jointly prepared by the Treasury and the responsible government agency.

<u>Estate and gift taxes</u> -- Estimates are based on stock prices and historical experience.

<u>Customs duties</u> -- Estimates are based on current levels of GNP results.

<u>Miscellaneous receipts</u> -- Deposited earnings of the Federal Reserve System accounted for nearly 90 percent of the miscellaneous receipts in FY 1975. The only other major source of miscellaneous revenue in FY 1976 is the import fee and tariff on crude oil and petroleum products. This figure is based on estimates of future imports, prices and demand assumptions.

In general, the Treasury is responsible for the overall estimates of revenues but it must obtain necessary economic forecasts and information from a variety of outside sources. This procedure obviously creates the possibility that revenue estimates may turn out to be inaccurate because of errors: (1) in preparing the forecast of GNP; (2) in estimating the mix of economic activity as a basis for predicting personal incomes and expenditures, business spending and profits, unemployment, government transfer payments, etc.; and (3) in applying the equations developed within the Treasury for estimating probable revenues. Unfortunately, the underlying economic conditions constantly change and tax legislation is modified rather frequently. For example, the FY 1975 budget estimated that personal incomes would total $1,135 billion in 1974. The latest figure, which is still subject to further revision, is reported to be $1,150 billion. The $15 billion underestimate would create an error in estimating individual income tax receipts of at least $2 billion. Similarly, the FY 1975 budget forecast for 1974 corporate profits was underestimated by $17 billion, according to the current figures. That underestimate would generate an error of roughly $5 billion in estimating receipts.

Public and private economic forecasters have experienced great difficulty in predicting both the total GNP and major sectors. No matter how sophisticated our forecasts become, they will still be distorted by unexpected economic and political developments. In the final analysis we must recognize that complex mathematical models and careful human judgments must be combined to estimate future results which will ultimately be influenced by many unforseen developments.

It is also true that the tax law is constantly changing. The econometric models used for preparing the estimates attempt to apply equations to a time series of information in order to project future revenues. Unfortunately, it is difficult to develop these historical relationships because the tax law is changed so often and the specific collection and reporting procedures are frequently adjusted. To the extent that proposals in the President's budget prepared each January are modified, rejected or replaced by other actions, the revenue estimates will be disrupted.

The actual historical record for estimating errors in forecasting Federal receipts and outlays is summarized in Table 3. That record indicates that both under- and over-estimates have occurred over the years and that estimating errors persist even as the time horizon of the forecast shortens. For FY 1975 the Federal Budget revenues were overestimated by 5.0 percent in the original publication in January 1974 and outlays were underestimated by 6.2 percent (estimates prepared eighteen months prior to end of FY 1975 on June 30, 1975). In January 1975, at the mid-point of the forecast year, receipts were underestimated by 0.8 percent while outlays were underestimated by 3.5 percent. These errors are attributable to at least three major factors: (1) large changes in the underlying economic forecasts; (2) legislative actions; and (3) internal reestimates of the outlays and receipts as the year progressed. In summary, it is clear that economic forecasting -- including the estimating of Federal Budget revenues -- is far from qualifying as an exact science. The Treasury will continue to work with the best technical methods known to us and we will strive to

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refine our judgments as much as possible but the blunt fact that Federal budget revenue forecasts will continue to be subject to errors should be recognized by everyone.

In the Mid-session review of the 1976 Budget published May 30, revenues for FY 1976 were estimated to be $299.0 billion. Our latest estimates of expected FY 1976 revenues fall within a range of $297.6 to $305.6 billion. In preparing these estimates several key assumptions must be made as to future decisions concerning the Tax Reduction Act of 1975, tax withholding rates and various energy policy issues, including the status of the $2.00 oil import fee and the $0.60 fee applied to products. If the $2.00 oil import fee is continued (but not the product levy) and the tax relief provided by the 1975 Tax Reduction Act is discontinued, the revenue estimates would be at the high end of the range indicated. If the tax relief is extended, along with adjustments to the withholding rates to maintain the amounts of taxes withheld (at current levels), and the $2.00 oil import fee is not continued, then the revenues collected would probably be at the low end of the range. Since the final decisions may combine different variations of several different policies we believe that it is more realistic to estimate a range of possible collection figures.

It should be emphasized that these revenue estimates are still very tentative and contingent upon the basic decisions about tax and energy policies referred to above. In addition to the legislative uncertainties, a number of forecasting problems have complicated our FY 1976 revenue estimates:

1. The underlying forecasts for total GNP, personal income corporate profits, personal consumption, business investment, foreign trade and other important economic sectors are still uncertain at this early stage of the economic recovery. Even a small percentage change in these basic figures has a major impact on the actual taxes collected.

2. Possible inaccuracies in estimating individual capital gains (1974 figures will not be available until late 1975).

3. The potential effects of corporate net losses in calculating refunds is uncertain. It should also be emphasized that corporate accounting practices have frequently changed. For example, many companies have changed their accounting for inventories from a FIFO to a LIFO basis and such adjustments have had a major impact on the timing of tax collection.

4. Uncertainties about the receipts lag in collecting corporate tax liabilities given the flexibility corporations have in paying their taxes and the sharp drop in profits in calendar year 1975 measured on a National Income Accounts basis.

5. Uncertainties about the probable behavior of individuals in adjusting their personal claims for exemptions in order to adjust the amount of taxes currently withheld.

III. SUMMARY

Although the U.S. economy appears to be well into a period of economic recovery a very large Federal deficit will occur in FY 1976 and FY 1977 following the deficit of $43.6 billion in FY 1975. These unusual deficits result from: (1) an erosion of current tax revenues caused by the severe economic recession; (2) a temporary increase in Federal outlays intended to moderate the impact of the recession; (3) a permanent type increase in Federal outlays resulting from past legislative decisions and the initiation of new spending programs; and (4) the tax relief provided by the temporary Tax Reduction Act of 1975. The return to strong economic activity will restore the tax collections to a more normal level and reduce the temporary outlays directly related to the recession but this will not solve the fundamental erosion of fiscal stability caused by the rapid escalation of Federal spending and periodic permanent tax cuts.

Some analysts have claimed that the budget deficits of FY 1975 and FY 1976 are merely aberrations which will disappear once the economy returns to a normal pace. Unfortunately, the historical pattern of Federal budget deficits and the outlook for future fiscal years does not support this optimistic conclusion. At the end of FY 1976 we will record the fifteenth Federal Budget deficit in the last sixteen years. Furthermore, the pattern of increased Federal spending is not concentrated in the "temporary" automatic stabilizers associated with the recession. As summarized in Table 4, large spending increases have occurred throughout the permanent programs of the entire government. Even the emergency programs created for temporary relief tend to become part of the permanent activities of government.

The rapid increase in Federal outlays is not necessarily wrong if one agrees that more functions should be transferred from the private sector to the government. My strong preference is to maximize the role of the private sector because I believe that it is more efficient and responsive to the interests of our people and because I believe this approach provides for more individual freedom. This debate will continue and we cannot hope to resolve it during these hearings. However, one basic consideration is indisputable: When the combination of private and public sector demands exceeds the productive capacity of our economy an inflationary overheating of the economic system occurs. The total productive capability of the entire economy must be identified as a beginning point for ranking and selecting claims against the potential national output. Estimating the total economic capacity of the system and the existing private and public claims would help us avoid the simplistic arguments that additional government programs can be continuously created to meet every claim by simply shifting resources from the private to the public sector. Adding new government commitments is not feasible if the productive capacity of the economy is exceeded. This basic 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, such as occurred in the mid-1960's and again during the early 1970's.

Some analysts have claimed that adding new government spending programs is no threat because of the amount of slack created in the economic system by the severe recession. Beyond the fact that our measures of capacity and excess resources are very uncertain, I believe that this recommendation misses the basic point: The fiscal decision of the past have already eroded our fiscal flexibility in responding to the problems of the present and the future. If we accept the recommendations to expand Federal spending even more we will create permanent claims that will further disrupt the allocation of resources in the future. Many government programs now involve an "entitlement authority" which makes the actual outlays open-ended depending upon the eligibility rules and benefits established. There has been a tendency to liberalize both guidelines and many government programs are now indexed so that they rise automatically as inflation occurs. Other outlays are required by specific legislative and contractual agreements. In the future, there should be no such thing as an "uncontrollable" Federal budget commitment because the Congressional Budget Committee discipline will require careful consideration of priorities and the elimination of ineffective programs during the annual appropriations process. We must correct the historical approach of merely continuing existing programs so that any new claims were typically "added on" to current outlays.

I believe that by concentrating on short-term stabilization goals rather than the long-term allocation of resources our fiscal policies have actually become a disruptive force. Too often fiscal policies have lagged economic developments so that the desired stimulus or restraint typically arrives long after the economic situation has changed. The "emergency" spending programs created to pull the economy out of a recession often exaggerate the subsequent overheating of the economy and create additional commitments that last far into the future. A corresponding reduction of such programs during periods of economic expansion is unusual because the Executive Office and the Congress have been unwilling to shift their attention to longer-term goals or to face up to the agonizing experience of saying no.

This country now faces the reality of a strong challenge to our basic fiscal stability. Your Committee is a key factor in determining whether or not this challenge will be met. In preparing your Second Concurrent Resolution to Congress I hope that you will consider the future course of fiscal policies -- particularly the escalating pattern of Federal spending and "off-budget" commitments -- as well as the need to develop guidelines for FY 1976. We need to consider longer-term goals by relating the future impact of current government spending actions. When we consider the total impact of our fiscal decisions we will recognize that individual pieces of legislation cannot simply be added to existing commitments without considering what current claims need to be eliminated or curtailed. Too often we have ignored the economic discipline of allocating scarce resources to different claims according to national priorities which are responsive to the interests of the American public. The economic distortions of the past decade indicate that this was a costly decision. Your Committee has a major opportunity to help correct these distortions and I look forward to working with you as you attempt to achieve that goal. Thank you.

TABLE 1

FEDERAL BUDGETS

CHANGES IN THE UNIFIED BUDGET OUTLAYS

BY FISCAL YEAR, 1961-1976

(dollars in billions)

Fiscal Year over Preceding Year	Federal Outlays	Dollar Increase	Percentage Increase	Surplus or Deficit
1961	$ 97.8	$ 5.6	6.1	-3.4
1962	106.8	9.0	9.2	-7.1
1963	111.3	4.5	4.2	-4.8
1964	118.6	7.3	6.1	-5.9
1965	118.4	-0.2	--	-1.6
1966	134.7	16.3	13.8	-3.8
1967	158.3	23.6	17.5	-8.7
1968	178.8	20.5	13.0	-25.2
1969	184.5	5.7	3.2	+3.2
1970	196.6	12.1	6.6	-2.8
1971	211.4	14.8	7.5	-23.0
1972	231.9	20.5	9.7	-23.2
1973	246.5	14.6	6.3	-14.3
1974	268.4	21.9	8.8	-3.5
1975	324.6	56.2	20.9	-43.6

Source: Economic Report of the President, February 1975, Table C-64, p.324, for years 1961 through 1974; 1975 figure from Final Monthly Treasury Statement of Receipts and Outlays of the United States Government, for period from July 1, 1974 through June 30, 1975.

TABLE 2

Net Unified Budget Receipts, by Source, Percent of Total, and Five-year Average
Fiscal Years 1971-1975

	1971	1972	1973	1974	1975	5-year average
			Fiscal Year ($ billions)			
Individual income tax	86.2	94.7	103.2	119.0	122.4	105.1
Corporation income tax	26.8	32.2	36.2	38.6	40.6	34.9
Employment taxes and contributions	41.7	46.1	54.9	65.9	75.2	56.8
Unemployment insurance	3.7	4.4	6.1	6.8	6.8	5.5
Contributions for other insurance and retirement	3.2	3.4	3.6	4.1	4.5	3.8
Excise taxes	16.6	15.5	16.3	16.8	16.6	16.3
Estate and gift taxes	3.7	5.4	4.9	5.0	4.6	4.7
Customs duties	2.6	3.3	3.2	3.3	3.7	3.2
Miscellaneous receipts	3.9	3.6	3.9	5.4	6.7	4.7
Total budget receipts	188.4	208.6	232.2	264.9	281.0	235.0
			Fiscal Year - Percent			
Individual income tax	45.8%	45.4%	44.5%	44.9%	43.6%	44.7%
Corporation income tax	14.2	15.4	15.6	14.6	14.5	14.8
Employment taxes and contributions	22.1	22.1	23.6	24.9	26.8	24.1
Unemployment insurance	2.0	2.1	2.6	2.6	2.4	2.4
Contributions for other insurance and retirement	1.7	1.6	1.6	1.5	1.6	1.6
Excise taxes	8.8	7.4	7.0	6.4	5.9	7.0
Estate and gift taxes	2.0	2.6	2.1	1.9	1.6	2.0
Customs duties	1.4	1.6	1.4	1.3	1.3	1.4
Miscellaneous receipts	2.0	1.7	1.7	2.0	2.4	2.0
Total budget receipts	100.0	100.0	100.0	100.0	100.0	100.0

Office of the Secretary of the Treasury
Office of Tax Analysis

September 18, 1975

Note: Figures are rounded and may not add to totals.

TABLE 3

Budget Estimating Errors

Fiscal year	Overestimate (+) or Underestimate (-) as a Percent of the Actual Figure			
	Estimates made 18 months prior to the end of the fiscal year		Estimates made 6 months prior to the end of the fiscal year	
	Outlays	Receipts	Outlays	Receipts
1950 1/	+4.1	+10.3	+7.8	+1.9
1960 1/	-0.3	-1.7	+1.6	+0.2
1970 2/	-0.7	+2.6	+0.7	+2.9
1971 2/	-5.0	+7.3	+0.6	+3.1
1972 2/	-1.1	+4.3	+2.0	-5.2
1973 2/	-0.1	-4.9	+1.3	-3.1
1974 2/	+0.1	-3.4	+2.3	+1.9
1975 2/	-6.2	+5.0	-3.4	-0.8

Office of the Secretary of the Treasury
Office of Tax Analysis

September 19, 1975

1/ Administrative budget.

2/ Unified budget. The first estimate on a unified budget basis was prepared in January 1968.

TABLE 4

CHANGES IN BUDGET OUTLAYS BY FUNCTION; FY 1976 over FY 1975

(millions of dollars)

Function	FY 1975 (1)	FY 1976 (2)	Change over FY 1975	House Budget Committee Resolution (3) FY 1976	House Budget Committee Resolution (3) Change over FY 1975
National defense	87.4	94.1	+6.7	89.7	+2.3
International affairs	5.0	5.5	+0.5	4.9	-0.1
General science, space, and technology	4.3	4.6	+0.3	4.6	+0.3
Natural resources, environment and energy	9.7	10.3	+0.6	11.5	+1.8
Agriculture	1.8	2.0	+0.2	1.8	--
Commerce and transportation	12.6	15.7	+3.1	19.8	+7.2
Community and regional development	4.6	6.1	+1.5	9.5	+4.9
Education, manpower and social services	15.0	16.8	+1.8	20.4	+5.4
Health	27.6	29.0	+1.4	30.7	+3.1
Income security	109.1	122.8	+13.7	123.9	+14.8
Veterans benefits and services	16.7	17.1	+0.4	17.4	+0.7
Law enforcement and justice	3.0	3.3	+0.3	3.4	+0.4
General government	2.7	3.2	+0.5	3.4	+0.7
Revenue sharing and general purpose fiscal assistance	7.0	7.3	+0.3	7.2	+0.2
Interest	31.2	34.4	+3.2	35.0	+3.8
Allowances	--	6.8	+6.8	1.1	+1.1
Undistributed offsetting receipts	-14.1	-20.0	+5.9	-16.2	+2.1
Total	323.6	358.9	+35.3	368.2	+44.6

(1) Mid-Session Review of the 1976 Budget, May 30, 1975, Table 9, p.15.

(2) FY 1976 Administration estimates as published in Mid-Session Review of the 1976 Budget.

(3) First Concurrent Resolution on the Budget-Fiscal Year 1976, Report of the Budget, House of Representatives, Appendix A-2, p.49.

e Department of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 964-2041

FOR RELEASE AT 4:00 P.M. February 6, 1976 172

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $6,400,000,000 , or thereabouts, to be issued February 19, 1976, 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 November 20, 1975, and to mature May 20, 1976 (CUSIP No. 912793 ZH 2), originally issued in the amount of $3,401,085,000, the additional and original bills to be freely interchangeable.

182-day bills, for $3,600,000,000, or thereabouts, to be dated February 19, 1976, and to mature August 19, 1976 (CUSIP No. 912793 A5 5).

The bills will be issued for cash and in exchange for Treasury bills maturing February 19, 1976, outstanding in the amount of $6,405,015,000, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,836,230,000. 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 non-competitive 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 Standard time, Friday, February 13, 1976. 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 February 19, 1976, in cash or other immediately available funds or in a like face amount of Treasury bills maturing February 19, 1976. 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.

Department of the TREASURY
OFFICE OF REVENUE SHARING
WASHINGTON, D.C. 20226
NEWS
TELEPHONE 634-5248

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FOR IMMEDIATE RELEASE
FRIDAY, FEBRUARY 6, 1976
CONTACT: PRISCILLA R. CRANE (202) 634-5248

Data to be used to allocate funds for the final (seventh) entitlement period of the general revenue sharing program are being sent to all units of general-purpose government for review and comment today.

The U. S. Treasury Department's Office of Revenue Sharing is sending to each of approximately 39,000 units of local government the latest available figures on its own population, per capita income, local tax collections adjusted for taxes attributable to education expenses and intergovernmental transfers.

On February 23, 1976, state governments will be provided their most recent data for population, urbanized population, state and local taxes, general tax effort, state individual tax collections and federal income tax liabilities.

Counties, cities, towns, townships, Indian tribes and Alaskan native villages are invited to review the figures and if changes are needed, to notify the Office of Revenue Sharing and provide documentation to support proposed changes by March 5, 1976. State governments must respond by March 15, 1976.

General revenue sharing funds are allocated according to formulas set forth in Title I of the State and Local

Fiscal Assistance Act of 1972 (revenue sharing law). The formulas use data pertaining to each unit of government which are provided primarily by the Bureau of the Census of the U. S. Department of Commerce. The amount of money each government receives for an entitlement period is based on the data applicable to that government in relation to the data for others.

Today's mailing of new data also includes special forms for recipient governments whose figures for the coming entitlement period may have been affected by major natural disasters since April 1, 1974. The Disaster Relief Act of 1974 provides that pre-disaster data may be used for such governments in the allocation of shared revenues. Recipient units of government so affected are provided both their pre-disaster and post-disaster data elements. They are asked to certify whether the disaster caused the less favorable post-disaster figures. If so, the Office of Revenue Sharing will use the pre-disaster data in allocating seventh entitlement period general revenue sharing funds.

The final entitlement period of the general revenue sharing program, as presently authorized, will extend from July 1, 1976 through December 31, 1976. Quarterly checks will be mailed to recipient governments in October 1976 and January 1977. A total of $3.33 billion is available to allocate and distribute for the period.

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Allocations of funds are announced by the Office of Revenue Sharing in April, after all data changes have been entered into the system and the allocations have been run.

In April 1975, President Ford asked the Congress to act promptly to renew general revenue sharing past its present 1976 deadline. Hearings were held in the fall of 1975 by the Subcommittee on Intergovernmental Relations of the House Committee on Government Operations. No hearings have been scheduled in the Senate as yet.

Since the general revenue sharing program first was authorized, in 1972, more than $23.5 billion has been paid directly to nearly 39,000 states and local governments. A total of $30.2 billion will have been paid when the present program expires.

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e Department of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 964-2041

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REMARKS BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
AT THE
REPUBLICAN REGIONAL CONFERENCE
WASHINGTON, D.C., FEBRUARY 7, 1976

It gives me great pleasure to come to this podium today and see so many friends from the battles of the last few years.

Soon after I came down here to Washington 3 years ago, many of us in this room were thrown together to struggle with the energy embargo imposed on us by foreign nations. That was a difficult struggle, but we survived that blackmail and now we're hopefully on our way to energy self-sufficiency. I have always appreciated the personal help that you gave me during the energy crisis.

Then about a year ago, many of us here began working together in fighting the twin evils of inflation and recession. And now although that battle is by no means won, there can no longer be any doubt how it will come out -- if we can only stay on course. Inflation has been cut nearly in half in the past 12 months, and yesterday's news on unemployment showed the biggest single drop in unemployment in more than 15 years. All of us recognize that New England still faces massive unemployment problems, but we know we're on the right track and I assure you we will stay there until this battle is won.

In the midst of the recession, there was still a third challenge which brought many of us together: the urgent need to restore the financial integrity of New York City. Again our struggle was long and difficult. Again, the struggle is by no means over. But again, I believe we know today that we are on the right course and that it can be won.

So the struggles of the last few years have not been easy. Many said we would never succeed. The doomsayers, those that are so willing to predict disaster at every turn -- remember the predictor's depression, analyses of our federal

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system -- $1 bread, $1 gas, $1 sugar, $1 toilet paper. Did any of these predictions come true? No -- but that does not discourage them. They have been crying at our doorstep as long as I can remember. But they continually forget that this is not some banana republic; we have never been a people who cave in at the first sign of trouble. The rock-hard determination of the pilgrims who came to Massachusetts, Rhode Island and other ports of entry along the Eastern seaboard still fires the American spirit. As Winston Churchill once said while his own country was under siege, "We have not journeyed all this way across the centuries, across the oceans, across the mountains, across the prairies, because we are made of cotton candy." No, we are of better stock, and I'm damn proud of it.

Everyone who has grown up in the Northeast was brought up to believe, as I still do, that our country has developed the most efficient and creative economic system the world has ever known.

It is really a marvel, bringing material benefits to our people that are unsurpassed in the history of mankind. Literally tens of millions of poor immigrants came to the United States since the early 1800's in search of a better life and achieved for themselves, their children, and their children's children a standard of living that was beyond their fondest hopes. This economy is so strong and dynamic that since the early 1960's despite the abuses we have inflicted on it, remarkable progress has been made:

-- The real income of the American family has increased by over 40% (and that's after inflation and taxes);

-- Total production has risen by over 60% in real terms, even after allowing for three recessions over this time span;

-- The percent of families below the poverty line has been cut in half; to 10%.

-- Real farm output has risen over 25%, enabling us to feed not only ourselves but many people in other countries; and

-- Almost 20 million new jobs have been created.

This is not to imply that the private enterprise system is perfect. It does not change human nature nor solve all problems everywhere. It does not guarantee personal and social freedoms. And it does not ensure human happiness. But it provides more men and women with the freedom to decide and the opportunity to obtain economic security than any other system known to man. And it is a powerful safeguard against the erosion of our personal freedoms.

And yet as I have said, despite this excellent overall performance of our free market system, there are strong and growing developments which raise serious concern about the future. America is on a path that may not hold the same promise as in the past. There are clear indications that government at all levels is increasingly constraining innovation, personal initiative, and individual spending decisions. And at the same time poll after poll points to a rising disenchantment by the public with business and with government.

In a more concrete sense, let me call your attention to some economic developments which highlight the creeping and excessive rise in government activity in our economic affairs:

In 1930 total government spending -- that is, spending by Federal, State and local government -- was about 12% of our GNP. By 1950 it was 21% and this year it will be around 35%. In other words, over one in every three dollars of income is now spent by government. And if current trends prevail, government spending will reach nearly 60% of our GNP by the end of the century.

In FY 1962, Federal Government spending exceeded $100 billion for the first time in history. Since then it has quadrupled, pushing toward $400 billion. Federal government outlays are now running over $1 billion per day or the equivalent of almost $5,500 per year for every family in the United States.

Today's Federal Tax Provisions contain over 6000 pages of finely printed material. No wonder the average citizen feels cut off from his government in Washington. Even my economists at the Treasury, with all their Phds, have thrown up their hands at Form 1040 and now go to the Tax Specialists.

It took 75 years for the national debt to reach $1 billion, an event which occurred in 1863 during the Civil War. Today it is growing by a billion per week. Is there any wonder why we have an inflation problem? Up in the Northeast, you manufacture many wonderful products for our people; in Washington,

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the only products we seem to manufacture are hot air and inflation.

There are over 5000 forms required by the Federal Government today which take business over 130 million work hours to fill out. The costs of simply processing these forms by the government are estimated to be an incredible $15 billion a year. These costs must ultimately show up in higher prices to consumers.

In five years, under the government's monopoly over the Postal Service, the cost of a first class stamp has more than doubled. As Bob Hope said when they raised the price last time, "Now they're going to charge us 10¢ for delivery and 3¢ for storage."

Regulatory agencies directly control economic decisions of airlines, railroads, trucking, broadcasting, power production, energy, the securities market -- almost 10% of everything we make. Furthermore, there are other indirect controls (including environmental protection, safety regulations, consumer requirements) which affect the costs in a great variety of industries.

The point of all this is to try to give you a feeling for some serious and distrubing economic changes I see and hopefully an understanding of what President Ford is trying to do regarding these developments. We in the Administration genuinely want to stem the tide toward ever bigger government, to an ever larger and more cumbersome bureaucracy -- not just to be anti-government -- but because of a fundamental belief that the market mechanism can do a much better job in meeting the needs and preferences of the American people.

The thrust of the President's recommended spending and tax policies is to strike an appropriate balance between long-and-short-term needs, between conflicting and yet desirable objectives. As outlined in the new Budget there is to be a fairness and balance:

-- Between the taxpayer and those who will benefit by federal spending;

-- Between national security and other pressing needs;

-- Between our own generation and the world we want to leave to our children;

-- Between the desire to solve our problems quickly and the realization that for some problems, good solutions will take more time; and

-- Between Federal control and direction to assure achievement of common goals and the recognition that state and local governments and individuals may do as well ~~or~~ better without restraints.

President Ford's program clearly strives to bring about a durable and sustained economic advance that will steadily reduce unemployment but at the same time will not bring back high rates of inflation. Some people say our program isn't bold enough. I say that this is probably the boldest program we have had in years, because we now have a President who goes before the American people and doesn't promise them the moon. That's the kind of "boldness" we ~~need~~ in America today. We are not going to fall into the trap of trying to spend our way to prosperity again. It is precisely the kind of impatience with the speed of economic recoveries which has overheated the economy twice in the last decade, and I would hope that we have learned our lessons about such stop-go policies. There is no real benefit in helping people get jobs for a while, only to bring about even greater hardship later on.

The President's proposals deal with four major objectives.

First, to reduce the unemployment rate, several new steps have been proposed to keep the economic recovery moving ahead, including,

-- A permanent tax cut of approximately $28 billion to become effective on July 1; and

-- Accelerated depreciation for the construction of plant and equipment in areas experiencing high unemployment (in excess of 7%). As many economists in New England have recognized, this provision could be especially beneficial in revitalizing industry and creating new jobs in the Northeastern states.

Second, to prevent the inflation from accelerating back toward high-single or double-digit inflation. The President is proposing that:

-- Projected Federal spending for the coming fiscal year be cut by some $28 billion. This would mean not only that a tax cut would be possible but that Federal spending gains would be limited to only 5-1/2% in FY 1977 (compared to a total rise of 40% in the past two fiscal years);

-- It also means that the Federal budget would be brought into actual balance within three years and that another major tax cut could be enacted before the end of the decade.

Third, to slow the rise of government influence on the economy,

-- The growth in total outlays is to be limited not only in FY 1977 but well beyond;

-- Reforms are to be pursued in terms of excess and counter-productive regulations in order to move toward more competitive markets; and

Finally, to meet the pressing need for greater capital formation and long-term job creation:

-- Corporate tax rates and the Investment Tax Credit are to be permanently shifted to the present more favorable base;

-- Double-taxation of dividends is to be eliminated; and

-- Middle income taxpayers are to be given incentives to invest in common stocks in order to broaden and strengthen stock ownership in American companies.

To a far greater extent than in the past, our policy must take into account long-run needs and not focus almost exclusively on short-run problems with their expedient "solutions". In the long run there is no substitute for sound, sustained, even-handed policies that create an environment in which private enterprise can flourish.

It took a long time for our economic problems to build up and it is going to take a long time to wring them out of the economy. There is no quick fix. We cannot pay for the sins of a decade with the one year's penance. Some say that the principles and ideals of the past no longer work. Somehow they are no longer relevant. What nonsense. It is not that our principles have failed us but that we have failed to live up to them.

With patience and responsibly balanced policies - and with firm adherence to sound economic principles -- we can eventually work ourselves back to a healthy growing economy on a stable enduring basis. If the country chooses the route of stop-go again, we will have only ourselves to blame for the inevitable problems that will develop.

It seems to me that we are faced with a fundamental choice -- not only for 1976 but well behond -- in the kind of economy and society we want. The economic objectives of more jobs and stable prices may be pretty well agreed to, but the routes to them are very different. Our emphasis in the Republican Party is on a sound durable expansion that will permit the free market to live up to its potential. The other route is one that holds out a false, cruel promise of a more rapid return to prosperity but at a cost of future hardship and further erosion of our economic and personal freedoms.

President Ford has set a course which points us in the right direction and will permit us to get a much better grip on these problems, but it will take several years, not months, to bring this about. Unfortunately, the election is only a bit over nine months away. There will be calls from the opposition for "sweeping changes" and "broad new initiatives" which will really mean bigger spending, bigger deficits and ultimately bigger governmental control of the economy. We must persuade the American people that this course is wrong and that our approach is much sounder in the long run. The real choice is between greater government control or greater individual freedom.

That is the battle before us. But we have been through the fires before -- over energy, over inflation, over recession, and over New York City. And just as we have proved that we could win those battles, I am confident that we will win this one, too.

Ours is a great cause, and America will be even greater because of our success.

Thank you.

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FOR IMMEDIATE RELEASE February 9, 1976

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3.1 billion of 13-week Treasury bills and for $3.9 billion of 26-week Treasury bills, both series to be issued on February 13, 1976, were opened at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS: 13-week bills maturing May 13, 1976 : 26-week bills

	Price	Discount Rate	Investment Rate 1/
High	98.790	4.840%	4.98%
Low	98.779	4.884%	5.03%
Average	98.782	4.872%	5.01%

	13-wk		26-wk
	4.811	Last week	5.066
	4.872	To-day	5.133
High since	5.266	1/5/76	5.521

Tenders at the low price for the 13-week bills w
Tenders at the low price for the 26-week bills w

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESER

District	Received	Accepted	Recei	
Boston	$ 115,325,000	$ 62,325,000	$ 32	
New York	3,929,000,000	2,553,800,000	5,214	
Philadelphia	24,390,000	24,390,000	33	
Cleveland	49,395,000	37,915,000	61	
Richmond	25,515,000	25,515,000	74	
Atlanta	37,410,000	29,950,000	30	
Chicago	180,425,000	99,725,000	244	
St. Louis	56,200,000	34,800,000	40,400,000	12,400,000
Minneapolis	28,325,000	21,925,000	24,905,000	9,905,000
Kansas City	31,435,000	26,245,000	20,085,000	14,385,000
Dallas	31,755,000	19,045,000	26,900,000	10,900,000
San Francisco	197,815,000	164,815,000	407,460,000	229,360,000
TOTALS	$4,706,990,000	$3,100,450,000 a/	$6,211,385,000	$3,901,215,000 b/

a/Includes $344,435,000 noncompetitive tenders from the public.
b/Includes $149,470,000 noncompetitive tenders from the public.
1/ Equivalent coupon-issue yield.

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FOR IMMEDIATE RELEASE FEBRUARY 9, 1976

STATEMENT OF THE HONORABLE CHARLES M. WALKER
ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY
BEFORE THE 1976 ADVANCED STUDY SESSION OF THE
AMERICAN BAR ASSOCIATION SECTION ON TAXATION
(JOINTLY SPONSORED WITH THE AMERICAN LAW INSTITUTE-
AMERICAN BAR ASSOCIATION) HOUSTON, TEXAS
FEBRUARY 9, 1976

This is an appropriate occasion to step back for a moment from the day-to-day work of the Treasury Department, Office of Tax Policy and to take advantage of the collected experience of the tax experts in this gathering to discuss the subject of the long-range objectives of tax policy.

In a recent speech in New York City, Secretary Simon expressed his desire to move toward a radically simplified income tax system, sweeping away the exemptions and deductions of the present law, and obtaining needed revenue by a progressive structure of rates substantially below those now in use. Judging by the mail received in the Treasury from a great variety of people, including representatives of many walks of life, Congressmen, a Governor, etc., Bill Simon struck a responsive cord for many people.

The Secretary has clearly done us all a service by taking the lead in this. However, as we practitioners know, to make progress towards this objective we must deal with a large number of policy questions arising from the complexity of the present Code, which over the years has become ever more complex as efforts have been made to provide equity among competing interests and to effect particular resource allocation objectives. Many times additional complexity has arisen from patchwork efforts to correct unforeseen consequences of earlier legislative decisions.

To date, public discussion of this issue has brought forth largely generalized opinions either that it is a wonderful idea and let's do it or that it is a wonderful idea but we'll never do it or we can't do it. Fortunately, there are

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exceptions. A good example of a constructive analysis has been provided recently by my predecessor, Frederic W. Hickman, writing in the Wall Street Journal. Fred lays out with great care several of the issues involved both in the appeal and the political obstacles to a radical reform of the tax system.

My purpose today is to discuss some of the puzzles which must be solved if we are to succeed in developing a radically simplified yet fair and efficient tax system, and to indicate the direction our efforts are taking as we move forward with this project. And let me assure you we are moving forward. We have committed substantial manpower to it; we are in the process of designing appropriate computer programs to aid in the analysis of the various ingredients of the project; and most important of all we have the will and in my opinion the resources to bring forth something very much worthwhile.

The first assignment is to fix our goals. We must have a set of criteria by which to judge the various alternatives to be considered. Today is not the time to lay out all of the desirable characteristics of a tax system. However, let me focus on three broad properties which are certainly of great importance:

The tax system should be fair.

The tax system should promote economic efficiency.

The tax system should be simple.

Let me take a moment to elaborate a bit on these objectives and to illustrate the way they can be analyzed with specific tax provisions in mind. At the outset however I wish to make it very clear that the tax provisions used in the analysis today have been selected today for illustrative purposes only. It is far too early in our study to suggest that any conclusions have been reached or any positions taken with respect to them.

Clearly the tax system should distribute the burdens of financing the Government (both the resources it uses and the transfer programs it has) in a fashion that is widely agreed to be fair and equitable. While there are bound to be differences of opinion about what constitutes fairness, the traditional criteria of horizontal and vertical equity represent a good starting point. Horizontal equity refers to equal treatment of equals. This might be further translated to mean the tax system should assign roughly equal burdens to those whose opportunities and capabilities, for example of earning a living, are the same. Vertical equity refers to the property of assigning relatively larger burdens under the tax system to those whose opportunities and capabilities are relatively more ample.

An example in our present tax system which might be criticized as being neither horizontally nor vertically equitable is the exemption from tax of interest on state and municipal bonds.

Let me first dismiss a false interpretation of what constitutes horizontal equity. It is sometimes said that the tax-exempt bond provision is horizontally inequitable because it treats income from such bonds differently from income from a taxable corporation bond. This misses the point however, since the person holding the one clearly has the opportunity to purchase the other so that this choice is made voluntarily. Thus since everyone with capital to invest has the same opportunity to purchase tax-exempt bonds there is no horizontal inequity associated with the fact that some choose to purchase them and others do not.

However, there is another way in which horizontal inequity may be said to arise, namely, in the different rates of tax on earnings from capital on the one hand and earnings from personal services on the other. Currently the maximum rate of tax on personal services is 50 percent, while in effect the rate of tax on capital held in the form of tax-exempt bonds is only 30 percent, measured by the difference in yield between the tax-exempt and taxable bonds. Such a difference might be regarded as the effective tax paid on capital in the form of tax-exempt bonds. Thus one might argue there is a horizontal inequity implied by the difference in treatment between income from services and income from tax-exempt bonds.

The same phenomenon arguably leads to a situation of vertical inequity since one person with a larger capability for deriving income, namely one with a large stock of financial capital, might well be taxed implicitly at a lower rate than one who has a smaller capability of deriving income and who must earn it in the form of payment for personal services.

The second major goal of a good tax system noted above should be to foster economic efficiency. One thing this means is that the tax system should be as inexpensive as possible to administer; it should impose as low compliance cost as possible. Furthermore it would be desirable to minimize the effort required of the nation's talended minds to the discovery of tax saving arrangements and to maximize the efforts to enhancement of true economic yield.

However, these costs important though they are, are probably relatively small compared to the potential mischief which can be done by the effect of the tax laws to distort the allocation of resources. For example, the tax system which applies rates so high that individuals are unwilling to put in a full measure of work or to work in the most demanding calling may impose a serious loss of economic output. A tax provision which results in more or less investment taking place in a certain line of activity than is called for by the undistorted demands of the marketplace imposes a similar loss. A further example is seen in the disincentive effect of the corporation income tax. The maximum social yield obtainable from that remarkable form of business enterprise, the limited liability firm, may be substantially impaired. One well regarded economic study places the loss associated with this inefficiency at one-half to one percent of GNP!

Broadly speaking, the inefficiencies which have attracted the most attention of economists who have studied the subject arise from the effects of the tax system on the provision of labor services by the household, including the services of husbands and wives, and the overall supply of saving for capital formation together with its allocation among industries and forms of enterprise.

The third objective noted above is simplicity. This may seem a bit incongruous placed beside the goals of fairness and efficiency. In fact, simplicity should perhaps be regarded as an instrumental objective, one which contributes to the other two. However, given the highly complex state of our tax system I think simplicity must be listed right up there with the other two goals.

We should perhaps distinguish simplicity of different kinds. Most importantly we should distinguish the simplicity of the tax system as it touches the average taxpayer whose income is principally from wages, and salaries from the simplicity relevant to the higher income taxpayer and business enterprise.

For the average taxpayer the income tax system need not be complex, although it has become increasingly so in recent years. As noted above, much of the complexity has resulted from efforts to provide equity among competing interests.

For the upper income and business taxpayer the complexity is much more formidable, arising in part from the sheer difficulty of defining the income from a business activity. Some would regard the complexity faced by the business enterprise or high-income taxpayer as of little moment on the argument that these taxpayers can "afford" the services of tax experts to advise them and prepare their returns. Whatever the intrinsic merits of this view it overlooks the effect on all taxpayers of the existence of a tax system which few can understand. The feeling is increasingly widespread that those who can afford the talents of highly skilled tax advisors are able to avoid paying their fair share of taxes. When few can understand the law confidence in general is sure to be eroded.

Having discussed the goals and illustrated the way in which they can be analyzed in light of particular tax provisions let me now approach the subject of broadening the tax base as a means of furthering the goals.

To broaden the base on which the income tax is levied means bringing into it elements now freed from tax. This approach has clear promise. A broader base would seem likely to be a move in the direction of greater fairness, treating income of all types and sources similarly, thus serving horizontal equity and better defining the basis upon which the vertical equity of the system can be implemented through the progressive system of rates. Furthermore a broader base would allow lower rates of tax thus presumably reducing the distorting effect of the tax system on the allocation of resources, serving the objective of efficiency. Finally, the general approach to base broadening involves the elimination of deductions and exclusions thus serving the objective of simplicity.

When we look closely at some of the major components of the typical approach to base broadening, however, we find that some problems remain. Let me spend a few minutes exploring with you some examples of addition to base, and here again, as noted above, let me make it clear that these are only examples selected to illustrate today the character of the studies underway. There have been no conclusions reached and no positions taken. The examples are: social security benefits; imputed net income from owner-occupied housing; excluded half of capital gains; presently deferred items in retirement plans.

Let me give you a very rough idea of the impact these few changes would have on the annual income tax base. I should emphasize that the figures I am about to give you are very rough preliminary estimates and that they do not take into account all of the refinements which will be involved in a concrete proposal. Presently (calendar 1975) the payments to social security beneficiaries are running at approximately \$60 billion. Of these payments about \$40 billion are received by individuals who file tax returns. Given the present structure of personal exemptions and deductions this would translate into about \$30 billion of taxable income. The net rental value of owner-occupied housing is estimated to be something between \$15 and \$20 billion. The excluded half of capital gains accruing to present tax return filers is estimated at a little over \$15 billion. The earnings on pension funds is estimated to be about \$30 billion.

Taken together these changes amount to nearly \$100 billion of taxable income which is to be compared with the present level of individual taxable income (1975) of almost \$600 billion. Thus these four examples alone might increase the tax base by about one-sixth. Put otherwise adding these items to the tax base would permit a reduction of approximately 15 percent in the tax rates. Naturally any such rate reduction would have to be designed to provide an appropriate distribution of tax burden among income classes.

Let me turn now to a closer analysis of these four rather typical examples of base broadening measures to see how they fare when judged against the three criteria discussed above.

Social security benefits are currently untaxed, regardless of the other income of the recipient. It is often suggested that this source of income should be brought into the income tax base. Generally this proposal is accompanied by the proposal to eliminate the employee's share of the social security payroll tax from the tax base. To tax social security benefits, would serve the interests of fairness, since it would treat those with income from different sources alike and would appropriately tax those with relatively larger incomes. The impact of such a change on the efficiency of the allocation of resources in the economy is not obvious, except that the resulting lower tax rates would be an advantage. A slight plus would be the increased savings for retirement which might be undertaken by those who would pay taxes in order to maintain their after-tax income in retirement. Thus there would be some offset to the inherent bias against capital accumulation in an income tax system. This base broadening step would seem to make its contribution to simplicity also by means of the lower rates. In one respect it might involve increased complexity since it might increase the number of tax return filers.

Imputed net income from owner-occupied housing is another item of income often overlooked but generally recommended by base broadening studies for inclusion in the income tax base. The tax benefit can be seen most easily by asking what the tax consequences would be of my neighbor and me renting each other our identical houses. This would bring the yield from investment in the housing into the tax base even though it would not change the real flow of services in the economy.

In the interests of fairness, this is appealing. It would bring about a parity of homeowners with renters. But this source of horizontal equity may well be exaggerated for the same reasons that we outlined before in the case of the corporate and municipal bonds. That is, since everyone has the choice whether to be an owner or a renter there is a presumption of horizontal equity. The main effect may perhaps be on vertical equity since the institutional forms are such that it is easier for wealthier individuals to be owners and therefore the degree of progression of the tax system is in effect reduced.

The fact that renters and owners would be treated alike would, however, contribute to efficiency, since it would mean that the choice of the tenancy form would not be distorted by the existence of the tax provisions. Furthermore, the lower rates made possible by increasing the base will have a generally favorable impact on the allocation of resources. However, it must be recognized that the imputed income from owner-occupied housing is a yield to capital and therefore the effect of this base broadening would be to increase the overall rate of tax on capital, thus worsening the impact of the tax system on the allocation of resources to capital formation.

On the score of simplicity, it is doubtful that this reform would get very high marks. Most schemes for carrying out an explicit imputation to the owner of the market value of the occupancy of his own house are rather complex. It would be somewhat less complex to adopt the approximate alternative plan of simply eliminating the deductions of property taxes and mortgage interest on owner-occupied houses.

Most base broadening proposals include the elimination of the presently excluded one-half of capital gains. This is argued to be in general accordance with the objective of fairness since it would tend to equalize the treatment of individuals who derive money from personal services with those who derive money from capital. In my view this approach overlooks the related problem of "double taxation" of capital income arising from the imposition of both the personal and corporate income tax on distributed corporate earnings. However for the purpose of this talk I have skirted this issue by assuming full integration of the corporate and individual income taxes together with appropriate basis adjustments associated with undistributed corporate earnings.

The efficiency questions raised by including all the capital gains in the tax base are rather complicated. Again we must make explicit our assumption about integration since corporate stock is one of the major types of assets which yields capital gains. As matters now stand there is a bias in the tax system against equity financing. Bias results from the fact that the corporation income tax base excludes interest paid on debt (that is, it is deductible) but includes dividends paid on stock (that is, dividends are not deductible). Removal of the favored treatment given to capital gains would worsen that bias. With integration of the corporation and individual income taxes that particular source of inefficiency would be eliminated. There remains however the general question of the bias of the tax system agianst capital formation. Since capital gains represent a yield to capital, their inclusion in the tax base would represent an increase in the effective rate of tax on yield to capital, worsening the overall effect of the tax system on the net investment undertaken by the economic system.

There is no doubt that including the presently excluded half of capital gains in the tax base would vastly simplify the Internal Revenue Code. It also would remove a major source of tax litigation and controversy during tax audit.

On the example of retirement plans, the taxation of various categories of income can be deferred until retirement: employer contributions to retirement plans and earnings on plans; contributions to and earnings on Individual Retirement Accounts; earnings implicit on annuities. Consideration could be given to the elimination of some or all of these deferrals under a broad-based tax reform. Generally such a move would seem to be acceptable on fairness grounds.

The access of different individuals to these favored forms of savings varies widely, depending on each person's employment circumstances (however, again here one must add the note that the opportunity for free choice of occupation and use of an IRA mitigates the apparent horizontal inequity). On the grounds of vertical equity this example would seem to be more or less neutral, not favoring inherently any particular income class of taxpayers. On the efficiency criterion we again run into the unfortuante impact of this base broadening step on rewards to savings. At present, the tax deferral on retirement savings provides one way to neutralize the disincentives of the tax system to savings. From the standpoint of simplicity this example would substantially simplify the Code. The employee benefit provisions are very complicated requiring tremendous resources, both in and out of Government, to deal with the long Code provisions and the longer provisions of the Regulations, probably among the most complicated in the tax law.

Let me quickly review. We have been looking at four examples of possibly broadening the tax base. Each of these has been briefly examined against the criteria of improving the tax system with respect to fairness, efficiency and simplicity. The four examples are (1) social security benefits, (2) imputed income from owner-occupied housing, (3) excluded half of capital gains, (4) presently deferred retirement income. The first of these examples, social security benefits, receives positive marks on all three criteria of fairness (assuming the rate structure makes appropriate distribution of the tax burden among income classes), efficiency and simplicity. Second, imputed income from housing receives positive marks for fairness, plus and minus marks for efficiency (with the gain due to a removal of bias against tenant occupied housing but a loss on yield from investment) and a big minus on the criterion of simplicity. The third, the excluded half of capital gains, receives a plus on fairness grounds, a minus on efficiency grounds (since it increases the anti-savings bias) and a big plus on simplicity grounds. Fourth, removing the deferral features for retirement income provisions is rather a neutral change on the criterion of fairness, a minus change from the viewpoint of efficiency (in view of the capital formation incentive effect) and a substantially affirmative change on the grounds of simplicity.

As is not surprising the ideal tax system is not going to jump out of the hat unaided. However, we think we can begin to sort out the issues.

The examples suggest two important points. First, we may have to come up with more innovative approaches to the problems than simple base broadening. Base broadening alone is likely to lead to substantial improvements in some respects but exact costs in other respects which could be avoided by more immaginative approaches.

Second, in thinking about the gainers and losers from changes in the Code of the sort we have been talking about, it may be that a one step at a time approach to improvement may be less promising than a wholesale change. This will have to be carefully evaluated. Achieving a major reform will mean for many removal of features of the law which benefit them. It may be that progress will require a perception that many are giving up a little in the short run for the larger gain of all over the long run.

As our work unfolds, it may be desirable to assemble a blue ribbon advisory group to counsel with us not only on the specifics involved, but also upon the method of implementation.

The more I delve into this subject the more persuaded I am of the desirability of fundamental reform. I am confident that a balance can be achieved among competing objectives and that the result will be very much worthwhile. Certainly I shall welcome all the help you may be willing to give in that effort.

Thank you.

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FOR IMMEDIATE RELEASE

SUMMARY OF LENDING ACTIVITY

January 16 - January 31, 1976

Federal Financing Bank lending activity for the period January 16 through January 31, 1976 was announced as follows by Roland H. Cook, Secretary:

The Federal Financing Bank made the following advances to borrowers guaranteed by the Department of Defense under the Foreign Military Sales Act:

Date	Borrower	Amount	Maturity	Interest Rate
1/20	Government of China	$ 277,631.49	9/30/83	7.513%
1/20	Government of China	20,421,453.67	7/1/83	7.492
1/29	Government of Argentina	3,320,269.76	4/30/83	7.609
1/30	Government of Korea	9,024,708.31	6/30/83	7.486
1/30	Government of Brazil	4,313,200.00	10/1/83	7.612
1/30	Government of Israel	12,859,653.76	6/10/85	7.694

The National Railroad Passenger Corporation (Amtrak) made the following drawings against Note #6, a $130 million renewable line of credit with the Bank:

Date	Amount	Maturity	Interest Rate
1/16	$15,000,000	3/30/76	5.104%
1/27	10,000,000	3/30/76	5.002%

On January 30, Amtrak borrowed $7 million against Note No. 4, a $120 million line of credit. The note matures March 31, 1976. The interest rate is 4.969%. Amtrak borrowings from the FFB are guaranteed by the Department of Transportation.

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The Bank made the following loans to utility companies guaranteed by the Rural Electrification Administration:

Date	Borrower	Amount	Maturity	Interest Rate
1/19	Cooperative Power Association	$4,510,000	12/31/10	8.144
1/19	Associated Electric Coop, Inc.	6,500,000	12/31/10	8.144
1/20	South Mississippi Electric Power Association	6,300,000	1/23/78	6.650
1/30	Oglethorpe Electric Membership Corporation	1,915,000	12/31/10	8.130

Interest payments are made quarterly on the above loans.

On January 20, the Bank purchased $1,000,000 of notes from the Department of Health, Education and Welfare. The Department had previously acquired the notes which were issued by various public agencies under the Medical Facilities Loan Program. The notes purchased by the Federal Financing Bank are guaranteed by the Department of Health, Education and Welfare and mature on July 1, 2000. The interest rate is 8.097%.

On January 28, the United States Railway Association borrowed $1 million against Note No. 3, a $296 million line of credit with the FFB. The line matures February 23, 1976. The interest rate is 5.002%. USRA borrowings from the FFB are guaranteed by the Department of Transportation.

The Student Loan Marketing Association borrowed $15 million on January 29 at an interest rate of 6.60%. The loan matures January 26, 1978. The proceeds of the loan were used to partially repay a $25 million note maturing with the FFB. SLMA borrowings are guaranteed by the Department of Health, Education and Welfare.

The Postal Service borrowed $800 million on January 29. The loan will be repaid in 25 annual installments of $32 million beginning May 30, 1976 and ending on May 30, 2000. The interest rate is 8.075%.

On January 30 the Tennessee Valley Authority borrowed $280 million of 28 day funds at an interest rate of 4.675%. The loan matures February 27, 1976. Proceeds of the note were used to repay $230 million of notes maturing with the FFB and to raise new funds.

On January 30 the FFB purchased a $500 million 5 year Certificate of Beneficial Ownership from the Farmers Home Administration. The maturity is January 30, 1981. The interest rate is 7.77% on an annual basis.

On January 30, the FFB and the Small Business Administration signed a Transfer and Guaranty Agreement dated as of January 1, 1976 whereby the FFB purchased from SBA 3,273 mortgages with a principal balance due of $193 million. The Bank paid $173,032,642.66 for the assets which includes $23,941.04 of accrued interest. The effective rate of return to the FFB is 7.746% calculated on a monthly payment basis. The mortgages have an average length to maturity of approximately 6 years. The final maturity is October 1, 2000. Principal and interest payments to the FFB are guaranteed by the Small Business Administration.

Federal Financing Bank loans outstanding on January 31, 1976 totalled $19.3 billion.

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FOR IMMEDIATE RELEASE February 10, 1976

Secretary of the Treasury, William E. Simon, today called for the broadening and intensification of an Internal Revenue Service drive to uncover tax evasion and avoidance through the improper deduction of bribes and similar wrongful payments both abroad and in the United States. He said he intends to see to it that all those who have made improper payments and bribes do not profit through reducing their Federal tax liabilities. Secretary Simon considers this action essential for the protection of the integrity of the tax system and of the U.S. business community.

The Internal Revenue Service has been working closely with the Department of Justice and the SEC to deal with tax evasion and avoidance through the improper deduction of bribes and other wrongful payments to or for government officials both abroad and in the United States. Commissioner Alexander assured the Secretary that the IRS will give this investigation increased and vigorous emphasis.

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FOR IMMEDIATE RELEASE February 10, 1976

DALE S. COLLINSON
APPOINTED TAX LEGISLATIVE COUNSEL

Secretary of the Treasury William E. Simon today announced the appointment of Dale S. Collinson as Tax Legislative Counsel for the Treasury Department.

Mr. Collinson, 36, will head the Office of Tax Legislative Counsel, a group of lawyers that provides assistance and advice in matters of domestic tax policy and tax legislation to the Assistant Secretary of the Treasury for Tax Policy, Charles M. Walker. Mr. Collinson's appointment was effective December 30, 1975.

Prior to becoming Tax Legislative Counsel, Mr. Collinson served as Deputy Tax Legislative Counsel (1975), Associate Tax Legislative Counsel (1973-74), and Attorney-Advisor (1972-73) with the Treasury Department. From 1966-72, Mr. Collinson was Assistant Professor and Associate Professor of Law at Stanford Law School, and from 1969-70 was an Associate with the firm of Cleary, Gottlieb, Steen and Hamilton of Brussels, Belgium.

A native of Oklahoma, Mr. Collinson received an A.B. degree (Summa Cum Laude) from Yale University in 1960, and an LL.B. degree from Columbia University in 1963, where he was Notes and Comments Editor of the Law Review.

Mr. Collinson is married to the former Susan Waring Smith of Irvington-on-Hudson, New York. They have one son, Stuart, 3, and reside in Arlington, Virginia.

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The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

FOR IMMEDIATE RELEASE February 11, 1976

TREASURY DEPARTMENT SCHEDULES PUBLIC HEARING ON CONSUMER REPRESENTATION PLAN

The Department of the Treasury will hold formal public hearings in Room 4121, Main Treasury Building, 15th and Pennsylvania Avenue, NW, Washington, D.C. on February 23, 1976, to provide opportunity for public comment on the proposed Treasury Department Consumer Representation Plan.

The hearings will he held from 2:00 pm - 5:00 pm and from 6:00 pm - 9:00 pm. The evening sessions have been scheduled specifically to hear testimony from interested parties not able to participate during normal working hours.

Parties desiring to be accorded a place on the hearing schedule should write or call the Treasury Department hearing clerk with the following information:

1. Name
2. Address
3. Telephone number
4. Capacity in which presentation will be made (i.e., public official, organization representative, individual, etc.)
5. Principle issue to be addressed
6. The names of other parties known to have similar positions regarding the principal issue to be addressed.
7. Preferred session to testify.

The deadline for reserving time on the hearing agenda is 4:30 pm Wednesday, February 18, 1976. Parties scheduled to testify are asked to provide the hearing clerk with two (2) copies of their testimony on the day of the hearing. Parties not scheduled to testify, but who wish to do so, are also requested to provide copies of their testimony and will be permitted to speak at the conclusion of the formal hearing agenda on a time-available basis. Additionally, written comments by any interested person, including those who may not have sufficient time to express their full views at the hearing, may be submitted to the hearing clerk before 5:00 pm Monday, March 1, 1976.

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The general public and the press are invited to attend the hearings. The hearings will be transcribed, and along with written submissions will become a part of the record in these proceedings.

Testimony received at the hearings is inteded to further aid the Treasury Department with revision of its proposed Consumer Representation Plan, which appears in detail on page 55221 of the Federal Register for November 26, 1976.

The hearing clerk for the Treasury Department is:

David Lefeve
Main Treasury, Room 1454
15th and Pennsylvania Avenue, NW
Washington, D.C. 20220
Telephone (202) 964-5487 or
(202) 964-8079

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Contact: L.F. Potts
Extension 2951
February 11, 1976

FOR IMMEDIATE RELEASE

TREASURY ANNOUNCES 3-MONTH EXTENSION IN INVESTIGATORY PERIOD ON KNITTING MACHINERY FOR LADIES' SEAMLESS HOSIERY FROM ITALY

The Treasury Department announced today a 3-month extension in the anti-dumping investigatory period on knitting machinery for ladies' seamless hosiery, from Italy. Notice of this action will appear in the Federal Register of February 12, 1976.

A tentative decision was to have been made on February 15, 1976, but will now be made on or before May 15, 1976.

Imports of the subject merchandise from Italy during CY 1974 were valued at roughly $2.25 million.

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Department of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 964-2041

REMARKS BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE THE
JACKSONVILLE BOARD OF REALTORS
JACKSONVILLE, FLORIDA - FEBRUARY 11, 1976

Thank you Mr. Carter, Ladies and Gentlemen.

It is a pleasure for me to be here in Jacksonville, and an honor to be introduced by a man like Jack Carter, who set such an outstanding example of service for his community. And, of course, it's always a delight to visit this beautiful, friendly state, as so many millions of other Americans do each year.

There is, however, a difference between them and me. Almost all of them come to Florida to enjoy the warm weather and tropical sunshine. I'm here to cool off -- I have to take all the heat I need back in Washington.

Considering the many problems our country has had to face in recent years and the many hard decisions that still lie ahead, it is only reasonable that the current political economic debate should be vigorous and, at times, heated. We are just beginning to bounce back from the worst recession in a generation and the effects are still strongly felt across the nation, even in a southern paradise like Jacksonville.

I am well aware of the impact that recession, inflation, and especially high energy costs, have had here, and I realize that this, in turn, has taken its toll on credit, on construction and, of course, on real estate.

But I am not a pessimist about America and I am not a pessimist about Jacksonville. It's just not in my nature. Our country, and this fine community, have too much going for them -- talent, resources, initiative, and plain old American know-how and determination -- to be stymied by anything for long, no matter what the professional pessimists may say.

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Which brings me to a story told about one of the greatest leaders -- and greatest optimists -- of history, Sir Winston Churchill. For some years after he retired as Prime Minister, Sir Winston stayed on as a sitting member of Parliament. In fact, most of those last years he didn't do much else besides sit. But every once in awhile, when least expected, a spark of the old Churchill wit would flare up.

On one occasion, as Sir Winston was sitting in the members' bar, fortifying himself for the duties of the day, the bell rang for a vote on the floor of the House of Commons. Downing what remained of his brandy, Churchill resolutely waddled toward the door. At the same time, a 250 pound laborite from Liverpool, a walking battleship by the name of Bessie Braddock, also started plowing toward the door.

The inevitable collision occured, and Bessie went down for the count. But, to her credit, she came up fighting. "Sir Winston," she fumed, "you are drunk. Furthermore, you are disgustingly drunk."

Churchill peered at Bessie for a moment through steady if somewhat glazed eyes and replied, "My dear Mrs. Braddock you are ugly. Furthermore, you are disgustingly ugly. But tomorrow, I -- Winston Churchill -- I shall be sober."

Without drawing too fine an analogy, I think it is fair to say that, like Mrs. Braddock's ugliness, the pessimism of the professional doom sayers will still be with us tomorrow. On the other hand, like Sir Winston, the American economy is already proving that it is quite capable of sobering up and getting back on the track.

Right here in Jacksonville, for instance, I was glad to see that your retail sales are up 6% from 1974 and that local businesses reported tremendous Christmas receipts. Like the rest of the country, Jacksonville is on the comeback trial . . . not that this should surprise anyone who knows our country and our people.

But while I have a deep and abiding faith in this Republic and in its people, I must tell you that I am very troubled by what has happened in Washington over the past 15 years -- the sinister drift toward an ever-bigger Federal Government usurping more and more of the rights and resources that belong in the private sector and in the hands of the individual citizen. This dangerous undercurrent has been ignored for too long. In the long run it could undo all of the progress we have made toward a balanced, healthy economic recovery.

Without question, our country has developed the most efficient and creative economic system the world has ever known. It is really a marvel, bringing material benefits to our people that are unsurpassed in the history of mankind. Literally tens of millions of poor imigrants came to the United States since the early 1800s in search of a better life and achieved for themselves, their children, and their children's children a standard of living that was beyond their fondest hopes. This economy is so strong and dynamic that since the early 1900s despite the abuses we have inflicted on it, remarkable progress has been made:

-- Real income of the American family has increased by over 40% (and that's after inflation and taxes);

-- Total production has risen by over 60%, in real terms, even after allowing for three recessions over this time span;

-- The percent of families below the poverty line has been cut in half (to around 10%);

-- Real farm output has risen over 25%, enabling us to feed not only ourselves but many people in other countries; and

-- Almost 20 million new jobs have been created.

This is not to imply that the private enterprise system is perfect. It does not change human nature nor solve all problems everywhere. It does not ensure human happiness. While it does not guarantee personal and social freedoms, it does provide more men and women with the freedom to decide and the opportunity to obtain economic security than any other system known to man. And it is a powerful safeguard against the erosion of our personal freedoms.

And yet as I have said, despite this excellent overall performance of our free market system, there are strong and growing developments which raise serious concern about the future. America is on a path that may not hold the same promise as in the past. There are clear indications that government at all levels is increasingly constraining innovation, personal initiative, and individual spending decisions. And at the same time poll after poll points to a rising disenchantment by the public with business and with government.

In a more concrete sense, let me call your attention to some economic developments which highlight the creeping and excessive rise in government activity in our economic affairs;

* In 1930 total government spending -- that is, spending by Federal, state and local government -- was about 12% of our GNP. By 1950 it was 21% and this year it will be around 35%. In other words, over one in every three dollars of income is now spent by government. And if current trends prevail, government spending will reach nearly 60% of our GNP by the end of the century.

* In FY 1962, Federal government spending exceeded $100 billion for the first time in history. Without the restraint advocated by the President, it will exceed $420 billion in FY 1977. Indeed, even with $395 billion ceiling, this is an effective four-fold increase in just 15 years time. Federal Government outlays are now running over $1 billion per day or the equivalent of almost $5,500 per year for every family in the United States.

* Today's Federal Tax Provisions contain over 6000 pages of finely printed material. No wonder the average citizen feels cut off from his government in Washington. Even my economists at the Treasury, with all their PhD's, have thrown up their hands at Form 1040 and now go to the tax specialists.

* It took 75 years for the National Debt to reach $1 billion, an event which occurred in 1863 during the Civil War. Today it is growing by a billion per week. Is there any

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wonder why we have an inflation problem?

* There are over 5000 forms required by the Federal Government today which take business over 130 million work hours to fill out. The costs of simply processing these forms by the Government are estimated to be an incredible $15 billion a year. These costs must ultimately show up in higher prices to consumers.

* In five years, the cost of a first class stamp has more than doubled. There is nothing like a government monopoly -- to deliver good, low cost services. As Bob Hope said when they raised the price, "Now they're going to charge us 10¢ for delivery and 3¢ for storage."

* Regulatory agencies directly control economic decisions of airlines, railroads, trucking, broadcasting, power production, energy, the securities market -- almost 10% of everything we make. Furthermore, there are other indirect controls (including environmental protection, safety regulations, consumer requirements) which affect the costs in a great variety of indutries.

The point of all this is to try to give you a feeling for some serious and disturbing economic changes I see and hopefully an understanding of what the President is trying to do regarding these developments. We in the Administration genuinely want to stem the tide toward ever bigger Government, to an every larger and more cumbersome Bureaucracy -- not just to be anti-government -- but because of a fundamental belief that the market mechanise can do a much better job in meeting the needs and preferences of the American people.

The thrust of the President's recommended spending and tax policies is to strike an appropriate balance between long- and short-term needs, between conflicting and yet desirable objectives. As outlined in the Budget there is to be a fairness and balance:

-- Between the taxpayer and those who will benefit by Federal Spending;

-- Between National Security and other pressing needs;

-- Between our own generation and the World we want to leave to our children;

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-- Between those in some need and those most in need;

-- Between the desire to solve our problems quickly and the realization that for some problems, good solutions will take more time; and

-- Between Federal control and direction to assure achievement of common goals and the recognition that State and Local Governments and individuals may do as well or better without restraints.

As obvious and as straightforward as these goals seem, they cannot all be achieved simultaneously. This inevitably implies some choice or compromise; and being an election year means that there will be differences, which will be publicly and loudly voiced, about the relative importance of each goal and about the ways to achieve them. Liberals and Conservatives will differ greatly on these matters.

President Ford's program clearly strives to bring about a durable and sustained economic advance that will steadily reduce unemployment but at the same time will not bring back high rates of inflation. Some people say our program isn't bold enough. I say that this is probably the boldest program we have had in years, because we now have a President who goes before the American people and doesn't promise them the moon. That's the kind of "Boldness" we need in America today. We are not going to fall into the trap of trying to spend our way to prosperity again. It is precisely the kind of impatience with the speed of economic recoveries which has overheated the economy twice in the last decade, and I would hope that we have learned our lessons about such stop-go policies. There is no real benefit in helping people get jobs for a while, only to bring about even greater hardship later on.

President Ford's proposals deal with four major objectives.

First, to reduce the unemployment rate, several new steps have been proposed to keep the economic recovery moving ahead, including,

-- A further tax cut of approxiamately $10 billion to become effective on July 1; and

-- Accelerated depreciation for the construction of plant and equipment in areas experiencing high unemployment (in excess of 7%).

Second, to prevent the inflation from accelerating back toward high-single or double-digit inflation,

-- Federal spending gains to be limited to only 5-1/2% in FY 1977 (compared to a total rise of 40% in the past two fiscal years);

-- Monetary growth is to be held to 5-7-1/2% and eventually is to taper in speed as the economy gathers steam; and

-- The economy is not to receive undue net fiscal stimulus but rather is to be set on a course of modest GNP growth around 6 to 6-1/2% which is both sustainable and desirable. We will continue warming up the economy, but we are not going to overheat it again.

Third, to slow the rise of Government influence on the economy,

-- The growth in total outlays is to be limited not only in FY 1977 but well beyond;

-- Reforms are to be pursued in terms of excess and counter-productive regulations in order to move towards more competitive markets; and

-- Budget deficits are to be eliminated by FY 1979 so that the private sector can obtain more of the total credit flow.

Finally, to meet the pressing need for greater capital formation and long-term job creation:

-- Corporate tax rates and the Investment Tax Credit are to be permanently shifted to the present more favorable base;

-- Double-taxation of dividends is to be eliminated; and

-- Middle income taxpayers are to be given incentives to invest in common stocks in order to broaden and strengthen stock ownership in American companies.

To a far greater extent than in the past, our policy must take into account long-run needs and not focus almost exclusively on short-run problems with their expedient "solutions". In the long run there is no substitute for sound, sustained, even-handed policies that create an environment in which private enterprise can flourish.

There will, of course, be calls to do more, to try new approaches. Indeed, one of the more fascinating sets of proposals in dealing with our economic goals is contained in two bills currently before the Congress which have been sponsored by a very close friend of mine -- who will remain nameless even though he is a distinguished Senator from Minnesota. The first bill is entitled "The Balanced Growth and Employment Act of 1975". The second is entitled "The Equal Opportunity and Full Employment Act of 1975". Now I ask you, how can anyone possibly not support Balanced Growth or Equal Opportunity or Full Employment? In fact, aren't these the very goals we all would like? Of course they are. Unfortunately, the titles on the bills fail to capture their contents.

The first bill advocating Balanced Growth would set up an Economic Planning Board in the White House. Every two years this Board would draw up detailed long-term plans for the economy and submit such plans to the Congress for their approval. The plans would establish economic objectives, identify the resources necessary to achieve them, and recommend appropriate administrative and legislative actions. Supposedly, this plan would be an invaluable guide to both the private and public sectors. Let's think about this.

Who is to decide on the objectives for the overall economy? Who is to take action if certain goals are not met? Who is to decide which localities, which businesses, which industries are to do which tasks? Who decides on credit allocation, investment decisions, output targets, even pricing and wage policies? The answer is clear; The Economic Planners.

The implications of this potential power in the hands of a government bureaucracy are absolutely frightening! The heart of any planning program is to go from planning to action and ultimately to compulsion. Inevitably this would mean most economic decisions would be made in Washington by an ever more powerful bureaucracy controlling the market place and interfering with our individual freedoms so that we get what the bureaucracy knows is good for us. Such a planning scheme is not a move in the direction of a better functioning market mechanism but instead is an open ended commitment to make mistakes and sap the very vitality of our economic machine. In point of fact we already have the World's most sophisticated system of economic planning -- Free Markets planned by individual consumers. We do not need more "guidance" from Washington.

The second proposal also is deceptively simple. To assure full employment, we would have the Federal Government act as employer of last resort and guarantee a job to all persons looking for work. In a bit over a year's time the unemployment rate would be lowered to 3% (or less) or else the government could be sued for being derelict in its responsibility. Already, it sounds like another lawyer's relief bill. Furthermore, the cost of the taxpayer is not supposed to be very great since the people employed would not be drawing unemployment compensation anymore but rather would be paying taxes on their income. Isn't this a sound idea? By a wave of the wand we can almost reduce the number of unemployed by five million workers and achieve the lowest rate of unemployment since the peak activity of the Korean War. Why are the Republicans, and especially the President, resisting such good advice?

The answer, of course, is that the scheme totally ignores what happens to prices and the ultimate impact on economic activity. Two independent studies of this jobs program say that it will bring a new wave of inflation that will curl your hair. One forecasts an inflation around 10%; the other a rate of 13%. Some believe it could go even higher because the public is highly sensitive to every new burst of inflation. This obviously would lead to a sharp erosion of the real value of peoples' savings and incomes, would cause severe strains in our financial system, and ultimately would give way to an even more serious recession than the one we have already experienced.

The whole point of my discussion tonight is to highlight the very serious economic questions we face and the policies that are needed for our future. It took a long time for our economic problems to build up and it is going to take a long time to wring then out of the economy. There is no quick fix. We cannot pay for the sins of a decade with one year's penance. Some say that the principles and ideals of the past no longer work. Somehow they are no longer relevant. What nonsense. It is not that our principles have failed us but that we have failed to live up to them.

With patience and responsibly balanced policies -- and with firm adherence to sound economic principles -- we can eventually work ourselves back to a healthy growing economy on a stable enduring basis. If the country chooses the route of stop-go again, we will have only ourselves to blame for the inevitable problems that will develop.

Address by the Honorable William E. Simon
Secretary of the Treasury

Orlando, Florida
February 12, 1976

Thank you, Mr. Dantzler, Congressman Lou Frey, Ladies and Gentlemen.

It is a great pleasure for me to be here, and to bring you greetings from Fantasyland North. I sometimes think that the only difference between Washington and Disney World is that the weather is much nicer down here -- that, and the fact that Disney World pays its own way.

I understand that 12.5 million tourists visited Orlando last year. That is quite a figure, although it's easy to understand why so many people are drawn to one of the most beautiful parts of the country and one of the most fantastic tourist and amusement complexes in the world. However, I think that the record pales by comparison to ours in Washington. Disney World may amuse and fascinate millions of tourists, but Washington has taken every single American taxpayer in our great country on one of the longest, bumpiest rides in history.

Even in Washington, however, there are times when common sense and sound principles win out. And I like to believe that the Administration and the President I serve have helped to gain a few of these victories.

Soon after I came to Washington three years ago, something approaching a panic hit the city. America was struggling with an energy embargo imposed on us by foreign nations and there was real fear that the impact might wreck, among other things, tourism in areas like Orlando.

But we survived the blackmail and now we are on the road to energy self-sufficiency. It took time, but common sense prevailed.

Then, about a year ago, we had to start tackling the twin evils of inflation and recession at the same time -- problems that have also had a serious impact right here in Orlando. Well, we haven't fought the last battle against inflation and recession yet, but there is no longer any doubt about the outcome. If we hold true to a policy of

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restraint and responsibility -- of saying no to massive Federal boondoggles and massive Federal interference -- we are going to win the economic war.

The doomsayers and gloom merchants who predicted collapse during the energy crisis have already been proven wrong.

Remember the predictions of a collapse of our international financial system, of a depression, of $1 bread, $1 gas, $1 sugar? They all turned out to be phoney. Our free enterprise system, while troubled, was vibrant and alive. As Winston Churchill once said while his own country was under seige, "We have not journeyed all this way across the centuries, across the oceans, across the mountains, across the prairies, because we are made of cotton candy." No, we are of better stock, and I'm damn proud of it.

Everyone who has grown up in this great country of ours was brought up to believe, as I still do, that our country has developed the most efficient and creative economic system the world has ever known.

It is really a marvel, bringing material benefits to our people that are unsurpassed in the history of mankind. Literally tens of millions of poor immigrants came to the United States since the early 1800's in search of a better life and achieved for themselves, their children, and their children's children a standard of living that was beyond their fondest hopes. This economy is so strong and dynamic that since the early 1960's despite the abuses we have inflicted on it, remarkable progress has been made:

--The real income of the American family has increased by over 40%.

--Total production has risen by over 60% in real terms, even after allowing for three recessions over this time span;

--The percent of families below the poverty line has been cut in half; to 10%.

--Real farm output has risen over 25%, enabling us to feed not only ourselves but many people in other countries;

and

--Almost 20 million new jobs have been created. This is not to imply that the private enterprise system is perfect. It does not change human nature nor solve all problems everywhere.

It does not guarantee personal and social freedoms. And it does not ensure human happiness. But it provides more men and women with the freedom to decide and the opportunity to obtain economic security than any other system known to man. And it is a powerful safeguard against the erosion of our personal freedoms.

And yet as I have said, despite this excellent overall performance of our free market system, there are strong and growing developments which raise serious concern about the future. America is on a path that may not hold the same promise as in the past. There are clear indications that government at all levels is increasingly constraining innovation, personal initiative, and individual spending decisions. And at the same time poll after poll points to a rising disenchantment by the public with business and with government.

In a more concrete sense, let me call your attention to some economic developments which highlight the creeping and excessive rise in government activity in our economic affairs:

In 1930 total government spending -- that is, spending by Federal, State and local government -- was about 12% of our GNP. By 1950 it was 21% and this year it will be around 35%. In other words, over one in every three dollars of income is now spent by government. And if current trends prevail, government spending will reach nearly 60% of our GNP by the end of the century.

In FY 1962, Federal Government spending exceeded $100 billion for the first time in history. Since then it has quadrupled, pushing toward $400 billion. Federal government outlays are now running over $1 billion per day or the equivalent of almost $5,500 per year for every family in the Untied States.

Today's Federal Tax Provisions contain over 6000 pages of finely printed material. No wonder the average citizen feels cut off from his government in Washington. Even my economists at the Treasury, with all their Phds have thrown up their hands at Form 1040 and now go to the Tax Specialists.

It took 75 years for the national debt to reach $1 billion, an event which occurred in 1863 during the Civil War. Today it is growing by a billion per week. Is there any wonder why we have an inflation problem? Private industry manufactures many wonderful products for our people; in Washington, the only products we seem to manufacture are hot air and inflation.

There are over 5000 forms required by the Federal government today which take business over 130 million work hours to fill out. The costs of simply processing these forms by the Government are estimated to be an incredible $15 billion a year. These costs must ultimately show up in higher prices to consumers.

In five years, under the Government's monopoly over the postal service, the cost of a first class stamp has more than doubled. As Bob Hope said when they raised the price last time, "Now they're going to charge us 10¢ for delivery and 3¢ for storage."

This past decade has also seen unparalleled growth in the regulatory apparatus of the government. Regulatory agencies of the government now exercise direct control over 10 percent of everything bought and sold in the United States and indirect control over almost every other sector of the private economy.

The point of all this is to try to give you a feeling for some serious and disturbing economic changes I see and hopefully an understanding of what President Ford is trying to do regarding these developments. We in the Administration genuinely want to stem the tide toward ever bigger Government, to an ever larger and more cumbersome bureaucracy -- not just to be anti-government -- but because of a fundamental belief that a free market can do a much better job in meeting the needs and preferences of the American people.

The thrust of the President's recommended spending and tax policies is to strike and appropriate balance between long-and short-term needs, between conflicting and yet desirable objectives. As outlined in the new budget there is to be a fairness and balance:

--Between the tax payer and those who will benefit by Federal Spending;

--Between National Security and other pressing needs;

--Between our own generation and the World we want to leave to our children;

--Between the desire to solve our problems quickly and the realization that for some problems, good solutions will take more time; and

--Between Federal control and direction to assure achievement of common goals and the recognition that State and local governments and individuals may do as well or better without restraints.

President Ford's program clearly strives to bring about a durable and sustained economic advance that will steadily reduce unemployment but at the same time will not bring back high rates of inflation. Some people say our program isn't bold enough. I say that this is probably the boldest program we have had in years, because we now have a President who goes before the American people and doesn't promise them the moon. That's the kind of "boldness" we need in America today. We are not going to fall into the trap of trying to spend our way to prosperity again. It is precisely the kind of impatience with the speed of economic recoveries which has overheated the economy twice in the last decade, and I would hope that we have learned our lessons about such stop-go policies. There is no real benefit in helping people get jobs for a while, only to bring about even greater hardship later on.

The President's proposals deal with four major objectives.

First, to reduce the unemployment rate, several new steps have been proposed to keep the economic recovery moving ahead, including,

--A permanent tax cut of approximately $28 billion to become effective on July 1; and

--Accelerated depreciation for the construction of plant and equipment in areas experiencing high unemployment (in excess of 7%).

Second, to prevent the inflation from accelerating back toward high-single or double-digit inflation. The President is proposing that:

--Projected Federal spending for the coming fiscal year be cut by some $28 billion. This would mean not only that a tax cut would be possible but that Federal spending gains would be limited to only 5-1/2% in FY 1977 (compared to total rise of 40% in the past two fiscal years);

--It also means that the Federal budget would be brought into actual balance within three years and that another major tax cut could be enacted before the end of the decade.

Third, to slow the rise of Government influence on the economy,

--The growth in total outlays is to be limited not only in FY1977 but well beyond;

--Reforms are to be pursued in terms of excess and counter-productive regulations in order to move toward more competitive markets; and

Finally, to meet the pressing need for greater capital formation and long-term job creation:

--Corporate tax rates and the investment Tax Credit are to be permanently shifted to the present more favorable base;

--Double-taxation of dividends is to be eliminated; and

--Middle income taxpayers are to be given incentives to invest in common stocks in order to broaden and strengthen stock ownership in American companies.

To a far greater extent than in the past, our policy must take into account long-run needs and not focus almost exclusively on short-run problems with their expedient "solutions." In the long run there is no substitute for sound, sustained, even-handed policies that create an environment in which private enterprise can flourish.

It took a long time for our economic problems to build up and it is going to take a long time to wring them out of the economy. There is no quick fix. We cannot pay for the sins of a decade with the one year's penance. Some say that the principles and ideals of the past no longer work. Somehow they are no longer relevant. What nonsense. It is not that our principles have failed us but that we have failed to live up to them.

With patience and responsibly balanced policies -- and with firm adherence to sound economic principles -- we can eventually work ourselves back to a healthy growing economy on a stable enduring basis. If the country chooses the route of stop-go again, we will have only ourselves to blame for the inevitable problems that will develop.

It seems to me that we are faced with a fundamental choice -- not only for 1976 but well beyond -- in the kind of economy and society we want. The economic objectives of more jobs and stable prices may be pretty well agreed to, but the routes to them are very different. Our emphasis in the Republican Party is on a sound durable expansion that will permit the free market to live up to its potential. The other route is one that holds out a false, cruel promise of a more rapid return to prosperity but at a cost of future hardship and further erosion of our economic and personal freedoms.

President Ford has set a course which points us in the right direction and will permit us to get a much better grip on these problems, but it will take several years, not months, to bring this about. Unfortunately, the election is only a bit over nine months away. There will be calls from the opposition for "sweeping changes" and "broad new initiatives" which will really mean bigger spending, bigger deficits and ultimately bigger governmental control of the economy. We must persuade the American people that this course is wrong and that our approach is much sounder in the long run. The real choice is between greater government control or greater individual freedom.

That is the battle before us. But we have been through the fires before -- over energy, over inflation, over recession, and over New York City. And just as we have proved that we could win those battles, I am confident that we will win this one, too.

Ours is a great cause, and America will be even greater because of our success.

Thank you.

REMARKS BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
LINCOLN DAY DINNER
CLEARWATER, FLORIDA
FEBRUARY 11, 1976

It is a pleasure for me to be here this evening in Clearwater to participate in this Lincoln Day Dinner, and to salute a fine Congressman, Representative Bill Young. As I was preparing my remarks for this evening it occured to me that Bill Young is a particularly appropriate man to honor on Lincoln's birthday.

As the first Minority Leader in the State Senate, as a National Committeeman and as an outstanding member of the House of Representatives, Bill Young has served his state and his party well -- and through difficult times.

In fact I understand that back in 1960, when Bill was first elected to the State Senate, the only reason there was any State Party in Florida at all was because Republicans were protected by the game laws.

But Bill believed with Lincoln that "The probability that we may fail in the struggle ought not to deter us from the support of a cause we believe to be just." Bill has fought for what he believed in, and, in return, he has won the faith and belief of the people he serves.

But, then, isn't that what effective government is all about -- mutual trust and mutual understanding? The problem, in a society as complex and specialized as ours is that it is too easy to lose sight of basic principles and truths in the maze of conflicting technical data, statistics and political double talk.

Of course this is not exactly a new problem. It was one that plagued Abraham Lincoln more than a century ago. "I have faith in the people", Lincoln said, "...the danger is in

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their being misled. Let them know the truth and the country is safe."

Lincoln's faith was vindicated in his own time, although his life was cut tragically short by an assassin's bullet. Despite the suffering and destruction of the War Between the States -- and the later ordeal of the reconstruction -- America and the American people survived.

And time and again, as challenge after challenge has faced us since Lincoln's day, the American people have again understood, have again sacrificed and have again perservered.

Much has changed since Abraham Lincoln's day. Breakthroughs in education, technology and communications, working in tandem with a free economic and political system, have offered Americans of our generation a broad vista of experiences and opportunities that the men and women of Abraham Lincoln's day never dreamed possible. And, inevitably, new problems and challenges have followed in the wake of progress.

So much has changed that some people may even question the relevance of Abraham Lincoln, and the values he stood for, to contemporary American life.

In the narrowest political sense, there is some doubt that "Honest Abe", with his unpleasant, nasal voice and homely, awkward figure, could have politically survived in the age of television. Certainly, it is hard to imagine Abe putting himself into the hands of "image makers" -- capping his teeth, taking drama lessons, being fitted for contact lenses, having his face lifted or his hair restyled. As he once said, "the Lord must love homely people, or he wouldn't have made so many of them."

Lincoln's character, like his immortal Gettysburg Address, was a thing of substance, not of style. Charisma had nothing to do with it. Abe Lincoln stood for beliefs, for principles, for integrity and for basic decency -- and that is why history remembers him, and why we still celebrate his birthday today.

Oh, he had plenty of personality -- among other things, perhaps the sharpest sense of humor of any President. And to those who knew him -- who knew of the private grief of a father who had lost his favorite son, and who, once the duties of the day were over, was sometimes plunged into dark, brooding despair -- Lincoln was something close to a tragic figure long before his assassination. Certainly, he was a heroic one.

But I suppose it was Lincoln's humor, often tinged with irony, that was his most saving grace. Once his sense of humor was brought to bear, it became a piercing weapon for truth.

Responding once to a rhetorical defense of slavery, Lincoln remarked that, "Whenever I hear anyone arguing for slavery, I feel a strong impulse to see it tried on him personally."

And when friends warned him of the extensive coverage being given to his opposition, he shrugged the matter off, "What kills a skunk," he said, "is the publicity it gives itself."

When one of Lincoln's more energetic but less intelligent field commanders persisted in sending him dispatches signed "Headquarters in the Saddle," Abe quipped that the trouble with that particular general was that, "his headquarters were where his hindquarters ought to be."

A century later, some Federal officials -- both civilian and military -- still show a remarkable tendency to do things backwards.

And that admittedly frivolous remark opens up an area of as much serious concern in our own time as in Lincoln's -- the fundamental question of how much power a clumsy and sometimes misdirected Federal Government ought to have over our everyday lives and our destiny.

There are hundreds of arguments in favor of Federal control. The list is as long as the number of problems, real or imaginary, that plague society at any given time --

problems which <u>seem</u> to lend themselves to a quick fix at the hands of Federal bureaucrats.

You name it: someone wants the government to do it or regulate it. So much so that it is estimated that today private industry spends $18 billion a year just filling out Federal forms and complying with government red tape -- $18 billion in expenses that ultimately come out of the consumer's pocket.

Today Federal officials are doing everything from ordering parents where to send their children to school to telling local governments how to spend their money. And the massive cost of this vast, inefficient federal control machinery is drying up the sources of capital and just plain initiative that are needed to create more jobs and more opportunity for all Americans in business and industry.

The plain truth -- the truth that most grass roots Americans have known for a long time, but that too many politicians have ignored -- is that government has grown too big, too fast, for too many years.

Now, as I said a moment ago, the advocates of big government can give you reasons by the hundreds. Every vested interest group, every fat cat and every special cause, has its own set of excuses.

Those of us who are against big government are not so lucky. We only have one argument -- but it's a good one. It's called individual freedom, and it's what America is supposed to be all about.

No one understood this better than Abe Lincoln, and the words he had to say on the subject are even more relevant today than they were in 1854 when he first spoke them:

"The legitimate object of government," Lincoln said, is to do for a community of people whatever they need to have done, but cannot do...in their separate and individual capacities. In all that the people can individually do well for themselves, government ought not to interfere."

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It's instructive to note that on this basic issue, Lincoln, the first Republican President of the United States was in basic agreement with Thomas Jefferson, the first Democratic President, whose motto was "That government is best which governs least." Both of our great political parties, like the nation itself, were founded on this bedrock proposition.

But too many politicians today have lost sight of it. As I work each day with President Ford in Washington, trying to keep Federal spending and Federal interference to a minimum, I see the problem first hand.

There are times when even the power of the veto cannot stop the fiscal flood.

The only way we can be sure of victory -- the only way we can ensure the triumph of common sense and sound principle -- is by mobilizing public opinion.

This is not a battle between Republicans and Democrats or liberals and conservatives.

It is a battle between good and bad ideas.

It is a battle between those of us who believe in freedom, in running to a government that has already grown too large and too domineering.

In 1976, as the nation celebrates the bicentennial of a struggle that was fought and won for the freedom of the individual, we can and must elect the kind of President and the kind of Congress that believe in government of the people, by the people, for the people -- not government of the bureaucrats, by the bureaucrats, for the bureaucrats.

For, despite Abraham Lincoln's warning that "no man is good enough to govern another man without that other's consent," more and more of the decisions that govern our lives are being made for us by anonymous officials we wouldn't have voted for, did not hire and cannot fire.

As a citizen, as a father, and as one who has seen the intimate workings of government, I deeply believe that the central, underlying issue of our time is this basic confrontation between the freedoms we cherish as Americans and their erosion by runaway big government.

And I submit to you this evening that unless we stand together now -- unless we turn America away from the road of ever greater government spending and ever greater government controls -- then our children will be robbed of their birthright as free Americans. And you and I will be condemned to spend the rest of our lives in a society doomed to chronic inflation, economic stagnation and lingering unemployment.

How serious and how immediate is this threat? Let me give you the figures and you can decide for yourselves.

For most of our history the Federal Budget stayed below the $100 billion mark -- way below it most of the time. Then, in 1962, 186 years after the founding of the Republic and a century after Abe Lincoln's first Administration, we finally went over the $100 billion mark.

Unfortunately, that was only the beginning. Seven years later the budget broke the $200 billion mark and, only four years later, in 1975, we broke the $300 billion mark.

And now, in our bicentennial year, the government is spending $1 billion a day. That's right, $1 billion every single day. And every week, the Federal Government goes another billion dollars into debt.

This trend has not been limited to the Federal Government alone. In 1930, Government spending at all levels -- Federal, state and local -- amounted to about 12 percent of our Gross National Product. Today, government accounts for a third of our national output. And, if recent trends prevail, the government's share of the total economy could reach 60 percent before the end of this century.

Now I put it to you that, when the day comes that the average American taxpayer has to pay half or more of his earnings to subsidize big government, ours will no longer be a free society as we know it.

We must stop this disastrous trend before it is too late.

I am proud to be part of an Administration that is in there fighting, even when the action means temporary unpopularity. For example, on December 17th, President Ford stood firm by vetoing the tax cut extension bill. And thanks to his firm stand, the Congress had to add a good faith pledge to tie future tax cuts to similar cuts in Federal spending before the legislation was signed into law.

The Ford Administration is exercising the same brand of calm, firm leadership across the economic board.

As our country emerges from the worst recession in a generation, Federal fiscal policy must strike a delicate balance. It must stimulate the economy enough to keep it moving forward -- and thereby reduce the rate of unemployment.

But, at the same time, Federal policy must not reach the point where it triggers another round of runaway inflation. By limiting the budget deficits to a level that can, with proper management and the cooperation of the Congress, be brought into balance by Fiscal 1979, the Administration has struck the proper economic balance.

The question is, can we hold that balance? For, even now, those who advocate more government and more spending have begun to call for a new round of Federal spending and "quick fix" programs that, while they may be politically popular in the short run, will cause problems for the average taxpayer and the wage earner for years to come.

We have already begun a strong, healthy economic recovery. The best way to keep that recovery going and growing is to do what President Ford is urging us to do -- to follow a fiscal course that will create permanent jobs and permanent prosperity in the private sector.

Americans want jobs, not handouts. Artificial, "make work" government projects never have been and never will be an adequate substitute for real jobs with a real future in industry, in crafts, in the professions and in big and small business.

In two hundred years we as a people tamed a savage continent and transformed thirteen tiny colonies bounded by the sea on one side and sprawling wilderness on the other into the mightiest and most abundant nation in human history.

Government didn't do that. People did. The original colonists, and the millions of immigrants who followed them, came to these shores to escape the kind of government that over-taxed, over-regulated and, ultimately, stripped the individual of both his material and his spiritual independence.

We are the heirs of those successive waves of men and women from all over the globe who came here, not to be "taken care of" by some faceless central bureaucracy, but to build proud, free lives for themselves.

As long as we, in our turn, stand for the same principles and live for the same ideals -- and as long as we support men like Jerry Ford and Bill Young who defend them -- government "of the people, by the people, shall not perish from the earth."

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for learning, travel, and general upward mobility -- not everyone understands the basic economic facts of life that create all these benefits.

Small wonder then, that when economic difficulties like the recent recession hit, millions of otherwise reasonable people fall for the quack nostrums of politicians who are more interested in promising than performing, and for quick fix government spending programs that provide some short term relief but only aggravate the long-term economic ills of inflation and stagnation in the private sector.

Because of this, I believe that the time is ripe for an economic heart-to-heart talk with the American people -- especially young Americans. And I believe that organizations like the Chamber must do even more than they are now if such a national dialogue is to succeed.

What is at stake is not just the future of this or that industry. At stake is the survival of the private sector, and the individual liberties which have never long survived the collapse of a society's free enterprise system.

Unless we get the facts across today, the America of tomorrow -- of our children and grandchildren -- will be doomed to a system of economic and political bondage that is the very opposite of all that we hold dear.

The problem already exists, as I have had ample opportunity to observe in my job as Secretary of the Treasury. And it is getting worse, not better. It is a question of both policy and perception for faulty perception of the economy makes faulty economic policy almost inevitable.

And I am firmly convinced that, taken together, misunderstanding and misdirection of the American economy have become the central, underlying problem of our times.

Part of it is a matter of image. Frequently, and especially to youthful idealists, those who support bigger government spending and more government domination of the private sector are perceived as concerned, socially progressive men and women who "care" -- in a nutshell, they are seen as the humane champions of the persecuted underdog.

On the other hand, those who warn that the government should not -- and cannot -- effectively solve every new problem that comes down the pike, and who advocate instead the strengthening of the free enterprise system are seen as either outdated theorists or a new generation of economic exploiters, indifferent to human suffering and only out to make a fast buck for themselves and their companies.

To make matters worse, surface appearances often tend to confirm this inaccurate impression. Advocates of big government are able to wax eloquent for hours about the ills they imagine they can cure by cranking out more currency and soaking up more credit through massive deficit spending. They have as many arguments as there are social, economic and political problems -- even though the spending they advocate, as we have seen with the New Frontier's war on poverty, is often part of the problem rather than part of the solution.

Those of us who recognize the fallacy of the big government approach have only one argument. It's the right one, but, by dint of repetition, people are getting tired of hearing about it. For we constantly invoke the free enterprise system, too often without defining the freedoms and the opportunities that it, and it alone, provides. We chant a slogan, a label, without defining it in comprehensible, human terms.

We can talk about the free enterprise system until we are blue in the face, but it still won't mean anything to those who do not understand what it really is and what makes it work. It's like trying to sensibly discuss the birds and the bees with someone who is unshakable in their belief that babies are delivered by the stork.

People who have never seen what happens to countries with state-controlled economies simply have no standard for comparison.

They have never witnessed the long lines of workers and housewives who have to cue up for hours outside state-owned food and department stores in order to buy a poor selection of overpriced food staples and state-manufactured clothing and merchandise.

They don't realize what a miracle of variety, economy and productive competition the average American shopping center would represent to nine-tenths of the earth's people.

They have never asked themselves why a country like the Soviet Union, with some of the largest, richest tracts of grainland in the world, but with a government-owned and run agricultural system, cannot even feed its people without turning to American farmers who own their own land, make their own decisions and feed not only our own people, but millions of others as well.

Too often they have been taught to scoff at the very profit and property motives which make our prosperity possible.

They have never had the opportunity to compare the miraculous economic recovery of a free enterprise country like West Germany, to state-controlled East Germany.

They have never lived in countries where the seemingly idealistic dream of a non-profit, propertyless society has turned into a nightmare reality -- where the state and the state alone dictates what kind of education you will receive; whether or not you will be allowed to travel; what kind of job you can have; what you will be paid; what merchandise you can buy with your earnings; where you will live; where you will receive medical treatment; and, utlimately, where you will be buried.

They have not seen first-hand the political and social aftermath in societies where the government has destroyed free enterprise. For the personal rights all Americans cherish -- freedom of worship, freedom of speech and freedom of association -- have never long endured once economic freedom has been destroyed. As Alexander Hamilton warned so long ago, "Power over a man's substance amounts to power over his will."

Without the individual profit motive, people simply do not work as hard, produce as much, or bother to come up with as many new improvements. Whether we like it or not, it is an immutable law of human nature.

Unfortunately, like clean air, economic freedom is something most people don't really appreciate until it begins to run out -- and then it is often too late.

So we have reached the point where, although the free enterprise system works, and works better than any other economic system in effect anywhere in the world -- and although it feeds, clothes and houses more people more affluently than any other while serving as the underpinning of our free society -- it is somehow losing the semantic war to an alien philosophy of government control and economic irresponsibility that has never worked but has somehow managed to preserve an aura of idealism and altruism that attracts many young idealists.

I am simply saying that those of us who believe in the free enterprise system have got to do a better job of getting our story across -- especially to young Americans.

All of these misconceptions would be unimportant if they were not so misleading -- so blatantly phoney. My experience in Washington has convinced me that almost every man and woman in a position of high public trust cares deeply about the well being of our people, especially those who are impoverished or face disadvantages because of their sex or the color or their skin.

The central question is not who cares the most, but rather how we broaden prosperity and reduce human hardship without sacrificing our freedom or destroying the most successful economic system that man has ever known.

I submit to you today that if America continues down the road toward greater governmental spending and greater governmental control over our economy and our lives -- a road that we have been moving steadily down for several decades -- then our children, no matter how many of them are individual young achievers, will be robbed of their personal and economic freedoms. And, in the meantime, all of us will be condemned to an economy riddled by chronic inflation and incurable unemployment.

That is really what is at issue underneath the semantics and the misleading labels, and young Americans have an even greater stake in the outcome than the rest of us.

Let's look at a few facts about government spending. For most of our history, the Federal budget stayed somewhere below the $100 billion mark -- usually way below it.

Then, in 1962, we finally hit $100 billion -- and that was only the beginning. Seven years later, the budget broke the $200 billion barrier and then, only four years after that, we hit the $300 billion mark. And now, in our bicentennial year, we have reached the point where the Federal Government is spending $1 billion a day.

The very size of such numbers makes them almost meaningless to the average American. But there are ways of getting the message across. For example: suppose that on the day that Christ was born, a man had been given $1 billion on the condition that he or his heirs spent $1,000 every day, seven days a week. How long would that $1 billion last? Adding it up, I think you'll find that today, almost 2000 years later, the grandchildren would still not have spent the full billion dollars.

Yet our Federal government is spending $1 billion every single day, and going into debt another $1 billion every week.

And as the budget grows, the government comes to occupy a more and more dominant role within our society.

In 1930, government spending at all levels -- Federal, state and local -- amounted to about 12 percent of the Gross National Product. Today, because budgets have mushroomed, government accounts for a third of our entire national output. And if recent trends prevail, the government's share of the total economy could reach 60 percent before the end of this century.

For taxpayers, the burden of paying the Government's bills has become so heavy that many are now in open rebellion. In the 1974 general elections, for example, voters across the country turned down some three quarters of all bond issues on the ballot. But too many get around this public opposition by voting more Federal spending without increasing taxes.

The result has been a string of Federal budget deficits that are unparalleled in our history. In 16 of the last 17 years, the budget has been in the red. And now, just when a balanced, healthy economic recovery has begun, the advocates of big spending would have us launch another round of reckless spending and runaway inflation.

It is up to us to stop them.

I wish that there was some way for television cameras to portray this story as vividly as they did the war in Vietnam or the race riots of earlier years. For while the visual images are less dramatic, the problem is every bit as pressing and important.

But, as the great 19th century historian Thomas Carlyle once said, political economics is the "dismal science." On the surface, it seems nothing more than a pile of charts and a jumble of numbers so large as to be incomprehensible in everyday terms. To put it mildly, economics seldom makes "sexy" news stories. And yet the economy is the one thing that affects every other aspect of american life -- the food we eat, the quality of our education, our mobility, our freedom of choice in careers, services and merchandise, and our material and personal sense of pride and independence.

The smallest shock to the economy is felt in every limb of the body politic. And that is a big story, if only a graphic, gripping way of telling it could be found.

Consider the case of the Federal debt and its impact. As the debt climbs rapidly upwards, we have to pay higher and higher interest costs on it. By the end of fiscal year 1976 we will have spent $36 billion in interest payments alone.

That's more than we spent in any single year on the war in Vietnam. It's more than a third of our national defense budget. And it is money that could be better spent on needs such as public transportation, health care or any of a dozen worthy purposes.

This heavy borrowing by the government has also aggravated inflation and increased interest rates, creating strains in money and capital markets. This, in turn, affects everyone from the businessman interested in expanding his plant to create new jobs, to the young couple trying to buy their first home without paying an arm and a leg in mortgage interest.

Reckless government spending is the basic cause of inflation and inflation was the underlying cause of the worst recession our country has experienced in a generation -- a recession we are only now beginning to recover from.

It was inflation that caused a loss in real income and the confidence of consumers, prompting the sharpest drop in consumer spending since World War II. And it was inflation that helped dry up the flow of savings into our thrift institutions, driving up interest rates and causing the housing industry to collapse.

So one of our prime concerns as we proceed with the economic recovery is to avoid another dose of the poison that brought the recession on in the first place -- rampant inflation fed by runaway Federal spending.

But spending isn't the whole problem. There is also the matter of government controls and regulation for, as government spending has grown by leaps and bounds, so too has Federal red tape.

Did you realize that government regulatory agencies now exercise direct control over 10 percent of everything bought and sold in the United States and indirect control over almost every other sector of the private economy?

Did you know that it costs private industry -- and that means each one of us as consumers -- an estimated $18 billion a year just to do the paper work demanded by Federal bureaucrats?

Some of these regulations are, of course, necessary. But many of them are counter-productive, wasteful or obsolete. And as President Ford has repeatedly stated, those regulations and regulatory bodies that no longer serve a useful purpose should be abolished, before we strangle in our own red tape.

Today happens to be Abraham Lincoln's birthday and, all over the country, people are delivering Lincoln Day addresses about the man who was probably the single greatest President in the history of the Republic. Yesterday, in Clearwater, I spoke at a Lincoln Dinner myself.

In preparing my speech for that occasion I read a number of Lincoln's own words. What struck me most about them was the fact that, although they were all more than a century old, they were still vital, alive and full of meaning today. One quote in particular stuck with me.

Speaking in 1865, Lincoln said, "I have faith in the people....the danger is in their being misled. Let them know the truth and the country is safe."

That is what I have been trying to stress here this evening -- the need to get the truth, the economic facts of life, across to the American people, especially the young Americans who must lead us in the years ahead.

Given the truth, I am confident that, as always, Americans will rise to the challenge.

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REMARKS BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE THE
PALM BEACH ECONOMIC COUNCIL
PALM BEACH, FLORIDA, FEBRUARY 13, 1976

Thank you, Jerry Thomas, President J. B. Stancliffe, Executive Vice President Harold Stayman, Ladies and Gentlemen.

It is a special pleasure for me to be here in Palm Beach, especially before such a distinguished audience. The Economic Council is still a very young group, only a year old, but you have already built up an impressive record of community service. Much of the credit for the way that Palm Beach has managed to combine new ideas and new businesses with a respect for the traditional charm and quality of life here belongs to your group. My hat is off to you.

I always welcome the chance to visit Palm Beach, but on this particular occasion, I have an added sense of mission. I feel that, in this busy election year, with a presidential primary just around the corner, Floridians deserve a little change of pace; they deserve to hear from at least one out-of-state speaker who isn't running for President.

So here I am, asking not for your votes, but for a few minutes of shared thoughts on some of the basic facts and basic problems facing America -- the sort of thing that sometimes gets buried in the political rhetoric of an election year.

The late Raymond Moley once said that "A political war is one in which everyone shoots from the lip," and it was Henry Adams who warned that "Practical politics consists in ignoring facts."

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Well, I am not here to shoot from either the hip or the lip. And, rather than ignore the facts, I would like to discuss them with you -- important economic facts and trends that will shape the destiny of our country long after the political sound and fury of 1976 have been forgotten.

Political rhetoric may make more dramatic headlines, but, in the long run, the cold, dry realities of economic policy will have more impact on the kind of life that we and our children lead.

And I appear before you today as Washington enters the first phase of an economic battle between the President and the Congress on what we should do and where we should be heading in the coming year, and beyond.

In all of the material that will be flowing forth from the White House during this period, one point will be abundantly clear: We believe that the first and foremost task of this Nation in 1976 is to restore the vitality of our economy. We are encouraged by the progress that was made during 1975:

-- As you will recall, the year 1975 opened with inflation raging at 12%; we have cut that rate nearly in half -- to about 7 percent.

-- During the spring of 1975, the unemployment rate reached 9 percent; today it is at 7.8 percent.

-- With the January increase of 800,000 employment nearly all of the jobs lost during the recession have now been restored.

-- During the third quarter of 1975, we registered the biggest single jump in the GNP in 25 years and the fourth quarter's pace, while slower, still indicates the recovery is maintaining its momentum.

-- There are also many other indices of an economy that is regaining its health -- higher industrial production, growing retail sales, and a very bullish stock market.

Thus we made considerable headway in 1975, and we will make even more in 1976. But it's not good enough and this is certainly no time for complacency. The unemployment rate is far higher than we can tolerate. And inflation is by no means under control. In fact, it remains the most dangerous enemy of future economic growth, and we must do nothing to unleash another inflationary spiral. The ruinous inflation that crested in 1974 was the chief cause of the severe recession of 1975; if we embark once again upon excessive fiscal and monetary policies resulting in double digit inflation, I will guarantee an even worse recession than before. Please let us not permit the pain and suffering of the 1974-75 recession be in vain.

There will be a tendency in Washington in 1976, especially as the elections draw closer, to look with great alarm upon the current unemployment figures and inflation figures. You are going to hear a great deal more rhetoric in coming months about the so-called indifference of this Administration to push hard enough, to spend enough, to act decisively enough in solving our problems. We must not fall prey to those who offer us instant cures -- the so-called compassionate people who promise us everything, but deliver us only one thing: inflation.

In judging this matter, I urge that you step back for a moment and ask yourselves a few basic questions:

-- How is it that the richest and most powerful country on earth could wander into this economic quagmire?

-- How could the most dynamic economic system in the world become infacted with the diseases of both inflation and unemployment at the same time?

-- Indeed, where did we lose our way as a people?

I believe it is essential to decide how we got into this mess before we can really determine the best way to get out. Otherwise, we may just become more deeply mired. Economists argue about this a good deal. Politicians often ignore this question entirely, and seek instead to capitalize on the effects of problems. But to me, there is no real mystery about how we got here, nor what we must do.

It is clear, for instance, that the economic and social problems of today do not spring from a lack of concern in Washington. In the 10 years after President Eisenhower left office, the Congress increased the number of domestic spending programs from about 100 to over 1,000.

It is also clear that we have not failed from a lack of compassion. Since 1960, this Nation has spent over one trillion dollars on social programs to support people and communities that needed help. 73 percent of our entire budget is now committed to social (non-defense) programs. The compassion and generosity of the American people should not be in question.

Nor can we say that our problems stem from a lack of trying to control the business cycle. In the 1960's, it was popular to believe that the Government could mandate permanent prosperity through the Great Society, could fine-tune the economy and abolish the ups and downs of economic growth. And we tried to do that with the tools of fiscal and monetary policy, making one adjustment after another.

Nor do our troubles result from a lack of effort on the part of the Government to control business -- big and small. Today we have an army of approximately 100,000 Government employees whose mission is to regulate and control almost every activity of the private sphere.

Nor have we had any lack of vision from our leaders. The staple of Washington life has become the politician with grand visions and even grander promises of what can be accomplished if he can only spend more of our money or can be given greater authority over our lives.

So, over the past 10-15 years, the Government has tried many, many solutions. Yet the problems persist and our people grow frustrated and disillusioned.

Does this mean there are no answers? Of course not. What it means, I would suggest, is that we have been taking fundamentally the wrong approach. We suffer not from a <u>lack</u> of Government action, but from an <u>excess</u> of Government action.

The trouble with the Federal Government is that it is trying to do more than its resources permit, to do many things that it cannot do very well, to do some things that it should never do at all, and to do all these things at the same time. That just does not make common sense.

Excesses in the Government have been most apparent, I would suggest, in three critical areas affecting the economy:

-- Fiscal policy;

-- Monetary policy; and

-- Regulatory policy.

No one who has followed the pattern of Federal spending in recent years can fail to be impressed by its explosive growth.

-- The Federal budget has quadrupled in 15 years;

-- We have had 16 budget deficits in 17 years;

-- And we have doubled the national debt in just 10 years time.

The Federal Government today is the Nation's biggest single employer, its biggest consumer, and its biggest borrower. And if present trends continue until the end of the century, Government at all levels will account for almost 60 percent of our gross national product. Let there be no doubt that if Government ever becomes such a dominant part of our society, our economic freedoms will disappear, and when we lose them, our political and social freedoms will not be far behind.

Partly to accommodate the Federal Government's borrowing needs in the private markets, there has also been a less noticed but equally significant shift in monetary policies. From 1955 to 1965, the money supply of the United States was growing at approximately 2-1/2 percent a year, and we enjoyed relative price stability. From 1965 to the present, however, the average rate of growth has more than doubled, and it is no accident that during this period we have also had spiraling inflation.

This past decade has also seen unparalleled growth in the regulatory apparatus of the government. Regulatory agencies of the Government now exercise direct control over 10 percent of everything bought and sold in the United States and indirect control over almost every other sector of the private economy.

Whenever I start talking about the bureaucracy in Washington, I am reminded of a remark by Pope John. The Pope was entertaining a visitor once who asked him: How many people work in the Vatican? The Pope though for a second and said -- "About half." Well, that's usually true in the bureaucracy too. But the Federal regulators are a different breed of cat -- they seem to work harder than anybody else in Washington, and they're even more creative, as their results certainly show. I'm told that American people now spend over 130 million work hours a year filling our Federal forms. That, too, just doesn't make good common sense.

The regulatory process has now become so burdensome, for all businesses big and small, that it is threatening to strangle much of free enterprise in red tape. Consider also the staggering costs involved. One major firm estimates that in 1974 it spent $1.3 billion dollars complying with or in anticipation of government regulation at all levels. It has been estimated that the American people paid the equivalent of $2,000 per family in increased costs for all the goods and services they purchased because of regulation.

When you add up all these factors of excessive government spending, excessive expansion of the money supply, and excessive governmental regulation, one conclusion seems inescapable: Both our inflation and our unemployment should bear a label -- made in Washington, D.C.

The fact is that governmental excesses of the past 15 years became a strong, underlying cause of inflation during the 1960's, and they remain so today. The rise in government spending has added enormously to the aggregate demand for goods and services in the economy, thus forcing up prices.

It is also clear that as the forces of Big Government have been fed and nourished, our private enterprise system -- the system that provides five out of every six jobs in the country and is the driving force of our society -- has become sadly undernourished. We have gradually channeled a higher and higher percentage of our resources into consumption and Government spending and less and less into savings and investment. As a result, the United States since 1960 has had the lowest rate of capital investment of any major industrialized country and one of the lowest rates of productivity growth. There can be no doubt that higher productivity is the secret to a higher standard of living. Thus, it is clear, as President Ford said, that we must strike a new balance in our economy -- a balance that favors a much stronger and healthier free enterprise system.

If the country could grasp these central truths -- and I beleive people are beginning to understand and appreciate them -- then it would be much easier for all of us to agree upon the solutions. As I have said, I believe the solutions are relatively straightforward -- and, I might add, they are the basic policies of this Administration.

The centerpiece of our economic policies is the President's proposal to cut the growth in Federal spending and to return the savings to the American taxpayer in the form of a major tax cut.

In the last several months, the President has spent literally hundreds of hours trying to pare down the budget -- in fact, he spent more time on this budget than any President in a quarter of a century. The result was a very realistic and solid budget that calls for a $28 billion cut in projected spending growth. Instead of spending over $420 billion, the President is asking that in fiscal year 1977 -- which begins this October 1 -- that we limit spending to $394 billion. We should realize that in the last two years alone, Federal spending has grown by 40 percent. Under the President's proposal, next year's spending increase will be limited to 5.5 percent -- the smallest increase since the days of President Eisenhower.

As the President said in his State of the Union address: The only way to hold down the cost of living is to hold down the cost of Government. No Government can spend more than it makes, year-in, year-out, without reaching a point of financial collapse. None of us want the tragic experience of New York City this past year to become a preview of our future as a Nation.

By holding down the growth in Federal spending, we can also afford additional tax cuts and thus leave more money in private hands where it can do the most good.

What the President is saying is this: We can have a much bigger and much better tax cut if we will only cut the growth in spending.

I think two points are critical: One, the tax and spending plan would put us on the road to balancing the Federal budget within three years. Secondly, if we stay on that road, I believe it should be possible to enact another tax cut before the end of the decade.

The Government has other ways to curb inflation. We are seeking greater competition in private industry through antitrust laws and we are trying to lower barriers to international trade. But the key is to restrain Federal spending, reduce the horrendous Federal deficits, and strengthen the free enterprise system.

If we are to fulfill our promise as a Nation, it is equally vital that there be enough jobs. The President's tax and spending cuts are a major part of that effort. But we can and must do more. We must offer the American people and American industry much greater incentives to invest in the future -- to expand our supply of housing, to build new plants and equipment, to modernize industry, to expand our energy resources, and of greatest importance, to accommodate a growing labor force. The capital investment needs of the future are extremely large: about $4-1/2 trillion in the next decade -- or three times as much as we spent in the last decade.

Most of the responsibility for raising new capital must lie with the private sector -- a private sector that is invigorated by getting the government out of the marketplace, invigorated by a reduction in taxes, and invigorated by striking a new balance that favors less consumption and government spending and more savings and investment.

Last summer, on behalf of the Administration, I proposed a plan that would eliminate the double taxation of corporate dividends and would thus encourage greater private investment. Most of our European competitors have already adopted this tax approach, and I firmly believe it is time for the United States to catch up. That tax plan remains a central part of our economic strategy within the Administration.

Furthermore, the Administration is advocating a broadened stock ownership plan to encourage more Americans to invest in American-owned companies.

Another major aspect of the President's economic program is in the regulatory field. It is even more difficult to achieve reform of Federal regulations than to fill out the Federal forms that go with them, but we are determined to try. Specifically, we are now seeking to lighten the regulatory burden in four key areas -- banking, airlines, trucking and railroads -- and we are currently investigating what can be done in others. It is no accident, we believe, that three of the industries in greatest difficulty today -- airlines, railroads and utilities -- are also among the most highly regulated industries in the country.

If time permitted, I would like to talk about many of the other aspects of policies -- what we are seeking to do in energy, what we are trying to achieve in our international policies, the cushions that we are placing beneath the unemployed, etc.

But let me conclude with these few observations:

As we enter our third century as a nation, I believe the time has come not to reappraise our dedication to a better life for all -- that dedication is clear -- but to reappraise what we can pay for and how we can do it. The current plight of New York City, the disease that afflicts the British economy, and the overwhelming size of our own Federal deficits are all grave warnings to us. We can pay for what we now have and provide for the future only if our great capitalist economy does its job -- produces goods in a free market and makes a sufficient profit.

I am sick and tired of people apologizing for the free enterprise system. It has given this country the highest standards of living and the greatest prosperity ever known, and of most importance, has helped to give us the greatest freedom ever known to man. And it will continue to do that unless it is crushed by the juggernaut of Big Government. What we need are not fewer but more capitalists in the United States -- more people with a real and direct stake in the profits generated by a productive economy. We cannot continue to have more and more of our citizens involved only in receiving benefits from the government, and fewer and fewer people responsible for paying for the benefits. We must broaden the base of those who work and narrow the base of those who are able but don't want to work.

President Ford urged that we strike a "new balance" in our national life:

-- A balance that favors greater freedom and vitality for our private enterprise system;

-- A balance that favors greater honesty and realism in dealing with the challenges of our time.

These are great goals -- goals worthy of the greatest nation on earth. We should not begin our Bicentennial year by retreating into the past, but by going forward into the future with a common combination of patience, realistic hope, courage, and common sense.

If we work together with common purpose and conviction -- with pride in ourselves and our Nation -- the goals we share today can become the first achievements of our third century together.

President Ford has set a course which points us in the right direction and will permit us to get a grip on these problems, but it will take several years, not months, to bring this about. Unfortunately, the election is only a bit over nine months away. There will be calls from the opposition for "sweeping changes" and "broad new initiatives" which will really mean bigger spending, bigger deficits and ultimately bigger governmental control of the economy. We must persuade the American people that this course is wrong and that the other approach is much sounder in the long run. The real choice is between greater government control or greater individual freedom. That is the decision before us.

Thank you.

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he Department of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 964-2041

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Contact: James C. Davenport
Extension: 8585
February 13, 1976

FOR IMMEDIATE RELEASE

TREASURY DEPARTMENT ANNOUNCES PRELIMINARY COUNTERVAILING DUTY DETERMINATION ON CAP SCREWS FROM ITALY

Assistant Secretary of the Treasury David R. Macdonald announced today the issuance of a preliminary determination that bounties or grants are being paid or bestowed on imports of cap screws, 1/4" in diameter and over, from Italy within the meaning of the United States Countervailing Duty Law (19 U.S.C. 1303). A notice to this effect will be published in the Federal Register of February 17, 1976.

Interested parties will be given an opportunity to submit written views before the Commissioner of Customs in time to be received no later than 30 days from the date of publication of this notice. As required under the Countervailing Duty Law, the Treasury has until August 11, 1976, in which to make a final determination.

The Treasury's preliminary determination concluded that the rebate of certain taxes on the subject merchandise under Italian Law 639 constitutes bounties or grants. If a final affirmative determination is made, the Countervailing Duty Law requires the Secretary of Treasury to assess an additional duty on merchandise benefitting from such bounties or grants.

During calendar year 1974 imports of cap screws, 1/4" in diameter and over, from Italy were valued at $1.9 million. During January-October 1975 imports of the subject product were valued at $1.7 million in comparison with $1.5 million during January-October 1974.

* * *

WS-647

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This Week 4.854 %

Last Week 4.872 %

Lowest since 2/2/76 4.811 %

182

This Wk. 5.171 %

Last Wk. 5.133 %

Highest since 1/5/76 5.521 %

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR IMMEDIATE RELEASE

February 13, 1976

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $ 2.8 billion of 13-week Treasury bills and for $ 3.6 billion of 26-week Treasury bills, both series to be issued on February 19, 1976, were opened at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing May 20, 1976			26-week bills maturing August 19, 1976		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	98.781	4.822%	4.96%	97.407	5.129%	5.35%
Low	98.769	4.870%	5.01%	97.364	5.214%	5.44%
Average	98.773	4.854%	5.00%	97.386	5.171%	5.40%

Tenders at the low price for the 13-week bills were allotted 74%.
Tenders at the low price for the 26-week bills were allotted 5%.

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Received	Accepted	Received	Accepted
Boston	$ 106,800,000	$ 77,200,000	$ 28,740,000	$ 28,740,000
New York	3,714,165,000	2,160,260,000	4,063,935,000	2,995,935,000
Philadelphia	59,430,000	59,430,000	4,460,000	4,460,000
Cleveland	162,615,000	82,615,000	137,120,000	92,120,000
Richmond	27,045,000	19,045,000	34,780,000	34,780,000
Atlanta	39,485,000	35,545,000	26,790,000	26,790,000
Chicago	301,780,000	177,780,000	216,975,000	186,975,000
St. Louis	58,285,000	31,525,000	39,985,000	34,985,000
Minneapolis	40,675,000	27,895,000	36,690,000	36,690,000
Kansas City	72,390,000	55,965,000	17,340,000	15,840,000
Dallas	46,500,000	21,500,000	17,140,000	17,140,000
San Francisco	131,470,000	52,690,000	151,195,000	126,195,000
TOTALS	$4,760,640,000	$2,801,450,000 a/	$4,775,150,000	$3,600,650,000 b/

a/ Includes $371,515,000 noncompetitive tenders from the public.
b/ Includes $151,490,000 noncompetitive tenders from the public.
1/ Equivalent coupon-issue yield.

WS-648

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR IMMEDIATE RELEASE February 13, 1976

WILLIAM F. RHATICAN
NAMED SPECIAL ASSISTANT TO THE SECRETARY FOR PUBLIC AFFAIRS

Secretary of the Treasury William E. Simon today announced the appointment of William F. Rhatican of South Orange, New Jersey as Special Assistant to the Secretary for Public Affairs for the Department of the Treasury. He will also be responsible for the public affairs activities of the Secretary in his capacity as Chairman of the Economic Policy Board.

As Special Assistant, Mr. Rhatican is responsible for management of all the public affairs policies, plans and programs of the Treasury Department.

Prior to joining the Treasury Department, Mr. Rhatican served as Assistant to the Secretary of Commerce for Public Affairs and Director of Communications. He was appointed Assistant to the Secretary and Director of Communications with the Department of the Interior by Rogers C.B. Morton in October 1974 and joined the Commerce Department when Mr. Morton was named Secretary in May 1975.

Prior to his service with the Interior Department, Mr. Rhatican was Vice President, Public Relations and Communications, for the American Paper Institute in New York. He also served three years on the White House staff directing media-oriented projects and as liaison to the Advertising Council. Earlier he was Partner and Account Executive with Advance News Associates, Elizabeth, New Jersey, specializing in community relations for industry and for state and local government agencies from 1965 to 1970.

Mr. Rhatican was born in Mt. Vernon, New York on September 18, 1940, and graduated in 1962 from Seton Hall University in South Orange, New Jersey.

Mr. Rhatican is married, with two children, and lives in Alexandria, Virginia.

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WS-649

DEBT LIMIT
BRIEFING MATERIAL
HOUSE COMMITTEE ON WAYS AND MEANS

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PUBLIC DEBT
SUBJECT TO LIMITATION
FISCAL YEAR 1976

Based on: Budget Receipts of $298 Billion,
Budget Outlays of $374 Billion,
Off-Budget Outlays of $9 Billion

($ Billions)

	Operating Cash Balance	Public Debt Subject to Limit	With $3 Billion Margin for Contingencies
1975		-Actual	
June 30	7.6	534.2	
July 31	4.2	539.3	
August 31	3.6	548.7	
September 30	10.5	554.3	
October 31	10.3	563.1	
November 30	6.5	567.9	
December 31	8.5	577.8	
1976			
January 31	12.0	585.5	
		-Estimated-	
February 29	6	592	595
March 15	6	601	604
March 31	6	607	610
April 15	6	615	618
April 30	6	606	609
May 31	6	621	624
June 15 (peak)	6	627	630
June 30	6	621	624

DATE: February 9, 1976

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PUBLIC DEBT
SUBJECT TO LIMITATION
TRANSITION QUARTER
JULY-SEPTEMBER 1976
Based on: Budget Receipts of $82 Billion,
Budget Outlays of $98 Billion,
Off-Budget Outlays of $4 Billion

($ Billions)

1976	Operating Cash Balance	Public Debt Subject to Limit	With $3 Billion Margin for Contingencies
		-Estimated-	
June 30	6	621	624
July 31	6	632	635
August 31	6	642	645
September 30	6	640	643

DATE: February 9, 1976

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PUBLIC DEBT
SUBJECT TO LIMITATION
FISCAL YEAR 1977
Based on: Budget Receipts of $351 Billion,
Budget Outlays of $394 Billion,
Off-Budget Outlays of $11 Billion

($ Billions)

	Operating Cash Balance	Public Debt Subject to Limit	With $3 Billion Margin for Contingencies
1976		-Estimated-	
September 30	6	640	643
October 31	6	650	653
November 30	6	659	662
December 31	6	663	666
1977			
January 31	6	665	668
February 29	6	680	683
March 31	6	695	698
April 15	6	703	706
April 30	6	691	694
May 31	6	705	708
June 15 (peak)	6	711	714
June 30	6	694	697
July 31	6	699	702
August 31	6	704	707
September 30	6	707	710

DATE: February 9, 1976

BUDGET RECEIPTS AND OUTLAYS BY FUND GROUP

($ Billions)

	Fiscal Year 1975 Actual	Fiscal Year 1976 Estimated	Transit Quart Actua
<u>Receipts</u>:			
Federal Funds...............	$187.5	$198.4	$54.
Trust Funds.................	118.6	134.8	33.
Interfund Transactions......	-25.1	-35.6	-6.
Unified Budget..............	281.0	297.5	81.
<u>Outlays</u>:			
Federal Funds...............	238.5	276.9	69.
Trust Funds.................	111.2	132.2	34.
Interfund Transactions......	-25.1	-35.6	-6.
Unified Budget..............	324.6	373.5	98.
<u>Surplus or Deficit (-)</u>:			
Federal Funds...............	-51.0	-78.5	-15.
Trust Funds.................	7.4	2.5	- 1.
Unified Budget..............	-43.6	-76.0	-16.

DATE: February 12, 1976

UNIFIED BUDGET MONTHLY
FISCAL YEAR 1976 AND
TRANSITION QUARTER

($ Billions)

	Receipts	Outlays	Surplus or Deficit (-)
1975	- Actual -		
July	$ 20.2	$ 31.2	$-11.1
August	23.6	30.6	- 7.0
September	28.6	29.0	- .4
October	19.3	32.4	-13.1
November	21.7	29.4	- 7.7
December	26.0	31.8	- 5.8
1976	- Estimated -		
January	25.5	31.9	- 6.4
February	20.4	30.7	-10.3
March	17.7	31.9	-14.2
April	35.1	33.3	1.8
May	23.3	31.7	- 8.4
June	36.1	29.6	6.6
Fiscal Year	$297.5	$373.5	$-76.0
July	22.8	34.3	-11.5
August	26.8	32.2	- 5.4
September	32.3	31.5	.8
Transition Quarter	$ 81.9	$ 98.0	$-16.1

DATE: February 12, 1976

FEDERAL FUNDS MONTHLY
FISCAL YEAR 1976 AND
TRANSITION QUARTER

($ Billions)

	Receipts	Outlays	Surplus or Deficit (-)
1975	- Actual -		
July	$ 13.4	$ 27.5	$-14.0
August	13.0	21.0	- 8.0
September	22.3	20.2	2.1
October	13.6	21.6	- 8.1
November	13.4	20.0	- 6.6
December	19.8	27.2	- 7.4
1976	- Estimated -		
January	18.3	24.0	- 5.2
February	10.0	20.7	-10.7
March	10.4	20.5	-10.1
April	25.2	23.5	1.7
May	10.2	22.0	-11.8
June	28.3	28.7	- .4
Fiscal Year	$198.4	$276.9	$-78.5
July	15.2	27.9	-12.7
August	14.7	21.3	- 6.6
September	24.8	20.6	4.2
Transition Quarter	$ 54.8	$ 69.8	$-15.0

Detail may not add to total due to rounding.

DATE: February 13, 1976

TRUST FUNDS RECEIPTS, OUTLAYS AND SURPLUS OR DEFICIT TRANSITION QUARTER

($ Billions)

	Receipts	Outlays	Surplus or Deficit (-)
ederal Old-Age Survivors, and Disability Insurance Trust Funds	$18.9	$19.9	$-1.1
ealth Insurance Trust Funds.....	5.1	4.6	.5
nemployment Trust Fund..........	3.4 1/	3.7	- .3
ailroad Employees Retirement Funds..........................	.5	.9	- .4
ederal Employee Retirement Funds	2.1	2.3	- .2
irport and Airway Trust Funds...	.3	.3	*
ighway Trust Funds..............	1.9	1.9	*
oreign Military Sales Trust Fund...........................	1.7	1.6	.1
eteran Life Insurance Trust Fund...........................	.2	.1	.1
her Trust Funds................	1.8	1.6 2/	.2
tal Trust Funds................	$33.8	$34.9	$-1.1

Includes $1.1 billion advances from general fund.
Includes net activity of trust revolving funds of $- .2 billion.
Less than $50 million.

DATE: February 12, 1976

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TRUST FUNDS RECEIPTS,
OUTLAYS AND SURPLUS OR DEFICIT
FISCAL YEAR 1976

($ Billions)

	Receipts	Outlays	Surplus or Deficit (-)
Federal Old-Age Survivors, and Disability Insurance Trust Funds	$70.8	$73.8	$-3.0
Health Insurance Trust Funds.....	18.6	17.4	1.1
Unemployment Trust Fund..........	16.7 1/	18.5	-1.8
Railroad Employees Retirement Funds........................	3.3	3.5	- .2
Federal Employee Retirement Funds........................	13.0	8.5	4.5
Airport and Airway Trust Funds...	1.1	.8	.3
Highway Trust Funds.............	6.3	6.6	- .3
Foreign Military Sales Trust Fund..........................	6.5	5.9	.6
Veteran Life Insurance Trust Fund..........................	.9	.7	.2
Other Trust Funds................	7.0	5.9 2/	1.1
Total Trust Funds................	$134.8	$132.2	$ 2.5

1/ Includes $8.5 billion advances from general fund.
2/ Includes net activity of trust revolving funds of $-1.1 billion.

Detail may not add to total due to rounding.

DATE: February 12, 1976

OFF-BUDGET AGENCY OUTLAYS MONTHLY
FISCAL YEAR 1976 AND
THE TRANSITION QUARTER

	Federal Financing Bank 1/	Other 2/	Total
1975	- Actual -		
July	$ .6	*	$ .6
August	.7	$-1.0	- .3
September	.1	.5	.6
October	.5	.8	1.3
November	.6	.3	.9
December	.2	.6	.8
1976	- Estimated -		
January	1.2	.5	1.7
February	.8	.3	1.1
March	.5	.5	1.0
April	.2	.5	.7
May	.1	.5	.6
June	.2	.3	.5
Fiscal Year	$5.6	$ 3.8	$9.3
July	1.8	.1	1.9
August	.7	.4	1.1
September	.4	.8	1.2
Transition Quarter	$2.8	$ 1.3	$4.1

1/The outlays of the Federal Financing Bank reflect only its purchase of Government-guaranteed obligations, not its purchases of agency debt, in order to prevent double counting. Virtually all of the other off-budget activity is financed through debt issued to the Federal Financing Bank.
2/Export-Import Bank, Postal Service and U.S. Railway Association.
DATE: February 13, 1976

OPTIONAL FORM NO. 10
MAY 1962 EDITION
GSA FPMR (41 CFR) 101-11.6
UNITED STATES GOVERNMENT

Memorandum

Department of the Treasury 7
Washington, D.C. 20220

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TO : Mr. Snyder

DATE: February 12, 1976

FROM : Mr. Cook RCC

SUBJECT: Federal Financing Bank

The Federal Financing Bank has saved the Federal and federally-guaranteed borrowers who use the Bank $340 million in the 20 months of the Bank's existence.

The amount of savings is based on the conservative assumption that the agencies who have borrowed from the Bank on the average could have raised funds in the market at a cost of 1/2 of 1% above marketable Treasury obligations of similar maturities.

Whereas one or two of these agencies who were established in the market, for instance the Tennessee Valley Authority, were able to raise funds at rates reasonably close to Treasury's cost, many of the guaranteed borrowers whose debt was less well known and who raised funds through negotiated offerings paid rates substantially above the Treasury curve.

Buy U.S. Savings Bonds Regularly on the Payroll Savings Plan

AMERICAN REVOLUTION BICENTENNIAL 1776-1976

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Federal Revenue Estimate Assumptions

The Department of Treasury is responsible for estimating Federal revenues as a basis for budget planning. These estimates are based importantly upon GNP forecasts by a trio of the Treasury, the Council of Economic Advisors and the Office of Management and Budget. The key components for revenue estimating purposes are nominal Gross National Product, personal income, wages and salaries, and corporate profits. As contained in Budget (p. 25), these forecasts are: (in billions)

	Calendar Year 1976	1977
GNP	$1,684	$1,890
Personal income	1,386	1,538
Wages and salaries	892	1,001
Corporate profits (after tax)	156	181

Using these general forecasts and specific revenue information obtained from a variety of sources, the Treasury prepares collection estimates.

The estimating process obviously depends upon several factors: (1) the accuracy of the GNP forecasts; (2) changes in the mix of economic results which cause adjustments in estimates of personal income and expenditures, business spending and profits, unemployment, government transfer payments, etc.; (3) the refinement of statistical estimating procedures; and (4) the frequent revision of tax legislation which can be anticipated only in part. As a result, actual receipts always vary from those which are forecast. However, the discrepancy usually is relatively small. Budget estimating errors over the past six years together with 1950 and 1960 are summarized in Table 1.

PROJECTIONS

SHORT-RANGE ECONOMIC FORECAST

[Calendar years; dollar amounts in billions]

Item	Actual 1974	Forecast 1975	Forecast 1976	Forecast 1977
Gross national product:				
Current dollars:				
Amount	$1,407	$1,499	$1,684	$1,890
Percent change	7.7	6.5	12.4	12.2
Constant (1972) dollars:				
Amount	$1,211	$1,187	$1,260	$1,332
Percent change	−1.8	−2.0	6.2	5.7
Incomes (current dollars):				
Personal income	$1,155	$1,246	$1,386	$1,538
Wages and salaries	763	802	892	1,001
Corporate profits	132	118	156	181
Price level (percent change):				
GNP deflator:				
Year over year	9.7	8.7	5.9	6.2
Fourth quarter over fourth quarter	11.4	6.3	5.9	6.3
Consumer price index:				
Year over year	11.0	9.1	6.3	6.0
December over December	12.2	6.9	5.9	5.9
Unemployment rates (percent):				
Total	5.6	8.5	7.7	6.9
Insured [1]	3.8	7.2	6.3	5.4
Average Federal pay raise, October (percent)	5.5	5.0	4.7	8.6
Interest rate, 91-day Treasury bills (percent) [2]	7.9	5.8	5.5	5.5

[1] Insured unemployment as a percentage of covered employment.
[2] Average rate on new issues within period; the rate shown for 1976 was the current market rate at the time the estimates were made.

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TABLE 1

Budget Estimating Errors

Fiscal year	Overestimate (+) or Underestimate (-) as a Percent of the Actual Figure			
	Estimates made 18 months prior to the end of the fiscal year		Estimates made 6 months prior to the end of the fiscal year	
	Outlays	Receipts	Outlays	Receipts
1950 1/	+4.1	+10.3	+7.8	+1.9
1960 1/	-0.3	-1.7	+1.6	+0.2
1970 2/	-0.7	+2.6	+0.7	+2.9
1971 2/	-5.0	+7.3	+0.6	+3.1
1972 2/	-1.1	+4.3	+2.0	-5.2
1973 2/	-0.1	-4.9	+1.3	-3.1
1974 2/	+0.1	-3.4	+2.3	+1.9
1975 2/	-6.2	+5.0	-3.4	-0.8

Office of the Secretary of the Treasury
Office of Tax Analysis

September 19, 1975

1/ Administrative budget.

2/ Unified budget. The first estimate on a unified budget basis was prepared in January 1968.

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Net Change in Federal Reserve Holdings
of Treasury Securities

($ millions)

	Net Change in Holdings	Net Purchases of Bonds Over 4-1/4%	Net Change in Other Securities
1975			
Jan.	844	28	816
Feb.	-258	82	- 340
Mar.	332	201	131
Apr.	6,428	165	6,263
May	-2,224	3	-2,227
Jun.	-873	109	-982
Jul.	-2,866	---	-2,866
Aug.	663	47	616
Sep.	4,452	124	4,328
Oct.	186	---	186
Nov.	-2,047	244	-2,291
Dec.	2,797	73	2,724
1976			
Jan.	1,948	64	1,884

Office of the Secretary of the Treasury
Office of Debt Analysis

February 11, 1976

FRB Market Purchases of Bonds Issued Under $10 Billion Authority
July 1974 - January 1976
($ millions)

		7%	6 3/8%	6 3/8%	6 1/8%	7 1/2%	6 3/4%	7%	8 1/2%	8 1/4%	7 7/8%	8 1/4%	8 3/
Month	Total 1/	Aug 81	Feb 82	Aug 84	Nov 86	Aug 88-93	Feb 93	May 93-98	May 94-99	May 90	Feb 95-00	May 00-05	Aug 95-
1974													
July	+ 36					7	8	4	16				
Aug													
Sep	+ 35		2	1		2	3	3	24				
Oct													
Nov	+ 25				2	8		7	8				
Dec	+ 22		5	1		3	2	2	9				
1975													
Jan	+ 28		1		2		1		23				
Feb	+ 82				1	15	1	5	12		49		
Mar	+201			1		18	10	21	107		44		
Apr	+165			2		15	2	14	64	52	15		
May	+ 3											3	
June	+109							5	10	45	4	45	
July													
Aug	+ 47					1			2	13	3	5	23
Sept	+124	1				8		4	8	18	2	24	60
Oct													
Nov	+244					1	3		12	17	17	3	191
Dec	+ 73	1	2	1		1	3	1	10	10	2	8	34
1976													
Jan	+ 64	2				1			9	21	1	9	22

Office of the Secretary of the Treasury
Office of Debt Analysis

February 11, 1976

Note: Figures may not add to totals due to rounding.

Treasury Borrowing Program

During the next nineteen months the Treasury will be required to raise $85-90 billion of new money in marketable securities to refund over $51 billion of maturing marketable securities held by private investors.

In accomplishing this unprecedented financing job, the Treasury will, insofar as its statutory authorities and market conditions permit, make maximum use of the coupon market in order (1) to minimize the build-up in floating, highly liquid short-term debt and (2) to avoid, insofar as possible, increasing the already severe structural problems summed up in the decline in the average maturity of the privately-held marketable debt.

The instruments available to Treasury for these purposes, until such time as its statutory authorities are amended, include:

--13 and 26 week bills, auctioned weekly, in current amounts now in the $7 billion range,

--52 week bills, auctioned every four weeks, in current amounts now in the $3 billion range,

--2-year cycle notes, at the end of each calendar month, which have been auctioned in amounts of up to about $3 billion,

--4-year cicle notes, at the end of each calendar quarter, which have also been auctioned in amounts up to $2.5 billion,

--Refunding issues, typically with 3, 5, or 7-year maturities, which have been auctioned in amounts from $3.5 billion for the shorter issues to $2.5 billion for the longer issues; with an overall limit of around $6 billion in any refunding.

--5-year cycle notes, which have been auctioned on an experimental basis in the first month of a calendar quarter to mature on a regular quarterly refunding date. Use of 5-year cycle notes, however, will likely preclude use of this maturity in regular refundings.

Apart from the auction method, either on a price basis against a fixed coupon or on a yield basis, the Treasury has recently used fixed pricing of a coupon issue; e.g., the 7-year note offered at par in the February 1976 refunding. This technique appears to allow a larger offering to be made than the auction technique by placing more debt directly with final investors, but raises policing problems to assure that the interest attracted is primarily investment interest.

	Estimated Market Borrowing Requirements		
	New Money	Refunding	Total
March 1-June 30, 1976	$19-24	9-3/4	28-3/4-33-3/4
July 1-September 30, 1976	18-1/2	7-3/4	26-1/4
October 1, 1976-September 30, 1977	47-1/2	34-1/4	81-3/4
Total	$85-90	51-3/4	136-3/4-141-3/4

7-Year Note Offering

The Treasury has been gratified by the market response to a major effort towards achieving significant debt restructuring and reducing the amount of very short-term Treasury debt in the market by issuing a significant amount of longer-term notes.

The seriousness of the debt management problems facing the Treasury today can hardly be overestimated. In addition to $85-90 billion of new money needs over the next nineteen months, the Treasury is faced with refunding $51 billion of maturing coupon issues in the same period. Moreover, the tremendous buildup in the debt, including a $95 billion increase in the privately-held marketable debt in 1975 and the first two months of 1976, has severely impacted the financing calendar and greatly reduced the options for placing new Treasury debt in a constructive fashion.

These problems have been further exacerbated by the exhaustion of the authority to issue additional long-term bonds without regard to the 4-1/4% interest rate ceiling and by the limitation of the maximum maturity of notes to seven years. The prospect, unless these restrictions are eased, is for a further decline in the average maturity of the public debt and for a further increase in the annual refunding burden. The consequence would be further calendar congestion, more difficulty in issuing coupon securities, and, therefore, increasing pressure to resort to the bill market to meet financing requirements, further shortening the average length of the debt and building up an already large, highly volatile pool of extremely liquid short-term Treasury debt in the hands of the public.

The offering of the 7-year, 8% notes at par represented a deliberate decision by Treasury to break away from the traditional pattern of debt offerings in order to, at least temporarily, relieve the structural problem.

Under the auction technique, which has been the standard offering method for Treasury securities since 1972, a considerable distributive burden is placed on the dealer community in its underwriting capacity. Unlike underwriters

for corporate and municipal securities, however, government dealers receive no price concession beyond the marginal advantage afforded them by their close contact with the market and technical expertness. The spread between the average bid on new Treasury issues and the low bid, however, is typically quite small; i.e., 2 to 4/32, which, at best, would represent a price advantage to a dealer of $1.25 per bond, compared to a concession of $5 to $10 to $20 on corporate and municipal issues, depending on the maturity of the security and the credit rating and marketability of the issue.

As a result, while the auction technique is highly efficient for Treasury offerings of moderate size, say, up to $2.5 billion in a single issue and up to $6 billion in a multiple issue offering, the distributive mechanism is overloaded by larger offerings. Thus, a judgment was reached that to sell an issue, even as large as the $3-1/2 billion initially offered, it would be necessary to change the offering technique so as to place more of the debt directly with final investors.

The response to the offering was unexpectedly strong, with more than 105 thousand individual tenders, totalling more than $29 billion, being received. Thus, the amount of the issue was increased to $6 billion, a 71% increase, and the maximum amount awarded to any subscriber was reduced to $200,000.

The subsequent market judgment is that the issue has been, in fact, well placed and that the speculative interest was held to small proportions. Indeed, the major complaint has been that there is an inadequate floating supply in the market to afford normal trading opportunities.

In contrast, the much smaller, much shorter 3-year, $3 billion issue has apparently been much less well placed with a considerable overhang in the market, which appears to confirm the judgment regarding the pricing of the 7-year issue.

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For information on submitting tenders in the Washington, D. C. area: PHONE WO4-2604

FOR IMMEDIATE RELEASE January 27, 1976

TREASURY ANNOUNCES FEBRUARY REFINANCING

The Department of the Treasury will sell $3.0 billion of 3-year notes, $3.5 billion of 7-year notes and $0.4 billion of 29-year 3-month bonds to refund $4.3 billion of notes held by the public maturing February 15, 1976, and to raise $2.6 billion of new cash.

Additional amounts of the notes may be issued to the Federal Reserve Banks for themselves and as agents for foreign and international monetary authorities and to certain Government accounts in exchange for maturing notes held by them in the amount of $3.8 billion, and to the Federal Reserve Banks as agents for foreign and international monetary authorities for cash. Government account holdings of the maturing notes in the amount of $0.5 billion will not be exchanged for the new issues but may be exchanged for special non-marketable issues.

The securities to be issued will be:

Treasury Notes of Series H-1979 dated February 17, 1976, due February 15, 1979 (CUSIP No. 912827 FG 2) with interest payable on August 15, 1976, and thereafter on February 15 and August 15. These notes will be sold at auction. The coupon rate will be determined after tenders are allotted.

8% Treasury Notes of Series A-1983 dated February 17, 1976, due February 15, 1983 (CUSIP No. 912827 FH 0) with interest payable on August 15, 1976, and thereafter on February 15 and August 15. These notes will be sold at par. Subscriptions will be received subject to allotment.

An additional amount of 8-1/4% Treasury Bonds of 2000-05 dated May 15, 1975, due May 15, 2005, callable at the option of the United States on any interest payment date on and after May 15, 2000 (CUSIP No. 912810 BU 1) with interest payable on May 15 and November 15. These bonds will be sold at auction.

The 3-year notes will be issued in registered and bearer form in denominations of $5,000, $10,000, $100,000 and $1,000,000. The 7-year notes and the bonds will be issued in registered and bearer form in denominations of $1,000, $5,000, $10,000, $100,000 and $1,000,000. Both the notes and the bonds will be available for issue in book-entry form to designated bidders. Payment for the securities may not be made through tax and loan accounts.

The subscription books for the 7-year notes will be open through Tuesday, February 3 except that subscriptions for $500,000 or less will be considered timely received if they are mailed to an official agency under a postmark no later than February 2. Subscriptions must be in multiples of $1,000.

Tenders for the 3-year notes and bonds will be received up to 1:30 p.m., Eastern Standard time, Thursday, February 5. Noncompetitive tenders will be considered timely received if they are mailed to an official agency under a postmark

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no later than February 4. Tenders for the 3-year notes must be in the amount of $5,000 or a multiple thereof. Tenders for the bonds must be in the amount of $1,000 or a multiple thereof. Each tender for the 3-year notes must state the yield desired, and each tender for the bonds must state the price desired, if a competitive tender, or the term "noncompetitive", if a noncompetitive tender. Fractions may not be used in tenders. The notation "TENDER FOR TREASURY NOTES OF SERIES H-1979" or "TENDER FOR TREASURY BONDS" should be printed at the bottom of envelopes in which tenders are submitted.

Tenders and subscriptions will be received at any Federal Reserve Bank or Branch and at the Bureau of the Public Debt, Washington, D. C. 20226.

Competitive tenders for the 3-year notes must be expressed in terms of annual yield in two decimal places, e.g., 7.11, and not in terms of a price. Tenders at the lowest yields, and noncompetitive tenders, will be accepted to the extent required to attain the amount offered. After a determination is made as to which tenders are accepted, a coupon yield will be determined to the nearest 1/8 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 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. Tenders at a yield that will produce a price less than 99.501 will not be accepted. Noncompetitive bidders will be required to pay the average price of accepted competitive tenders; the price will be 100.000 or less.

Competitive tenders for the bonds must be expressed in terms of price, in two decimals, e.g., 100.00. Tenders at a price less than 92.76 will not be accepted. Tenders at the highest prices will be accepted to the extent required to attain the amount offered. Successful competitive bidders will be required to pay for the bonds at the price they bid. Noncompetitive bidders will be required to pay the average price of all accepted competitive tenders; the price may be 100.00, or more or less than 100.00.

The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders and subscriptions, in whole or in part, and his action in any such respect shall be final. Subject to these reservations noncompetitive tenders for $500,000 or less for the 3-year notes and the bonds will be accepted in full at the average price of accepted competitive tenders, and subscriptions for the 7-year notes in the amount of $500,000 or less will be allotted in full. Subscriptions over $500,000 for the 7-year notes may be allotted on a percentage basis but not less than $500,000.

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 and subscriptions for the account of customers, provided the names of the customers are set forth therein. Others will not be permitted to submit tenders or subscriptions except for their own account.

Tenders and subscriptions will be received without deposit from commercial and other banks 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, Federal Reserve Banks, and Government accounts. Tenders and subscriptions from others must be accompanied by payment of 5 percent of the face amount of securities applied for. However, bidders who submit checks in payment on tenders or subscriptions submitted directly to a Federal Reserve Bank or the Treasury may find it necessary to submit full payment for the securities with their tenders or subscriptions in order to meet the time limits pertaining to checks as hereinafter set forth. Allotment notices will not be sent to bidders who submit noncompetitive tenders or subscriptions for $500,000 or less.

Payment for accepted tenders and subscriptions for the notes and bonds must be completed on or before Tuesday, February 17, 1976, and in the case of the bonds include accrued interest from November 15, 1975, to February 17, 1976, in the amount of $21.30495 per $1,000 of bonds allotted. Payment must be in cash, 6-1/4% Treasury Notes of Series A-1976 or 5-7/8% Treasury Notes of Series F-1976, which will be accepted at par, in other funds immediately available to the Treasury by the payment date or by check drawn to the order of the Federal Reserve Bank to which the tender or subscription is submitted, or the United States Treasury if the tender or subscription is submitted to it, which must be received at such Bank or at the Treasury no later than: (1) Wednesday, February 11, 1976, 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) Monday, February 9, 1976, 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. Where full payment is not completed on time, the allotment will be canceled and the deposit with the tender or subscription up to 5 percent of the amount of securities allotted will be subject to forfeiture to the United States.

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TREASURY ANNOUNCEMENT

In view of the substantial public response to the current 7-year note offering, the Treasury reminds investors that it has reserved the right to increase the size of the current offering of 8 percent notes due in 1983 or reduce below $500,000 the maximum amount to be awarded in full.

Consistent with sound debt management principles, either or both of these actions may be taken depending upon the extent of subscriptions received in amounts of $500,000 or less.

February 3, 1976

MEMORANDUM TO THE PRESS January 29, 1976

The response to the Treasury's financing package announced Tuesday has been highly favorable. To assure that the 7-year 8 percent note, which was announced as a part of the package, attracts investor interest, as distinct from interest of a more transitory nature, the Treasury is raising the downpayment requirement to 20 percent from the initially announced 5 percent.

FOR 10:00 A.M. RELEASE FEBRUARY 5, 1976

RESULTS OF OFFERING OF 8 PERCENT 7-YEAR TREASURY NOTES

Preliminary figures indicate that approximately 106,000 subscriptions totalling $29.2 billion were received for the offering of $3.5 billion of 8 percent, 7-year Treasury Notes of Series A-1983.

Due to the overwhelming response to the offering, the Secretary of the Treasury has found it necessary to exercise his authority to reduce the amount of notes to be allotted on subscriptions in amounts over $200,000. Accordingly, all subscriptions for $200,000 or less will be alloted in full and subscriptions over that amount will be allotted $200,000.

Approximately $6.0 billion of the notes will be allotted to the public. In addition, $1.9 billion of the notes have been allotted to Government accounts and Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities.

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

FOR IMMEDIATE RELEASE February 5, 1976

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RESULTS OF AUCTIONS OF 3-YEAR NOTES AND 29-1/4-YEAR BONDS

The Treasury has accepted \$3.0 billion of the \$4.4 billion of tenders for the 3-year notes, Series H-1979, and \$0.4 billion of the \$0.7 billion of tenders for the 29-1/4-year 8-1/4% bonds maturing May 15, 2005, received from the public for the notes and bonds auctioned today.

The range of accepted competitive bids for the notes was as follows:

Lowest yield	7.00% 1/
Highest yield	7.09%
Average yield	7.05%

The interest rate on the notes will be 7%. At that rate, the above yields result in the following prices:

Low-yield price	100.000
High-yield price	99.761
Average-yield price	99.867

The range of accepted competitive bids for the bonds was as follows:

	Price	Approximate Yield	
		To First Callable Date	To Maturity
High	102.14	8.04%	8.05%
Low	101.42	8.11%	8.12%
Average	101.75	8.08%	8.09%

The \$3.0 billion of accepted tenders for the notes includes 15 % of the amount of notes bid for at the highest yield and \$0.5 billion of noncompetitive tenders from the public accepted at the average yield.

The \$0.4 billion of accepted tenders for the bonds includes 68 % of the amount of bonds bid for at the low price and \$25 million of noncompetitive tenders from the public accepted at the average price.

In addition, \$ 1.7 billion of tenders for the notes and \$0.2 billion of tenders for the bonds were accepted at the average yields/prices from Government accounts and from Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities.

1/ Excepting 4 tenders totalling \$2,510,000

WS-631

UNITED STATES DEPARTMENT OF TREASURY

Washington, D. C.

PRESS CONFERENCE

Held by:

EDWIN H. YEO

Under-Secretary for

Monetary Affairs

and

RALPH M. FORBES

Special Assistant to

the Secretary

and

EDWARD P. SNYDER

Director, Office of

Debt Analysis

4:00 p.m.
Tuesday, January 27, 1976

Treasury Building
Room 4121
15th and Penn. Avenue, NW
Washington, D. C.

The above-entitled press conference was convened, pursuant to notice, at 4:10 p.m.

ASSISTANT SECRETARY YEO: We have I think an interesting and important job to do today. I am going to go slowly because we have a good many numbers to discuss.

First, our total requirements through the end of June. In other words, our requirements for the period January June, 1976, are in the range of $38 to 43 billion of borrowing from the public.

Market borrowing is in a range of $35 to 40 billion, the difference being essentially savings bonds. Through yesterday we had announced new cash financing totaling $8.6 billion. This includes the weekly bill to be settled on January 29 and the two-year note which will be settled on February 2.

Taking our first set of assumptions, the $38 to 43 billion, market borrowing $35 to 40 billion, deducting what we have announced through yesterday, gives you a net balance in terms of market borrowing from now through the end of June in the range of $26 to 31 billion.

The $26 to 31 billion range, coincidently, covers the amount of net borrowing we have before us to get through our low point in April.

We have some temporary borrowing to do in June at our low point, but our net cash needs in the last 2-1/2 months of the fiscal year, based on our present estimates -- I would like to emphasize that -- are quite moderate.

The exact amount is really dependent on what sort of end-of June balance we wish to arrive at. I think that if you take the combination of what we have done plus what we are going to announce, plus the concept involving the use of cash management bills to smooth out financing needs, you can see that we have a large but readily manageable debt management task before us.

As a matter of fact, we have already achieved a significant amount in terms of meeting with or dealing with this job.

Looking ahead, one of our objectives will be to minimize pressures on the bill market, making as much use as possible of the two- and four-year cycle notes, and we are also giving serious consideration to establishing a five-year note cycle.

This would be during the first month of each quarter. You could take a -- you could view our January financing as a start.

Now for the financing, we are planning on raising \$6.3 billion of new money financing in February. We will need somewhere between \$9 and \$11 billion the first half of March. This amount is substantial, but the requirement can be met quite readily through the use of the two-year note cycle, well established within the market structure; four-year note cycle; and additions to the weekly and annual bills and cash

management bills in the form of additions to late April or late June.

From mid-March through the April low point we estimate our needs between $12 and $13 billion of new money for borrowing.

As you know, there is a two-year note maturing at the end of March, and as I mentioned, the possibility of a five-year note issued in early April. The balance of requirements can be met through bill additions and further additions to regular bills, and further cash management bills.

Today we are announcing a $700 million addition to the weekly bill which settles on February 5 and the terms of the re-funding which settles on February 16.

There is a total of $4.4 billion maturing on February 16, and we will be offering $6.9 billion of new securities in three issues. This will raise $2-1/2 billion in new money, and bring the total amount through this announcement since the start of the year to $11.8 billion.

So you can see we have a rather, I think, good start.

The three re-funding issues include the following: $3 billion of a three-year note due February 15; $3-1/2 billion of a seven-year note due February 15, 1983; and $400 million in the reopening of outstanding eight-and-a-quarters of 5-15, 2,000 and 2005.

The three-year note and the reopened bond will be auctioned on Thursday, February 5. The three-year note auction will be a yield auction. The bond auction will be a price auction, since the coupon is already established.

The seven-year note will be offered at par with an 8 percent coupon, with the books open through Tuesday, February 3.

Now if you don't mind, it is probably redundant, but I would like to go over this again a little faster.

Our total requirements through the end of June, $38 to $43 billion of borrowing from the public. Market borrowing total is in the range of $35 to $40 billion, with the difference being savings bonds.

Through yesterday we had announced new cash financing totaling $8.6 billion. That includes a weekly bill settled on January 29, a two-year note which will be settled on February 2. As a result, we have a balance of net market borrowing from now through the end of June in the range of $26 to $31 billion.

The $26 to $31 billion range for market borrowing covers the amount of net borrowing. We still have before us to get through the low point in April.

QUESTION: Mid-month?

ASSISTANT SECRETARY YEO: Yes.

While we will have to do some temporary borrowing

to handle our June low point, our cash needs in the last 2-1/2 months of the fiscal year appear to be quite moderate.

I mentioned that one of our objectives will be to continue to minimize pressures on the bill market using the [illegible] and four-year note cycles, and that we are considering establishment of a five-year note cycle.

I mentioned that we are planning on raising $6.3 billion in February and the re-funding, and in the weekly one-year bills, the weekly and one-year bills, and that we will have to raise $10 billion. I gave you a range of $9 to $11 billion, which I think is a better way to approach it, in the first half of March.

In terms of our financing, $3 billion of a three-year note, $3-1/2 billion of a seven-year note due February 15, 1988, $400 million in the reopening of the outstanding eight-and-a-quarters, 5-15, 2,000 and 2,005, a three-year note and the bond auction on Thursday, February 5, the note at yield auction, the bond at price auction because of coupons established, the seven-year notes offered at par with an 8 percent coupon, with the books open through Tuesday, February 3.

Incidentally, on our re-funding, the settlement is February 17, not the 16th, which I mentioned.

This represents an outline plan for dealing with our financing needs this half. We think that it is important that we use the bill market, but use it in such a way that we are

not totally dependent on it.

We think that it is important that we continue to use our 2, 4, and possibly 5-year note cycles. But I would b less than candid if I told you that that was the solution to our overall debt management challenges, because if you have look at our developing maturity structure, you can see that we ar starting to fill up slot after available slot.

It is for this reason that we have asked Congress for additional long bond authority. It is for this reason that we have asked that notes be redefined from seven-year maturi to ten-year maturity.

What we are seeking to construct is a balanced de structure, one that will not provide a legacy for the future in terms of massive amounts of short-term finance resulting in the Treasury being in the market constantly in very, very signif cant size.

I personally think that a debt structure that involved very considerable amounts of short-term maturities results in increased volatility, reduced efficiency, and over the course of events, a higher net interest cost to be paid by the American public.

I think that we have seen over the last two years both domestically and internationally, the effects -- adverse effects -- of market volatility, which in part resulted from heavy reliance, not just on the part of the Treasury, but on part of most borrowers -- heavy reliance on short-term financ

We are using a pricing sale on the seven-year note with the objective of eliciting the maximum interest, and max response. It is related to another problem, which is that we going to have to increase the size of amounts of individual maturities.

On the present basis we are exhausting the calenda. We think that the eights at par represent an attractive invest ment from the standpoint of potential buyers and an attracti financing medium for the Treasury.

In terms of one of our concerns, the longer-run effects on our system of thrift intermediaries, the challeng is to move in the direction of a debt structure that contrib to, among other things, less interest rate volatility, rather than tends to facilitate it.

That is our financing, and I will try to answer a questions you might have.

QUESTION: Can you explain why you are not auction that seven-year note on a yield basis?

ASSISTANT SECRETARY YEO: I am not auctioning it on a yield basis because we think that we can elicit a larger response by pricing it, putting it out wherever one can see

We have the feeling that there are institutional buyers and non-institutional buyers that from time to time can benefit from the use of this particular technique.

QUESTION: Looking ahead, can you estimate whether the borrowing needs in the last half of the calendar year will be greater or smaller than the first half?

ASSISTANT SECRETARY YEO: I would just as soon not get into borrowing needs in the second half of the calendar year, Ed. I can say that I would expect that taking the second half of Calendar 1975 and the first half of Calendar 1976, that we will have completed the largest fiscal year financing that is prospective, assuming that ~~is~~ the policies that we advocate in terms of the budget are agreed to by the Congress.

In other words, we are in a sense thinking in terms of fiscal year. We are well on our way to completing a very large financing task that confronted us at the start of Fiscal '76.

QUESTION: What is borrowing totaling in the first half of the fiscal year?

ASSISTANT SECRETARY YEO: 48.

QUESTION: And just a small point -- the amount that is maturing on February 15 -- is that $4.4 or $4.3 billion?

ASSISTANT SECRETARY YEO: 4.3.

UESTION: You said that the total through this announcement would be $11.2 billion. If you add the $8.6 billion plus the $2.6 billion you are announcing today plus the $700 million of additional weekly notes for next week, you get $11.9 billion. Which one should we use?

ASSISTANT SECRETARY YEO: That is because you used the 4.3. It balances.

QUESTION: Did I understand you to say that for the remainder of February it is this announcement and bills and that is it?

ASSISTANT SECRETARY YEO: That is correct.

QUESTION: Also -- just a matter of memory -- did you suggest -- was there a five-year note sold in January?

ASSISTANT SECRETARY YEO: Yes.

QUESTION: So that could be the start of a cycle?

ASSISTANT SECRETARY YEO: Yes. We announced the five-year note at the end of last year. I don't want to labor the point, but this is necessary, given the large use of the two-year cycle and the four-year note cycle, and while we are making a very decided effort to produce a balanced financing program, we are still of course using the bill market heavily

QUESTION: Will you go over how you get the $11.8 billion?

ASSISTANT SECRETARY YEO: The $8.6 billion that we announced, $700 million in bills, $2.5 billion in terms of the financing.

QUESTION: So the first paragraph should be changed to 2.5 instead of 2.6?

ASSISTANT SECRETARY YEO: It depends on how you round. We will give you the figures.

MR. SNYDER: The amount of maturing securities publicly held we have been carrying in our own minds as a 4.4, and the Fed in its operations from time to time has picked up some coupon issues, and I suppose some of the agencies in their trust accounts have picked up some of the stuff, too. It is very close to 4.35, so you pay your money and take your choice.

ASSISTANT SECRETARY YEO: 4.35 is the precise figure.

QUESTION: So if you use 4.4, then we should have 2 ~~4~~.5 in the net?

ASSISTANT SECRETARY YEO: Yes, sir. Why don't we just agree on that?

QUESTION: 4 ~~2~~.4 and 2.5?

ASSISTANT SECRETARY YEO: Yes.

QUESTION: We will change the release.

QUESTION: I don't quite understand how, with the seven-year notes, this receiving subscriptions subject to allotment, works. Can you give me a brief description of that?

ASSISTANT SECRETARY YEO: We are announcing to the public that investors with a thousand dollars or multiples of $1,000 can subscribe to a seven-year note with an 8 percent coupon placed as par, and the subscriptions are taken by the various Reserve Banks and by financial institutions that in effect submit those subscriptions for their customers.

So that a person -- say that you wanted to invest

in one of our 8 percent seven-year notes, you would go to your bank or Federal Reserve Bank and tender your subscription.

We set it out in detail in the announcement that you have -- the procedure.

QUESTION: If I want to buy just $1,000 in an bond and there was an allotment of 50 percent or something, what happens?

ASSISTANT SECRETARY YEO: It is up to $500,000.

QUESTION: I see.

QUESTION: You are assuming that you will get enough subscriptions to make the $3.5 billion?

ASSISTANT SECRETARY YEO: Yes, sir.

QUESTION: What happens if you get more than that?

ASSISTANT SECRETARY YEO: After the initial $500,000 we allot on a pro rata basis. Let me give you an example.

We are offering 3.5, and let's say just as an example, we had a billion-and-a-half in subscriptions allotted in full. On top of that we had $4 billion and that would mean a 50 percent allotment.

QUESTION: Why did that 1.5 get a full allotment?

ASSISTANT SECRETARY YEO: Because we have indicated that subscriptions up to --

QUESTION: I see -- okay. So the small investor is pretty well assured of getting the full amount --

ASSISTANT SECRETARY YEO: Exactly. The idea is t

give the smaller investor who is not in the position to gauge the ebb and flow of interest, not in a position to really estimate what sort of allotments might be made -- it gives him an opportunity to subscribe and not be concerned about what he is going to receive.

In other words, if he subscribes for $50,000 in 8 percent notes, he is going to get 50,000 8 percent notes.

QUESTION: What are seven-year securities presently yielding in the market?

ASSISTANT SECRETARY YEO: About 7.72, 7.73.

QUESTION: Won't this push all those up to the 8 percent level?

ASSISTANT SECRETARY YEO: Well, we are selling $2 billion in notes. The market will adjust -- it can adjust three ways -- up, down, and unchanged.

The point is this -- that I think generally the market expected a smaller issue for the purposes, for the reasons that I have mentioned. We think it is important to have a good start on our financing needs, and I think that post this financing, investors can or will perceive that a large part of the job, a significant part of the job, has been done.

Gradually, but in retrospect a large part, a significant part completed, so that we do not have a need that is conjectural in terms of how it can be met.

We described how it can be met and we have already

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done a significant part of it.

I might also say that through the April low point that additional coupon financing will be short of the seven-year area.

QUESTION: Four would be the most?

ASSISTANT SECRETARY YEO: Five; maybe a five.

I think the Wire Services might want to -- if we are clear, the Wire Services might want to --

QUESTION: Since it is so complicated, can you give us a little more than five minutes?

ASSISTANT SECRETARY YEO: Sure. About 10 of?

QUESTION: 10 of is fine.

ASSISTANT SECRETARY YEO: Is there nothing new?

Thank you.

(Whereupon, at 4:40 o'clock p.m. the press conference was concluded.)

HYPOTHETICAL INTEREST SAVINGS
FROM ISSUING BONDS
(millions of dollars)

FY	Total Budget Outlays	Interest on Public Debt	Net Interest Cost of Hypothetical Bonds	Gross Interest Cost on Hypothetical Bonds	Less: Interest Savings on Reduced Notes
1966	$ 134,652	$ 12,014	$ ---	$ 14.8	$ 14.8
1967	158,254	13,391	- 0.2	85.8	86.0
1968	178,833	14,573	- 0.9	182.9	183.8
1969	183,548	16,588	- 9.6	302.0	311.6
1970	196,588	19,304	- 30.2	413.4	443.6
1971	211,425	20,959	- 52.1	605.9	658.1
1972	231,876	21,849	- 19.5	691.3	710.7
1973	246,526	24,167	- 7.7	711.3	718.9
1974	268,392	29,319	- 20.1	731.6	751.7
1975	324,601	32,165	- 61.5	731.6	793.1
1976	373,535e	37,700e	- 79.5	731.6	811.1
Total	$2,508,230	$242,029	-$281.2	$5,202.1	$5,483.3

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Details may not add to totals because of rounding.

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HYPOTHETICAL[1/] AND ACTUAL BOND SALES TO PRIVATE INVESTORS
AND EFFECT ON GROSS FINANCING REQUIREMENTS
($ billions)

Calendar Year	Per Year: Bond Sales Assumed	Actual	Total	Gross Financing	Cumulative: Bond Sales Assumed	Actual	Total	Gross Financing
1966	$1.663	$ 0	$1.663	$ 0	$ 1.663	$ 0	$ 1.663	$ 0
1967	1.719	0	1.719	- .381	3.382	0	3.382	- .381
1968	2.216	0	2.216	- 1.198	5.598	0	5.598	- 1.579
1969	1.498	0	1.498	- 1.358	7.096	0	7.096	- 2.937
1970	2.523	0	2.523	- 2.221	9.619	0	9.619	- 5.158
1971	1.389	1.000	2.389	- 2.585	11.008	1.000	12.008	- 7.743
1972	.294	3.321	3.615	- 1.770	11.302	4.321	15.623	- 9.513
1973	.303	1.114	1.417	- 1.916	11.605	5.435	17.040	- 11.429
1974	0	1.613	1.613	- 2.864	11.605	7.048	18.653	- 14.293
1975	0	3.307	3.307	- 1.754	11.605	10.355	21.960	- 16.047

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1/ Assumed sales are equal to 10% of actual notes issued in each quarterly financing in which no bonds were actually sold.

EFFECT ON GROSS REQUIREMENTS
QUARTERLY FINANCINGS, OF HYPOTHETICAL BOND SALES
($ Billions)

Calendar Year	Quarter	Gross Financing Requirements: Actual	With Assumed Bonds	Reduction
1966:	1	$ 7.4	$ 7.4	$0
	2	1.4	1.4	0
	3	4.2	4.2	0
	4	3.5	3.5	0
		$16.6	$16.6	$0
1967:	1	$ 4.0	$ 4.0	$0
	2	4.7	4.7	0
	3	4.0	3.7	.2
	4	4.9	4.8	.1
		$17.6	$17.2	$ .4
1968:	1	$ 8.1	$ 7.9	$ .2
	2	6.1	5.9	.2
	3	5.5	5.3	.2
	4	3.7	3.1	.6
		$23.4	$22.2	$1.2
1969:	1	$ 3.5	$ 3.1	$ .4
	2	4.3	3.8	.5
	3	2.8	2.4	.4
	4	5.8	5.8	0
		$16.3	$15.0	$1.4
1970:	1	$ 4.9	$ 4.9	$0
	2	7.2	6.0	1.1
	3	8.0	7.5	.4
	4	7.4	6.7	.7
		$27.5	$25.2	$2.2
1971:	1	$11.0	$10.4	$ .7
	2	4.2	3.5	.6
	3	5.5	5.3	.2
	4	8.6	7.5	1.1
		$29.3	$26.7	$2.6
1972:	1	$ 4.0	$ 3.4	$ .7
	2	1.8	1.1	.6
	3	8.2	7.7	.5
	4	2.9	2.9	0
		$17.0	$15.2	$1.8
1973:	1	$ 3.5	$ 3.0	$ .5
	2	2.5	1.2	1.3
	3	2.3	2.1	.2
	4	3.8	3.8	0
		$12.2	$10.2	$1.9
1974:	1	$ 4.1	$ 3.6	$ .4
	2	4.2	3.6	.7
	3	4.6	3.9	.7
	4	4.9	3.9	1.0
		$17.9	$15.0	$2.9
1975:	1	$ 5.8	$ 5.3	$ .5
	2	5.1	4.8	.4
	3	5.9	5.0	.8
	4	3.5	3.4	.1
		$20.3	$18.5	$1.8
1976:	1	$ 9.6	$ 9.2	$ .4

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HYPOTHETICAL MATURITY STRUCTURE
WITH ASSUMED BOND ISSUES
($'s Billions)

Calendar Year Quarter		Actual Quarterly Maturities	Hypothetical Maturities	Reduction
1976:	1	$4.4	$3.9	$ .5
	2	4.1	3.0	1.1
	3	4.6	3.6	1.0
	4	4.0	3.7	.3
1977:	1	2.1	1.7	.4
	2	4.4	3.7	.7
	3	3.3	2.9	.4
	4	2.4	1.8	.6
1978:	1	5.0	4.1	.9
	2	6.0	5.2	.8
	3	4.5	3.9	.6
	4	4.6	3.9	.7
1979:	1	3.1	3.1	---
	2	1.8	1.8	---
	3	2.8	2.6	.2
	4	2.3	2.1	.2
1980:	1	1.6	1.6	---
	2	1.7	.4	1.3
	3	1.7	1.4	.3
	4	1.1	1.1	---

Calendar Year Quarter		Actual Quarterly Maturities	Hypothetical Maturities	Reduction
1981:	1	$ 2.8	$ 2.5	$ .3
	2	2.0	2.0	--
	3	.4	.4	--
	4	2.7	2.3	.4
1982:	1	1.7	1.7	--
	2	1.4	1.3	.1
	3	1.9	1.6	.3
	4	2.4	2.3	.1
1983:	1	6.1	6.1	--
	2	1.2	1.2	--
	3	---	---	--
	4	---	---	--
Later:		17.3	28.9	11.6

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February 15, 1976

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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For information on submitting tenders in the Washington, D. C. area: PHONE WO4-2604

FOR IMMEDIATE RELEASE February 13, 1976

TREASURY TO AUCTION $2.5 BILLION OF NOTES

The Department of the Treasury will auction $2.5 billion of 21-month notes to raise new cash. Additional amounts of the notes may be issued to Federal Reserve Banks as agents for foreign and international monetary authorities.

The notes now being offered will be Treasury Notes of Series Q-1977 dated March 3, 1976, due November 30, 1977 (CUSIP No. 912827 FJ 6), with interest payable on a semi-annual basis on November 30, 1976, May 31, 1977, and November 30, 1977. They will be issued in registered and bearer form in denominations of $5,000, $10,000, $100,000, and $1,000,000, and they will be available for issue in book-entry form.

Payment for the notes must be made on March 3, 1976. Payment may not be made through tax and loan accounts. Notes in bearer form will be delivered on March 3, 1976.

Tenders will be received up to 1:30 p.m., Eastern Standard time, Friday, February 20, 1976, at any Federal Reserve Bank or Branch and at the Bureau of the Public Debt, Washington, D. C. 20226; provided, however, that noncompetitive tenders will be considered timely received if they are mailed to any such agency under a postmark no later than Thursday, February 19. Each tender must be in the amount of $5,000 or a multiple thereof, and all tenders must state the yield desired, if a competitive tender, or the term "noncompetitive", if a noncompetitive tender. Fractions may not be used in tenders. The notation "TENDER FOR TREASURY NOTES" should be printed at the bottom of envelopes in which tenders are submitted.

Competitive tenders must be expressed in terms of annual yield in two decimal places, e.g., 7.11, and not in terms of a price. Tenders at the lowest yields, and noncompetitive tenders, will be accepted to the extent required to attain the amount offered. After a determination is made as to which tenders are accepted, a coupon yield will be determined to the nearest 1/8 of 1 percent necessary to make the average accepted price approximately 100.000. 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 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. Tenders at a yield that will produce a price less than 99.751 will not be accepted.

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 $500,000 or less will be accepted in full at the average price of accepted competitive tenders, which price will be approximately 100.000.

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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 the 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 commercial and other banks 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, Federal Reserve Banks, and Government accounts. Tenders from others must be accompanied by payment of 5 percent of the face amount of notes applied for. However, bidders who submit checks in payment on tenders submitted directly to a Federal Reserve Bank or the Treasury may find it necessary to submit full payment for the notes with their tenders in order to meet the time limits pertaining to checks as hereinafter set forth. Allotment notices will not be sent to bidders who submit noncompetitive tenders.

Payment for accepted tenders must be completed on or before Wednesday, March 3, 1976, at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt in cash, in other funds immediately available to the Treasury by March 3, 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) Thursday, February 26, 1976, 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) Tuesday, February 24, 1976, 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. Where full payment is not completed on time, the allotment will be canceled and the deposit with the tender up to 5 percent of the amount of notes allotted will be subject to forfeiture to the United States.

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ADDRESS BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
TO THE TEXAS BANKERS ASSOCIATION,
FORT WORTH, TEXAS
FEBRUARY 16, 1976

Thank you Mr. Friedman, President J. B. Wheeler, Chairman Bruce Campbell, ladies and gentlemen.

It is a pleasure for me to be here in Fort Worth and to have this chance to get together with such an important group. We in Washington have to wrestle with the broad economic issues, but it is bankers like you who are on the front line every day, serving your communities, keeping the local economy alive and contributing to the general, national trend toward recovery which is now gaining momentum.

Yours is not an easy job, and public understanding of the magnitude of your task is often sketchy at best. Too many people still think of bankers as a strange, cold-blooded cross between Clifford Irving and Ebenezer Scrooge. To use Mark Twain's definition, they feel that, "A banker is a fellow who lends you his umbrella when the sun is shining and wants it back the minute it begins to rain."

And what the average American has experienced during the worst recession in a generation -- a recession we are only now beginning to rally from -- has done little to sweeten the public attitude toward the banking community.

The cartoon figure of the selfish, grasping banker, fattening on his moneybags while the plain citizen has more and more trouble just making ends meet is a vivid image in the public imagination. It's not an honest picture, but it is believed by an awful lot of otherwise reasonable people. And this makes it all too easy for political demagogues to use the banking community as a scapegoat whenever the economic going gets rough.

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As with so many of our other national institutions, the banking community faces an even greater challenge in winning and holding public confidence in this increasingly cynical age, a period that future historians may someday dub the "Era of Post-Watergate Morality".

More than ever before, the public is in a doubting, questioning mood -- and understandably so. On the face of it, this new questioning is all to the good, a sign of healthy interest in matters that affect the welfare of us all. Such an inquiring spirit is needed if real democracy is to survive.

But there comes a point where healthy questioning ends and a kind of poisonous cynicism begins; when people begin to think that the cause of all their problems is someone else's fault -- preferably someone high in government, business or finance.

In a negative kind of way, it is very comforting to be able to blame inflation, recession, productivity problems and the high cost of government on Wall Street wolves and local robber barons. It's a cop out, of course -- but a particularly tempting cop out for politicians who have spent the country into unbelievable debt and unacceptable inflation.

So, from a purely public relations point of view, it is not a very good time to be a banker -- as you can appreciate far better than I.

And the sad thing about this lies in one of the biggest economic ironies of our time. In recent weeks we have seen a wave of sensational news stories, in print and on the air, questioning the soundness of the American banking system. The impression that one got from these stories was that the whole structure is tottering on the brink of collapse, with some of the biggest names in banking ripe for the endangered species list.

Now you and I know that this is not the real picture. It is our job to know the facts, and the facts are that the American banking community has emerged from the recession in remarkably good shape. The surprise is not that a few banks -- an infinitesimal fraction of the banking community -- have experienced some difficulties. The real surprise, and it's a pleasant surprise for a change, is that American banks have weathered the storm of the worst recession in a generation, have covered problem loans out of operating funds and have still showed a substantial increase in earnings.

I submit to you that this is a record to be proud of. But I also submit to you that this is an untold success story -- a success story that most Americans have never heard and therefore do not appreciate.

After all the average worker and average housewife have enough to keep them busy without reading the fine print of the financial page or subscribing to the Wall Street Journal or Fortune Magazine. Most of their economic news comes in the form of scare headlines, short, dramatic T.V. spots and political rhetoric....hardly a mixture designed to give deep understanding or tell the full detailed story.

Who is to blame? Certainly not the public. It's hard enough keeping up with the general news -- much less the comparatively dry, complex economic situation. As the great 19th century historian Thomas Carlyle once pointed out, economics is "the dismal science". It doesn't lend itself to glossy picture spreads, spicy interviews or short, simple reports. So neither the public nor the media can be blamed for what is fast becoming the most dangerous communications gap in comtemporary America.

What about the politicians? Certainly they could be a little more responsible than they are. After all, unlike the average American, they do have the time and the resources to get at the facts and see the whole picture. But they have another problem. Every two, four or six years, they have to run for election. So, despite their best intentions, they often end up thinking and speaking not in terms of the long-range public interest, but rather, in terms of short-range political survival.

And that is another of the big ironies of our time. The very measures that are politically tempting in the short run -- Federal giveaways, pump-priming, pork barrel projects and using small segments of the population like the banking community as scapegoats -- these same ploys that help many politicians to buy a little time for themselves and create a false temporary sense of security with the public, spell long-term economic disaster for us all.

Now in fairness to the politicians, we really cannot expect them to do much more than they already are. The job of educating the public while running the office at the same time requires the courage of an Alexander, the wisdom of Socrates, the eloquence of a Demosthenes, and the luck of a good river boat gambler.

It would be both unrealistic and unfair to expect most politicians to combine all of these traits. If they did, we wouldn't face the problems we do right now; I would still be working as a private citizen in New York; and there wouldn't be any reason for you to be meeting here in Fort Worth other than good fellowship.

Which brings me to us -- you as bankers and me as Secretary of the Treasury. Perhaps a large part of the blame for the public's misconceptions about the economic situation lies with us.

If we can't get the story across for ourselves, how can we expect anyone else to do it for us?

The banking community, like the rest of the business community, has performed its internal functions admirably. But the whole private sector -- the source of the enormous abundance, opportunity and freedom that makes our country so unique in the world -- has failed at one crucial test. It is not making itself understood to the media, the politicians and, most importantly, to the people.

The free enterprise system has done a magnificent job for everyone but itself. And as a result, it faces an ever growing menace in the form of diminishing public confidence and increasing domination by the Federal Government.

Consider the energy field. In spite of the impact of the oil embargo and the general increase in the cost of imported fuel, Americans still pay less to heat their homes, run their automobiles and keep the giant wheels of industry turning than any other major industrial power.

The purpose of government energy policy should be to keep those costs as low as possible by encouraging, not discouraging, domestic energy production without creating a massive, permanent Federal energy bureacracy.

Unfortunately, that is not what is happening. I know, I was there at the creation of Federal Energy Administration. And if ever there was a clear illustration of the Federal foot in the door, it is the evolution of F.E.A. Originally, the F.E.A. was intended to be a temporary, emergency measure. Neither I nor anyone else wanted to become a Federal Energy Czar. But that is exactly what happened, not because I or my successors wanted it that way, but because bureacrats and bureacracies have a way of taking on a life of their own. Like too many politicians, their first instinct is for personal survival, whether that survival is in the public interest or not.

So, today, we have not only an energy czar, but a federal energy empire to go with him, and a constant clamor on the political front for more and more Federal regulation and control of petroleum and related energy industries.

Given the poor public image of the oil industry, these demands are increasingly taking the form of cries for divestiture, a move that could potentially cripple rather than enhance American's energy potential.

Attacking the oil corporations makes big headlines and short-term political hay, but those who advocate divestiture have a responsibility to show us how -- if at all -- their proposals would help us to solve our energy problems.

And so far, underneath all of the anti-business rhetoric, there has been precious little substance. Advocates of divestiture have found an entire industry guilty without benefit of trial, and they want the public to blindly agree to their kangaroo verdict.

I say they are wrong. To blindly argue for the dismantling an entire industry without considering the consequences makes about as much sense as arguing that you can get better mileage out of a car by chopping it up into tiny pieces. In fact, you may get no mileage at all. You may destroy the delicate, intricate mechanism beyond repair. At the very least, you will have to spend a great deal of time, energy and money in repairing the damage you have done before you can get it back into working order.

I am proud of the responsible role which the Administration I serve has played in the field of energy. The original legislation proposed by President Ford was sound and responsible; the changes that occurred were the inevitable result of the legislative process. Neither I nor the President are happy about some of those changes but the political climate in the land -- and the communications failure of the private sector -- made those changes inevitable.

The Administration's commitment has been, and continues to be, toward less, not more Federal intervention. But we can't fight this battle alone. It is going to take a massive swing in public opinion, and that, in turn, means a massive effort to educate the public.

As Abraham Lincoln once said, "I have faith in the people.... the danger is in their being misled. Let them know the truth and the country is safe."

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Already, in at least a broad sense, there are signs of a public awakening to the evils of big government.

More and more people are fed up with a Federal Government that costs a billion dollars a day and is going another billion dollars into debt every week.

They are sick and tired of a red ink Federal track record that has yielded 16 deficit budgets in the last 17 years; that has seen the Federal budget quadruple in the past 15 years, and has seen the national debt doubled in a decade.

And they are fed up with the growing encroachments of the Federal bureacracy into their everyday lives. They resent the fact that today Federal Bureacrats whom they would not have voted for, did not hire and cannot fire have the power to control everything from where their children go to school to how their local communities spend their revenues.

Yet unless this general public dissatisfaction can be channeled, informed and articulated, the Federal juggernaut will keep on rolling and growing by the weight of its own momentum.

The Federal Government today is the nation's biggest single employer, its biggest consumer, and its biggest borrower. If present trends continue until the end of this century, government at all levels could account for almost 60 percent of our gross national product -- 60 cents out of every dollar.

If that day ever comes, we will not longer be a free country in any meaningful sense of the word. And to stop that day from coming, we must act now.

Nineteen seventy six is our bicentennial year. Across the country millions of Americans are celebrating the 200th anniversary of a struggle that was fought and won for the freedom of the individual.

But, like all great and worthwhile undertakings, that struggle still goes on.

The men and women of '76 and the millions of immigrants who followed them came to these shores to escape the kind of government that over-taxed, over-regulated, and, ultimately, stripped the individual of his political as well as his economic freedoms.

Today, 200 years later, the question remains: Do we preserve the sacred heritage of government of the people by the people for the people or do we trade our heritage of freedom for the false security of a state-run economy "of the bureacrats, by the bureacrats, for the bureaucrats?"

As a citizen, as a father and as one who has seen the intimate workings of government first hand, I deeply believe that the central, underlying issue of our time is this basic confrontation between the freedoms we cherish as Americans and their erosion by runaway big government.

Our cause is just and our cause is strong. It is up to us to get it across to the American people.

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REMARKS BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE THE
MOBILE CHAMBER OF COMMERCE
MOBILE, ALABAMA, FEBRUARY 16, 1976

Congressman Jack Edwards, President William Holland, Ladies and Gentlemen:

It is a pleasure for me to be here in Alabama, not only in the traditional heart of Dixie, but in a city that is a shining example of the economic vitality of the modern South. And I am proud to share this occasion with a man who has again and again stood up for sound principles and common sense in both government and the economy -- Congressman Jack Edwards. Jack is doing a fine job for Mobile and for America.

In this election year, when the newspapers and the airwaves are overloaded with political rhetoric and promises of pie-in-the-sky, the last thing you want to hear from me is yet another political speech.

Don't worry. You're not going to.

"Practical politics too often consists of ignoring facts." And it is facts -- hard, crucial economic facts -- that I want to discuss with you today. For, long after the sound and fury of the 1976 campaigns are only a memory, the economic decisions that we make in the months immediately ahead will shape our lives and the lives of our children.

As I appear before you this evening, Washington has already entered the first phase of the annual economic battle between the President and the Congress on what we should do and where we should be heading during the coming year. And rest assured that the advocates of big government will be in there pitching for more federal interference and more federal spending with all of the enthusiasm of boll weevils burrowing into cotton plants.

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In all of the material that will be flowing forth from the White House during this period, one point will be abundantly clear; we believe that the first and foremost task of the Nation in 1976 is to restore the vitality of our economy. We are encouraged by the progress that was made during 1975:

-- As you will recall, the year 1975 opened with inflation raging at 12%; we have cut that rate nearly in half -- to about 7%;

-- During the spring of 1975, the unemployment rate reached 9%; today it is at 7.8%.

-- With the January employment increase of 800,000, nearly all of the jobs lost during the recession have now been restored.

-- During the third quarter of 1975, we registered the biggest single jump in the GNP in 25 years and the fourth quarter's pace, while slower, still indicates the recovery is maintaining its momentum.

-- There are also many other indices of an economy that is regaining its health -- higher industrial production, growing retail sales, and a very bullish stock market.

Thus we made considerable headway in 1975, and we will make even more in 1976. But it's not good enough and this is certainly no time for complacency. The unemployment rate is far higher than we can tolerate. And inflation is by no means under control. In fact, it remains the most dangerous enemy of future economic growth, and we must do nothing to unleash another inflationary spiral. The ruinous inflation that crested in 1974 was the chief cause of the severe recession of 1975; if we embark once again upon excessive fiscal and monetary policies resulting in double digit inflation, I will guarantee an even worse recession than before. Please let us not permit the pain and suffering of the 1974-1975 recession be in vain.

There will be a tendency in Washington in 1976, especially as the elections draw closer, to look with great alarm upon the current unemployment figures and inflation figures. You are going to hear a great deal more rhetoric in coming months about the so-called indifference of this Administration to push hard enough, to spend enough, to act decisively enough in solving our problems. We must not fall prey to those who offer us instant cures -- the so-called compassionate people who promise us everything but deliver us only one thing: inflation.

In judging this matter, I urge that you step back for a moment and ask yourselves a few basic questions;

-- How is it that the richest and most powerful country on earth could wander into this economic quagmire?

-- How could the most dynamic economic system in the world become infected with the diseases of both inflation and unemployment at the same time?

-- Indeed, where did we lose our way as a people?

I believe it is essential to decide how we got into this mess before we can really determine the best way to get out. Otherwise, we may just become more deeply mired. Economists argue about this a good deal. Politicians often ignore this question entirely, and seek instead to capitalize on the effects of problems. But to me, there is no real mystery about how we got here, nor what we must do.

It is clear, for instance, that the economic and social problems of today do not spring from lack of concern in Washington. In the 10 years after President Eisenhower left office, the Congress increased the number of domestic spending programs from about 100 to over 1,000.

It is also clear that we have not failed from a lack of compasssion. Since 1960, this Nation has spent over one trillion dollars on social programs to support people and communities that needed help. 73% of our entire budget is now committed to social (non-defense) programs. The compassion and generosity of the American people should not be in question.

Nor can we say that our problems stem from a lack of trying to control the business cycle. In the 1960's, it was popular to believe that the government could mandate permanent prosperity through the Great Society, could fine-tune the economy and abolish the ups and downs of economic growth. And we tried to do that with the tools of fiscal and monetary policy, making one adjustment after another.

Nor do our troubles result from a lack of effort on the part of the government to control business -- big and small. Today we have an army of approximately 100,000 government employees whose mission is to regulate and control almost every activity of the private sphere.

Nor have we had any lack of vision from our leaders. The staple of Washington life has become the politician with grand visions and even grander promises of what can be accomplished if he can only spend more of our money or can be given ~~greater~~ authority over our lives.

So, over the past 10-15 years, the government has tried many, many solutions. Yet the problems persist and our people grow frustrated and disillusioned.

Does this mean there are no answers? Of course not. What it means, I would suggest, is that we have been taking fundamentally the wrong approach. We suffer not from a lack of government action, but from an excess of government action.

The trouble with the Federal Government is that it is trying to do more than its resources permit, to do many things that it cannot do very well, to do some things that it should never do at all, and to do all these things at the same time. That just does not make common sense.

Excesses in the government have been most apparent, I would suggest, in three critical areas affecting the economy;

-- Fiscal policy;

-- Monetary policy; and

-- Regulatory policy.

No one who has followed the pattern of federal spending in recent years can fail to be impressed by its explosive growth.

-- The federal budget has quadrupled in 15 years;

-- We have had 16 budget deficits in 17 years;

-- And we have doubled the national debt in just 10 years time.

The Federal Government today is the Nation's biggest single employer, its biggest consumer, and its biggest borrower. And if present trends continue until the end of the century, government at all levels will account for almost 60% of our gross national product. Let there be no doubt that if government ever becomes such a dominant part of our society, our economic freedoms will disappear, and when we lose them, our political and social freedoms will not be far behind.

Partly to accommodate the Federal Government's borrowing needs in the private markets, there has also been a less noticed but equally significant shift in monetary policies. From 1955 to 1965, the money supply of the United States was growing at approximately 2-1/2 percent a year, and we enjoyed relative price stability. From 1965 to the present, however, the average rate of growth has more than doubled, and it is no accident that during this period we have also had spiraling inflation.

This past decade has also seen unparalleled growth in the regulatory apparatus of the government. Regulatory agencies of the government now exercise direct control over 10 percent of everything bought and sold in the United States and indirect control over almost every other sector of the private economy.

Whenever I start talking about the bureaucracy in Washington, I am reminded of a remark by Pope John.

The Pope was entertaining a visitor once who asked him: How many people work in the Vatican? The Pope thought for a second and said -- "About half". Well, that's usually true in the bureaucracy too. But the Federal regulators are a different breed of cat -- they seem to work harder than anybody else in Washington, and they're even more creative, as their results certainly show. I'm told that the American people now spend over 130 million work hours a year filling out Federal forms. That too, just doesn't make good sense.

The regulatory process has now become so burdensome, for all businesses, big and small, that it is threatening to strangle much of free enterprise in red tape. Consider also the staggering costs involved. One major firm estimates that in 1974 it spent \$1.3 billion dollars complying with or in anticipation of government regulation at all levels. It has been estimated that the American people paid the equivalent of \$2,000 per family in increased costs for all the goods and services they purchased because of regulation.

When you add up all these factors of excessive government spending, excessive expansion of the money supply, and excessive governmental regulation, one conclusion seems inescapable; both our inflation and our unemployment should bear a label -- made in Washington, D.C.

The fact is that governmental excesses of the past 15 years became a strong, underlying cause of inflation during the 1960's and they remain so today. The rise in government spending has added enormously to the aggregate demand for goods and services in the economy, thus forcing up prices. The heavy need for Governmental borrowing means it must now have 30% of all new long term lonable capital, leaving only 20% to the private sector.

It is also clear that as the forces of Big Government have been fed and nourished, our private enterprise system -- the system that provides five out of every six jobs in the country and is the driving force of our society -- has become sadly undernourished. We have gradually channeled a higher and higher percentage of our resources into consumption and Government spending and less and less into savings and investment. As a result, the United States since 1960 has had the lowest rate of capital investment of any major industrialized country and one of the lowest rates of productivity growth. There can be no doubt that higher productivity is the secret to a higher standard of living. Thus, it is clear, as President Ford said, that we must strike a new balance in our economy -- a balance that favors a much stronger and healthier free enterprise system.

If the country could grasp these central truths -- and I believe people are beginning to understand and appreciate them -- then it would be much easier for all of us to agree upon the solutions. As I have said, I believe the solutions are relatively straightforward -- and, I might add, they are the basic policies of the Administration.

The centerpiece of our economic policies is the President's proposal to cut the growth in Federal spending and to return to the savings to the American taxpayer in the form of a major tax cut.

In the last several months, the President has spent literally hundreds of hours trying to pare down the budget -- in fact, he spent more time on this budget than any President in a quarter of a century. The result was a very realistic and solid budget that calls for a $28 billion cut in projected spending growth. Instead of spending over $420 billion, the President is asking that in fiscal year 1977 -- which begins this October 1 -- that we limit spending to $394 billion. We should realize that in the last two years alone, Federal spending has grown by 40%. Under the President's proposal, next year's spending increase will be limited to 5.5% -- the smallest increase since the days of President Eisenhower.

As the President said in his State of the Union Address, The only way to hold down the cost of living is to hold down the cost of government. No government can spend more than it makes, year-in, year-out, without reaching a point of financial collapse. None of us wants the tragic experience of New York City this past year to become a preview of our future as a Nation.

By holding down the growth in Federal spending, we can also afford additional tax cuts and thus leave more money in private hands where it can do the most good.

What the President is saying is this: We can have a much bigger and much better tax cut if we will only cut the growth in spending.

I think two points are critical: One, the tax and spending plan would put us on the road to balancing the Federal budget within three years. Secondly, if we stay on that road, I believe it should be possible to enact another tax cut before the end of the decade.

The government has other ways to curb inflation. We are

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seeking greater competition in private industry through antitrust laws and we are trying to lower barriers to international trade. But the key is to restrain Federal spending, reduce the horrendous Federal deficits, and strengthen the free enterprise system.

If we are to fulfill our promise as a Nation, it is equally vital that there be enough jobs. The President's tax and spending cuts are a major part of that effort. But we can and must do more. We must offer the American people and American industry much greater incentives to invest in the future -- to expand our supply of housing, to build new plants and equipment, to modernize industry, to expand our energy resources, and of greatest importance, to accommodate a growing labor force. The capital investment needs of the future are extremely large: about $4-1/2 trillion in the next decade -- or three times as much as we spent in the last decade.

Most of the responsibility for raising new capital must lie with the private sector -- a private sector that is invigorated by getting the government out of the marketplace, invigorated by a reduction in taxes, and invigorated by striking a new balance that favors less consumption and government spending and more savings and investment.

Last summer, on behalf of the Administration, I proposed a plan that would eliminate the double taxation of corporate dividends and would thus encourage greater private investment. Most of our European competitiors have already adopted this tax approach, and I firmly believe it is time for the United States to catch up. That tax plan remains a central part of our economic strategy within the Administration.

Furthermore, the administration is advocating a broadened stock ownership plan to encourage more Americans to invest in American-owned companies.

Another major aspect of the President's economic program is in the regulatory field. It is even more difficult to achieve reform of Federal regulations than to fill out the federal forms that go with them, but we are determined to try. Specifically, we are now seeking to lighten the regulatory burden in four key areas -- banking, airlines, trucking and railroads -- and we are currently investigating what can be done in others. It is no accident, we believe, that three of the industries in greatest difficulty today -- airlines, railroads, and utilities -- are also among the most highly regulated industries in the country.

If time permitted, I would like to talk about many of the other aspects of our policies -- what we are seeking to do in energy, what we are trying to achieve in our international policies, the cushions that we are placing beneath the unemployed, etc.

But let me conclude with these few observations:

As we enter our third century as a nation, I believe the time has come not to reappraise our dedication to a better life for all -- that dedication is clear -- but to reappraise what we can pay for and how we can do it. The current plight of New York City, the disease that afflicts the British economy, and the overwhelming size of our own federal deficits are all grave warnings to us. We can pay for what we now have and provide for the future only if our great capitalist economy does its job -- produces goods in a free market and makes a sufficient profit.

I am sick and tired of people apologizing for the free enterprise system. It has given this country the highest standard of living and the greatest prosperity ever known, and of most importance, has helped to give us the greatest freedom ever known to man. And it will continue to do that unless it is crushed by the juggernaut of big Government. What we need are not fewer but more capitalists in the United States -- more people with a real and direct stake in the profits generated by a productive economy. We cannot continue to have more and more of our citizens involved only in receiving benefits from the government, and fewer and fewer people responsible for paying for the benefits. We must broaden the base of those who work and narrow the base of those who are able but don't want to work.

President Ford urged that we strike a "new balance" in our national life:

--A balance that favors greater freedom and vitality for our private enterprise system;

--A balance that favors greater honesty and realism in dealing with the challenges of our time.

These are great goals -- goals worthy of the greatest nation on earth. We should not begin our Bicentennial year by retreating into the past, but by going forward into the future with a combination of patience, realistic hope, courage, and common sense.

If we work together with common purpose and conviction -- with pride in ourselves and our Nation -- the goals we share today can become the first achievements of our third century together.

President Ford has set a course which points us in the right direction and will permit us to get a grip on these problems, but it will take several years, not months, to bring this about. Unfortunately, the election is only a bit over nine months away. There will be calls from the opposition for "sweeping changes" and "broad new initiatives" which will really mean bigger spending, bigger deficits and ultimately bigger governmental control of the economy. We must persuade the American people that this course is wrong and that the other approach is much sounder in the long run. The real choice is between greater government control or greater individual freedom. That is the decision before us. Thank you.

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STATEMENT BY THE HONORABLE GERALD L. PARSKY
ASSISTANT SECRETARY OF THE TREASURY
BEFORE THE
SENATE COMMITTEE ON INTERIOR AND INSULAR AFFAIRS AND
THE SENATE COMMERCE COMMITTEE
TUESDAY, FEBRUARY 17, 1976, AT 9:30 A.M.

Financing an Alaskan Natural Gas Transportation System

Mr. Chairmen and Members of the Committees:

I am pleased to testify before you today concerning the proposed Alaskan natural gas transportation systems. I will concentrate my remarks on the questions of the feasibility of financing this large project in the private capital markets.

At the outset, I should note that we believe that it is possible to arrange a financing without Federal financial assistance. Although the unprecedented size and the risks of the project make private financing a difficult task, we are convinced that with the proper regulatory actions as well as participation by the various parties benefiting directly from the project, a private financing could be accomplished.

Federal financial assistance should not be used as a substitute for proper regulatory action as this would surely

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generated by the project. The preliminary financing plans involve capitalization of 25 percent equity and 75 percent debt.

Before they will provide funds to either of the proposed projects, both equity and debt investors must be satisfied that the project is creditworthy and that the level and certainty of their expected return on investment is adequate to compensate them for the risks they assume. The bulk of the equity will be provided by the project sponsors, and the debt will be sought mainly from financial institutions.

Although debt investors generally assume some amount of risk in return for higher interest rates, the large amounts of capital required for this project probably cannot be raised if there is any substantial perceived risk to the timely repayment of principal and interest. Thus, a prerequisite to financing this project is to establish that payment of debt service could be expected regardless of what other events occur. The two major financial risks faced by investors are (1) the risk of non-completion of the project and (2) the risk that, once completed, revenues will be insufficient to cover all project costs--including debt service. Non-completion could result from unforeseen construction difficulties, excessive cost overruns that make the project uneconomic, environmental suits, and other legal or political difficulties. Insufficient revenues could result from (a) the failure of regulatory agencies to allow tariffs which recover the full project costs, or (b) interruption of gas flow due to natural disaster, mechanical failure, or other force majeure events.

The Non-Completion Risk

In the event of non-completion, the fundamental concept of project financing (i.e., service of debt through project revenues) is frustrated and, in the absence of other protection, the lender loses his investment. Therefore, before committing funds to an Alaskan gas transportation system, lenders will seek (a) assurances that there are adequate funds to finance completion and (b) protection in the event of non-completion for reasons other than lack of funds.

The first non-completion risk of major concern to investors involves large cost overruns which could result from such things as delays in the construction schedule or errors in engineering estimates. In addition, construction delays would add to debt-interest costs.

The second major non-completion risk of concern to potential lenders is the fact that their debt might not be repaid if the project never goes into operation to generate the revenues they are looking to as the primary source of their debt service. As in the case of cost overruns, investors must have adequate assurances that their debt will be repaid in the event of non-completion before they will advance funds to the project.

Thus, the key question is who will finance cost overruns and bear the other risks of non-completion of the project? At this point in time, the question remains unanswered. If a private financing is to be arranged, these risks must be borne by one or more of the various parties standing to benefit directly from the project, including:

--Equity investors

--Other gas pipeline and distribution companies receiving gas

--Gas consumers receiving gas

--Owners of Alaskan gas reserves or

--State of Alaska.

We believe that these potential project beneficiaries collectively have the capacity to provide lenders the necessary assurances against non-completion risks. The financing capabilities of these main project beneficiaries are discussed at some length in our contribution to the Interior Department Report. I refer you to that report for our detailed analysis, but I would like to summarize for you briefly our analysis of the various categories of beneficiaries.

Equity Investors. As discussed in the Interior Report, it appears that, considering both internally generated cash flow and external financing possibilities, the current group of project sponsors could provide the requisite equity capital--although this would clearly be a large undertaking for a group of companies of this size, and some problems could arise for particular companies.

However, the lenders will also be looking to the project sponsors to provide part of any cost overrun financing that might be required or possibly assist in repaying debt in the event of non-completion. While such commitments do not require the immediate generation of cash, they do result in a contingent liability of an indeterminate and conceivably quite large amount. As they themselves have indicated, the current sponsors apparently do not have the capacity to assume fully the risk of repayment of the project's debt.

Gas Pipeline and Utility Companies. There are a number of interstate gas pipeline and distribution companies, other than El Paso and those in the Arctic Gas group, who could be considered as potential project sponsors. For example, the ten largest of these other interstate gas pipeline companies (in terms of natural gas sales) had a combined internal net cash flow of about $1.5 billion in fiscal year 1974. Were the 1974 cash flow levels to continue, the combined internal cash flow of these companies over a six-year period would be around $9.0 billion. Thus, they could make a substantial contribution toward financing and bearing the cost overrun and non-completion risks of this project.

Owners of Alaskan Gas. Another potential source of financing would be the owners of the gas reserves. They recognize that without a transportation system the large proven gas reserves and potential future gas discoveries are virtually worthless. However, it must be recognized that any decision by the producers to help finance the project would have to take into account other competing demands for funds, the rates of return on alternative projects and the fact that they are already committed to provide substantial additional amounts of capital in order to produce North Slope oil and gas. One action which could affect the willingness and ability of these companies to participate in the financing would be the deregulation of wellhead price for Alaskan gas.

Gas Consumers. A third additional source of financing is gas consumers. The large benefits that are expected to accrue to consumers of Alaskan gas would appear to justify the adoption of regulatory procedures which would involve them more directly in financing and bearing the risks of this project. With respect to the cost overrun and non-completion risks, a surcharge on current gas consumption might be used to help finance cost overruns and/or repay project debt in the case of non-completion.

Very large amounts of capital could be raised in this way. One form of surcharge would be a direct add-on to the current utility bill which would be used to finance cost overruns. Another, somewhat more indirect, form would be the inclusion of work in progress in the rate base so that consumers would pay the interest charges on project debt and return on equity investment while the project is under construction. A consumer surcharge mechanism, in effect, increases the <u>current</u> cost of gas to consumers but reduces <u>future</u> costs to a level lower than would prevail if consumers did not help finance the project. This reduction in future costs comes about because the amount of debt service (i.e. principal and interest payments) that would have to be recovered through transportation tariff charges would be reduced.

State of Alaska. The State of Alaska is another potential source of financing. Alaska would receive significant benefits if production of Alaskan gas were assured by the building of a transportation system since it would receive a 12-1/2 percent royalty and approximately a 4 percent production tax. Thus, the State of Alaska, as a direct beneficiary of a transportation system for gas, might decide to finance a portion of the pipeline or help finance cost overruns or guarantee a portion of the debt to insure its repayment in the event of non-completion.

Other. Other potential project beneficiaries who might bear some of the cost overrun and non-completion risks include (1) large industrial gas customers who could provide substantial amounts of capital through advance payments in exchange for an assured supply of gas and (2) the financial institutions providing debt capital who might be willing to commit to finance some level of cost overruns.

As this summary indicates, there are direct beneficiaries of the project who together have the capacity to finance substantial cost overruns or repay the project's debt in the case of non-completion.

The Risk of Insufficient Project Revenues

Even if the various project beneficiaries were able to provide adequate assurances to the prospective lenders with respect to non-completion risks, the difficult question of who would bear the risks of inadequate project revenues would remain. With projects of this size and complexity, even a low risk of interruption or diminution of revenues is of concern to lenders. As in the case of non-completion, if a private financing is to be arranged, this risk must be borne by the various parties standing to benefit directly from the project.

There are two major ways of satisfying the lender's need to have some mechanism to insure debt repayment in the unlikely event of a long-term service interruption. First, the lender might be satisfied by a clearly creditworthy party, or parties, agreeing to guarantee repayments of the project's debt. In many projects, this type of guarantee is provided by the project sponsors. However, in the present case, the proposed projects are so large that the current group of gas pipeline and utility sponsors have indicated that they do not have sufficient aggregate credit to satisfy the lenders. Therefore, if a private financing is to be achieved, it may be necessary to strengthen the combined credit of the sponsoring group by adding new members (for example, additional gas pipelines and utilities, and/or the State of Alaska and/or the gas producers). As I noted earlier, this could also assist in covering the risks of project overruns or non-completion.

Second, users of the project's output or service might enter into what are called "all events full cost of service contracts." Under such a contract, the purchaser is obligated to pay a minimum amount sufficient to service the project's debt and cover certain other project costs even if he does not receive output from the project. In short, he pays regardless of what other events may occur. Thus, lenders might be satisfied with an "all events full cost of service contract" which would require gas shippers to pay the full cost of operating the transportation system (including debt service), regardless of whether gas was flowing or not. In theory, this type of tariff would assure lenders that, once the project is completed, revenues would always be adequate to cover the project's expenses. Under such a contract, the costs could be passed on to the local gas utilities, who in turn, assuming approval by relevant State regulatory authorities, would pass on the cost to gas consumers.

Such a tariff would be essentially an insurance program underwritten by consumers to cover whatever risks commercial insurance companies will not underwrite, or do not choose to underwrite, at reasonable costs. By accepting these risks, consumers would not only assist in arranging a private financing, but would also benefit from lower gas transportation charges from two sources. First, the insurance premiums associated with an unconventional commercial insurance program would be avoided. Second, the debt interest costs would be lower, reflecting the increased creditworthiness of the project.

Thus, an all events full cost of service tariff could provide substantial assurances to lenders with regard to the adequacy of revenues to repay the project's debt. If, in addition, there were a wide distribution of Alaskan gas, this could minimize any contingent price increase which consumers might face under such a tariff were there to be a service interruption. Taken together, a clearly enforceable all events full cost of service tariff and a wide distribution of Alaskan gas do offer one way of handling the risk of insufficient project revenues.

Nevertheless, it should be clearly recognized that an all events full cost of service tariff implies that gas consumers would bear much of the project's post-completion risks, including force majeure service interruptions or even costs resulting from management error. Whether it is reasonable to ask certain gas consumers to bear this level of risk must be judged in relation to the benefits those gas consumers could expect to receive, and whether such risk bearing is required in order to get the project financed. Apparently, the gas consumers receiving Alaskan gas could expect to receive substantial economic benefits. I believe that under the present system of regulated wellhead natural gas prices, gas consumers are in a favored position and could receive the bulk of the net economic benefits made available by a gas transportation system.

From the standpoint of arranging private financing, I believe that an all events full cost of service tariff could be needed. Nevertheless, it would be premature to rule out the possibility that the level of risk which gas consumers would bear under an all events tariff could be reduced by adopting something less than the full cost of service feature. This might be accomplished by carefully defining in the tariff which categories of costs are allowed to be passed on in all events. In addition, provision might even be made for a reduction in the return on, or a partial loss of, stockholder's equity in the case of management error. Through specially designed tariff formulas, we believe the risks associated with an Alaskan gas transportation system can be equitably shared between project sponsors and consumers.

In any event, such a tariff would have to be approved by the Federal Power Commission--a decision that has not yet been made. If approval does occur, it may be necessary to consider ways of assuring both the gas pipeline and gas distribution companies and the lenders who are relying on this tariff that the tariff will be maintained and enforced over the life of the project.

Feasibility of a Private Financing

On the basis of this analysis, we believe that the various private parties standing to benefit directly have the capacity to finance the project and bear its risks.

Since the project seems to be economic on current price/cost estimates, there is sufficient incentive for these parties to arrange a private financing provided the needed regulatory actions are taken, including steps to involve gas consumers in sharing the risk of the project. Certainly the extent of involvement of gas pipeline and distribution companies, as well as the extent of participation of the owners of the reserves, will be important. However, the regulatory conditions under which the project will operate will be critical to determining whether the project will be financed privately.

Government Financial Assistance

Whether a totally private financing is achievable will remain a matter of speculation until one of the projects is selected and its sponsors are able to determine further the capabilities and intentions of the potential financial participants and to determine the regulatory conditions under which the project would be constructed and operated. If the needed regulatory actions are not taken and a private financing cannot be arranged, then we believe that the economics and risks of the project raise serious questions as to whether it should be undertaken at the present time. On that basis, I think it would be premature to consider legislation providing Federal financial assistance to the project.

Despite this, if the Congress eventually determines that some form of Federal financial assistance to the project is both necessary and desirable, then the following important considerations should be kept in mind. First, any Federal financial assistance granted should be kept to the absolute minimum needed to achieve the desired result: Construction of the gas transportation system. Federal assistance should supplement and facilitate the maximum feasible amount of private financing for the project; it should not substitute for available private financing or for appropriate regulatory actions.

Second, any legislation providing such assistance should give the administrator of this assistance adequate flexibility to tailor the form of financial assistance to the needs of the project. At this time, we, of course, do not know which of the particular financial risks of this project which I have discussed may prove insurmountable without Federal assistance and it would seem desirable to defer legislation until the problems of the project are sufficiently well understood to allow identification of why the private market cannot respond. However, possible forms of such assistance would include Federal guarantees of the project's debt against certain specific risks such as non-completion of the project or long-term service interruptions, Federal insurance against the service interruption risk, or the financing of cost overruns above some determined level. The exact type, amount, and terms of any Federal assistance would have to be worked out through detailed negotiations with the project's sponsors.

<u>Third</u>, it is important to minimize the impact on our capital markets and on the management of the Federal debt of any Federal financial assistance program. Any type of Federal financial assistance resulting in the undertaking of investments that would not otherwise have been made leads to some redirection of resources in our capital markets. Such incentives increase the demand for capital while having little or no effect on the overall supply of capital and thus tend to cause interest rates to rise. Accordingly, we believe it is essential that the Secretary of the Treasury have the authority to approve the timing, terms, and conditions of any Federal guaranteed securities that might be issued.

<u>Conclusion</u>

In conclusion, I would like to stress again our belief that <u>if appropriate regulatory and administrative actions are taken</u>, Federal financial assistance to an Alaskan gas transportation system will not be necessary and therefore I would urge that no such Federal assistance be provided at this time. Instead, I would recommend that one or more of the following actions be taken:

1. Prompt selection of a specific gas transportation system;
2. Grant of all necessary governmental authorizations including timely resolution of all environmental and legal questions regarding the project;

3. Approval of all events tariffs which permit shippers to pass on a substantial portion of the costs, if not the full costs, of the project to the ultimate consumer coupled with strong assurances that they will be maintained in effect and enforced over the life of the project;
4. Approval of a mechanism (such as inclusion of work in progres in the rate base) by which the principal and interest payments on some part, if not all, of the debt funds used during construction could be passed on to gas consumers even in the remote contingency of non-completion of the project;
5. Approval of a consumer surcharge mechanism which would provide funds to help finance the project;
6. Decontrol of natural gas prices or setting the wellhead price of Alaskan gas at a level high enough to attract the financial participation in the project of the owners of the gas.

These actions would clarify the present regulatory and administrative uncertainties that are now holding up this project and would provide equitable means whereby the private beneficiaries of the project can assist in its financing and a sharing of the risks without the unnecessary and undesirable financial involvement of the Federal Government. In my view, there are great long-run dangers if we continue to substitute government financial assistance for difficult regulatory decisions which equitably apportion the costs and risks of large energy projects. I believe that this project affords us an opportunity to show that, through innovative governmental action, we can create the conditions necessary for the private capital markets to finance this project.

Thank you Mr. Chairmen, and I would be happy to answer any questions you and the Committees may have at this time.

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STATEMENT OF THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE THE HOUSE WAYS AND MEANS COMMITTEE
WASHINGTON, D.C., TUESDAY, FEBRUARY 17, 1976

Mr. Chairman and Members of this Distinguished Committee:

It is never easy to go through the process of reconciling the manifold demands for more government spending on the one hand with our willingness and ability to pay for these demands on the other. But while the budget, and particularly the fact of a substantial budget deficit, are of course intimately related to the issues which face us, we are not here to consider proposals to increase or reduce the size of the deficit. Today, we are here to consider another substantial increase in the temporary debt ceiling. But in addition, we also have the rare opportunity to consider legislative proposals which, simply stated, help everyone and hurt no one.

I refer, of course, to Treasury's proposals to amend the Second Liberty Bond Act in two respects. First, we are proposing that the authorized maximum maturity of notes issued pursuant to that Act be changed from seven years to ten years. And second, we are proposing that the amount of long-term debt exempted from the 4-1/4 percent rate ceiling imposed by the Act be increased by $10 billion.

While these proposals are not new, they are more important today than ever before. The reasons upon which the restrictions in existing law were originally based simply no longer apply. Indeed, there are few, if any, observers of the capital markets who believe the existing restrictions are healthy for the government, for the capital markets, for the economy or for the people of the nation.

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In addition, we are also proposing that the 6 percent rate ceiling on Savings Bonds be removed. Such action would permit the rate on Savings Bonds to be varied from time-to-time, reflecting the interests of both taxpayers and savers.

DEBT LIMIT

Before turning to these key proposals, let me address the primary question facing this Committee today: An increase in the temporary debt limitation.

As you know, the present temporary debt ceiling of $595 billion (enacted on November 14, 1975) will expire on March 15, at which time the limit will revert to the permanent ceiling of $400 billion. The Committee estimates of when the debt subject to the limit would approach the $595 billion level have been quite accurate. In the final week before the expiration of the temporary limit, the actual amount of debt subject to limit will closely approach the temporary limit. Accordingly, during that week, the limit may hinder the effective management of the Treasury's debt and cash balance.

As is customary, I have provided you with a monthly record of the debt subject to limit from June 30, 1975 through September 30, 1977, and interim monthly estimates for months in which the peak does not occur on the last day of the month. While today we are concerned primarily with establishing a debt limit for the near term, data is provided as an indicator of our financing requirements based upon the President's budget through fiscal 1977. As I will discuss in detail later, these requirements have serious debt management implications.

Specific Requirements

The Second Concurrent Resolution on the 1976 Budget provided for levels of public debt of $622.6 billion at the end of the fiscal year 1976 and $641.0 billion at the end of the Transition Quarter. It is, however, not clear what level for cash balance was assumed in the Congressional Budget Resolution. Furthermore, the level of debt in the Resolution apparently does not provide for agency debt that is subject to the statutory limitation. As a technical matter, moreover, depending on the cash volume assumption, the peak debt levels are reached on June 15 and August 31.

In the Federal Budget for fiscal year 1977, debt subject to statutory limitation is estimated at $624.2 billion at the end of fiscal year 1976 and $643.1 billion on September 30. These figures are based on an assumed $9 billion cash balance. The Treasury estimates assume a $6 billion cash balance and a $3 billion margin for contingencies and show debt limit needs of $630 billion at the June peak and $645 billion at the August peak. Accordingly, we are requesting that the temporary debt limitation be reenacted at $645 billion through September 30, or, in any event, not less than $630 billion for June 30.

SECOND LIBERTY BOND ACT AMENDMENTS

Let me now turn to an issue of only slightly less urgency and far greater concern: the current confinement of Treasury borrowing to maturities of seven years or less. To state our position most directly, we believe this restriction poses severe risks to the capital markets and provides nothing in the way of economic benefits.

Objectives of Treasury Debt Management

It is clear to all of us that the national debt cannot be managed without careful consideration of its impact. Because Federal borrowing now accounts for almost 80 percent of all financing in our nation's capital markets, all other markets, all other financial assets are directly influenced by the structure of the Federal debt. As a result, the structure of the debt has an impact on our economy; it can contribute to economic stabilization or detract from it. What are the implications of this tremendous influence? In my view, it means that we must use every available tool to insure that Federal borrowing needs are met in such a way that the resulting debt structure permits financing at the lowest cost, both in terms of interest rates and economic and financial dislocation.

Given these objectives, it is no longer possible to justify severe and anachronistic constraints that result in a debt structure that has been very expensive in an economic, as well as a financial sense. Moreover, in light of our massive borrowing needs, these constraints are destined to have an even greater adverse impact in the future. The extensive economic work which has been done in the area of debt structure has not only confirmed the potential for harm, but has also demonstrated conclusively that there are no countervailing benefits.

Consequences of the Current Restrictions

We know what the current restrictions have meant in absolute terms: a decline of more than 33 percent in the average maturity of the publicly-held debt in the last three years alone and more frequent and larger Treasury borrowings. But the question I want to concentrate on today is why we care: why we believe there are serious dangers in confining Treasury borrowing to only the short end of the market.

We care primarily because over-reliance on short term financing, as reflected in a short and shortening maturity structure and the resulting lack of balance in the overall debt structure exposes us to adverse financial and economic effects:

-- First, it poses the risk of higher Federal borrowing costs and imposes unnecessary transaction costs;

-- Second, it contributes to a more volatile market environment, placing substantial burdens on financial intermediaries and threatening the ability of the private sector -- and particularly small and medium-sized businesses -- to meet financing needs;

-- Finally, it poses an unmeasurable and uncontrollable threat to sound fiscal and monetary policies.

Cost

Our concerns begin with the fact that unless the Treasury is authorized to balance its borrowing throughout the maturity ranges, the taxpayer will be vulnerable to short run changes in interest rates. Moreover, whatever may happen with respect to interest rates, a debt structure weighted heavily to the short end imposes unnecessary transaction costs.

In periods of unexpected rises in interest rates, such as we have experienced during most of the last decade, the average cost of borrowing in the short-term market, and subsequent refunding in this market, may well exceed the rate for borrowing long-term in the first place. But in pursuing these proposals, it is not our purpose to suggest that interest rates are headed higher, or that any such estimates -- guesses may be more accurate -- ought to play a role in our consideration of these statutory limitations. Rather, I am suggesting that, from the standpoint of costs, it is imprudent to have statutory limitations that in effect mandate further dramatic shortening in the maturity structure of the debt. We need a balanced debt structure, not an extreme one.

In addition to possible interest rate costs, there are heavy transaction costs, which must be borne by the taxpayer. When Treasury borrowings are confined to the short-term area, obviously a large amount of debt roll-over is necessary, relative to what would be necessary if we could borrow more in the long-term area. Each time there is a roll-over, there are inevitable direct transaction costs. Moreover, the proliferation of short-term borrowings means that dealers have to carry larger inventories of securities. The cost of carrying such larger inventories adds further to the transaction price, increasing the overall cost which is ultimately borne by the taxpayer.

Effect on Private Borrowers

A concentration of Treasury financing in the short-term area also has potentially adverse effects on private users of short-term credit. With the Treasury constantly tapping the short-term market for substantial funds, both short-term interest rates and the availability of short-term financing become vulnerable to episodes of market congestion and to changes in the general monetary environment.

To understand the potential risks involved, we must first examine the enormous change in the magnitude of the Treasury's demands upon the market. Just in the last 2 years, the overall amount of privately-held marketable Federal debt outstanding has grown from $171 billion to $263 billion. When this overall growth is viewed in the context of a shortening maturity structure -- occasioned primarily by the limitations which concern us today -- the results are even more disturbing. For the first two months of this year, Treasury borrowed an average $9 1/2 billion per week. For the comparable period in 1974, the figure was $5 1/2 billion.

Part of this increase is, of course, due to our large new money requirements, primarily to finance the deficits. But the bulk of the borrowing is to finance the roll-over of maturing debt. And the shorter the debt structure, the greater the roll-over burden.

From the market's standpoint, there is virtually no difference between the two components. Each type of borrowing requires a new underwriting and investment decision. Roll-overs are not automatic; a holder of a maturing bill must make the choice between lending to the Treasury, lending to another borrower, or spending the proceeds. Accordingly, all of the costs and pressures of borrowing are there, irrespective of the purpose of the borrowing.

Let's be clear about the implications.

First, there are substantial pressures on intermediaries: Given a greater amount of securities outstanding and a sharp growth in periodic refunding, dealers must take larger and larger positions. To the degree that dealers cannot or will not increase their position-taking capacity, the breadth, depth and resiliency of the market is reduced. In every day terms, the market becomes thinner, and prices -- that is interest rates -- become more volatile.

Volatility is also enhanced by other factors. The enormous supply of riskless, liquid Treasury securities provides a tempting alternative for investors with psychological concerns about other assets -- e.g. commercial paper, certificates of deposits. Thus, in effect our debt structure facilitates large-scale and highly disruptive shifts of funds from one short term sector to another, irrespective of whether such shifts are economically justifiable.

Finally, the sheer increase in the number of decisions the market must make enhances the possibility of distortions.

Consider the process. The dealers on which we depend to distribute our securities must decide, separately, the amount they will purchase from us, and the price thereof, as well as the terms on which they will sell to their customers. Holders of maturing instruments have to decide whether and where to reinvest the proceeds, giving them an opportunity to rethink their needs in terms of the type of security to purchase as well as the maturity. And other investors have to decide whether they are going to buy our new securities, how much, and at what price. In terms of volatility versus stability, what kind of debt structure would we prefer: one that causes this unsettling process to occur less than 100 times a year, as was the case only a few years ago? Or today's, under which the process occurs, on average, nearly every business day.

What are volatility's ultimate by-products? At a minimum, we are likely to see an increase in rates on new short-term debt and a higher dealer mark-up on debt trading in the secondary market. These phenomena are the natural reaction of investors and dealers to a condition markets do not tolerate well: uncertainty.

If the uncertainty reaches greater levels -- for example, as might be the case if market disruption is accompanied by perceptions of change in Federal Reserve policy -- many market participants may temporarily withdraw from the market altogether.

In such circumstances, Treasury's ability to finance is obviously impaired. But, more importantly, the non-Federal portion of the market may feel far more serious repercussions. Local governmental units, small and medium-sized business -- indeed all but the top-rated credits -- may find themselves facing serious difficulties as they are cut-off from sources of funds to rollover maturing short-term debt.

Moreover, these shocks are not confined to the short-term market. They spread rapidly into the intermediate and longer-term markets and begin to interfere with orderly financing plans of business corporations and state and municipal governments, as well as with the growing volume of mortgage financing which is handled through securities markets.

Again, the impact is particularly acute on the smaller or lower-rated issuers. Because of the risks set forth above, investors know that such entities are especially vulnerable to even normal changes in the business cycle, especially when they have substantial short-term debt outstanding.

In the final analysis, therefore, perhaps the most dangerous consequence is a further reluctance on the part of investors to make long-term commitments to our nation's capital growth. This reaction, which accentuates the pressures on long-term investment caused by fears of future inflation, has grave implications for our future economic growth. It discourages outlays for new expansion, it discourages risk-taking and it discourages entrepreneurship at precisely the time in our nation's economic history when such conduct is needed most.

Impact on Economic Policy

Another aspect of this continued trend toward a shorter and shorter debt maturity -- which if carried to an extreme could give us a national debt with zero maturity, i.e., a huge stock of green pieces of paper called money -- is growing liquidity in the economy. By pumping more and more liquidity into the system, spending may be increased at the expense of savings and investment.

Even more disturbing is the fact that these consequences are unmeasurable and uncontrollable. Such spending effects could come at any time, irrespective of the course of fiscal and monetary policy at the time. And if the dam bursts, so to speak, in a period of growing inflation, the resulting sharp acceleration of the inflationary trend may be invulnerable to fiscal and monetary efforts.

We believe debt management should complement long-run economic and financial stabilization goals. An unbalanced debt structure poses the risk that policy efforts to control cyclical excesses -- such as might be appropriate at a future time when the economy is expanding rapidly -- will be thwarted by an accumulation of liquidity; and accumulation in the form of short-term Treasury securities. Given the debt structure in effect mandated by the size of recent deficits and the maturity limitations, this risk is serious.

Impact on Interest Rate Structure

The old argument against these proposals is that more long-term Federal borrowing would drive up long-term interest rates; in other words, that a balanced debt structure and judicious borrowing in all maturities would somehow be harmful to the long-term market. This argument, taken at face value, would imply that the Government should always finance in the short-term markets -- a conclusion which not only is wrong in concept but, as we have shown, has in the past been extremely costly in both financial and economic terms.

Long-term interest rate levels respond primarily to investors' views regarding inflation and the future course of inflation. If inflation is expected to persist, investors demand to be compensated not only for the use of their money, but also for the fact that when the money is repaid, it is worth less, as a consequence of inflation, than when it was lent out. The result is higher long-term rates.

In addition, inflation makes all borrowers -- but particularly the smaller or lower rated firms -- more vulnerable to economic reversals. Accordingly, it tends to enhance the investment risk, with respect to many long-term investments. Again, this higher investment risk will be reflected in the interest rate, providing another source of upward pressure on long-term rate levels.

Other factors in the level of long-term interest rates include expectations about the future course of short-term rates and existing short-term rates. If short-term interest rates are expected to rise, a potential long-term investor will demand a rate which compensates him not only for the principal risk presented by the investment, but also for the lost opportunity to rollover short-term debt at higher and higher returns.

Current short-term rate levels also play a role because many financial intermediaries rely on short-term credit as a principal source of funds. Thus, for example, if a savings and loan association is forced to pay higher rates on short-term deposits, the higher costs must ultimately be reflected in the rate at which it is willing to make long-term mortgage loans, and in the amount of long-term credit it is able to supply.

By contrast, there is no evidence that greater Treasury access to the longer maturities -- if judiciously employed -- would play any role whatsoever in the determination of long-term rates.

Indeed, for at least two reasons, just the contrary is likely to be the case. First, as we have shown, concentration of Federal borrowing in the short-term area can lead to greater uncertainty and, at some point, inflation in the economy. This leads to an increase both in short-term rate expectations and in the inflation premium demanded by long-term investors and, hence, to an increase in long-term interest rates.

Second, as heavy Treasury short-term borrowing drives up short-term rates, disintermediation takes place. As outflows occur, the ability of intermediaries to make long-term loans is curtailed and what loans are made are at higher rates, reflecting the relative scarcity of this form of credit.

In short, as we would expect, the distortion of the market mechanism caused by the artificial maturity limitations has no demonstrable benefits in terms of long-term interest rates or any other legitimate objective.

Debt Management in 1976-77

I have dwelled at length on the principles involved because they are crucial to an understanding of the issues. But let me turn now to the very real practical problems we face in the immediate future.

Our Government securities market is an immensely flexible, immensely capable market. Perhaps a good comparison is a freeway. With all lanes open, a freeway can handle a tremendous volume of traffic at the most efficient speeds. But when overloaded, either because traffic volume is simply too high, or because an accident or construction has closed some of the lanes efficiency drops precipitously. Not only is traffic on the freeway slowed, but the effects spill over on to other roads.

The capital markets today are hampered by the fact that, in effect, two of the four lanes are blocked off, insofar as the Treasury is concerned. We are forced to confine ourselves to the below two year and two-to-seven year ranges and these lanes, Mr. Chairman, have become severely congested.

Congestion exists not only because we must enter the market to raise new funds to finance our deficits and meet other new needs, but also because we must borrow to retire maturing debt. Looking first at new borrowing alone, by the end of this month, the Treasury will have borrowed nearly $16 billion in the market in 1976. And during the remainder of the fiscal year, through June, we will need to borrow an additional $19-24 billion of new funds; a total of $35-40 billion in the first six months of 1976.

In later periods, we will need to borrow nearly $20 billion in the transition quarter, and some $50 billion of new money in the market in fiscal year 1977.

All in all, our new money market borrowing needs in the next 19 months -- based on the President's budget -- will total upwards of $90 billion.

This is nearly $5 billion a month and more than $1 billion every week.

On top of these new money borrowing requirements, we also have an immense refunding job to do. In the same nineteen-month period, over $51 billion of privately-held coupon debt will mature. Our weekly issues of 13 and 26 week bills are now in the $7 billion range and will inevitably increase. And our issues of 52-week bills, every four weeks, are now in the $3 billion range and may well be in the $4 billion range by the end of fiscal year 1977. In short, our total requirements for both purposes are some ten times our new money needs; approaching $2 billion of borrowing every day.

To meet these needs, since 1972, we have relied primarily on the auction technique; that is, the yield on a particular issue is determined by public bids. While the auction technique has resulted in substantial savings to the taxpayer, it has one important limitation. We have found from experience that, given the absorptive capacity of the market, auctions of much more than $2.5 billion at one time result in disproportionately high interest costs.

All in all, we face a formidable financing job. It is one that can be managed, but there are severe costs and serious risks. And I hope, in my testimony this morning, I have conveyed some of these concerns to you.

Let me add that there is another legacy in this dilemma; one that will be faced by my successor, and yours as well. Even if we are successful in reducing the size of our deficits and the consequent need for new money financing, the enormous concentration of short-term financing will require similar magnitudes of financing, just for refunding, week after week, far into the future.

Accordingly, I must urge this Committee, as strongly as I can, to respond to these immediate needs. What is done in managing the public debt this month, and this year, will have a direct effect on the strength and sustainability of the economic recovery. Treasury must promptly minimize its reliance on short-term bills and maximize its use of the longer intermediate and longer-term markets. If, instead, we are forced to rely on short-term financing, we will be obliged to come to the market more frequently and for larger amounts. The excessive liquidity injected into the economy as a result of such shorter-term financing, when coupled with these more frequent incursions, will destabilize the overall market environment and will pose a continuing threat to all other borrowers and to the financial institutions on which the housing industry, small business, and all of us must rely.

SAVINGS BOND RATE CEILING

Finally, let me also urge that Congress act to remove the current 6 percent interest rate ceiling on Savings Bonds. Since Savings Bonds account for approximately one-fourth of the total privately-held Treasury debt, greater flexibility in this area can make a significant contribution to our overall debt management objectives. Savings Bonds provide a stable and important source of credit for the Government and we must have the flexibility to insure that the return to savers is a fair one; one that reflects financial and economic conditions as they may change from time to time.

Authority to vary the rate on Savings Bonds would, of course, be exercised with due regard for the impact of rate changes on depositary institutions. In this connection, I would note that we have consistently supported legislation such as the Financial Institutions Act which would allow all forms of institutions to compete, on an equal basis, in a free market environment. Freedom to compete and competitive equality, in our view, will contribute far more to the health of all institutions than artificial constraints such as the 6 percent limitation.

It is in no one's interest to price Savings Bonds at rates which would significantly erode depositary institutions' sources of funds. But it would be equally undesirable to deny the Government a stable source of credit by artificial constraints. We need the flexibility to strike the balance.

* * * *

Ladies and Gentlemen, we are not faced with a Gordian Knot which can be cut only with Herculean effort. It's a slip knot that can be undone by a simple pull from the Congress. As Winston Churchill once said, "Give us the tools and we will do the job." Give us in the Treasury the tools and we will do our job of debt management in a manner in which the Congress can take pride.

Thank you.

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DEBT LIMIT
BRIEFING MATERIAL
HOUSE COMMITTEE ON WAYS AND MEANS

PUBLIC DEBT
SUBJECT TO LIMITATION
FISCAL YEAR 1976
Based on: Budget Receipts of $298 Billion,
Budget Outlays of $374 Billion,
Off-Budget Outlays of $9 Billion

($ Billions)

	Operating Cash Balance	Public Debt Subject to Limit	With $3 Billion Margin for Contingencies
1975		-Actual	
June 30	7.6	534.2	
July 31	4.2	539.3	
August 31	3.6	548.7	
September 30	10.5	554.3	
October 31	10.3	563.1	
November 30	6.5	567.9	
December 31	8.5	577.8	
1976			
January 31	12.0	585.5	
		-Estimated-	
February 29	6	592	595
March 15	6	601	604
March 31	6	607	610
April 15	6	615	618
April 30	6	606	609
May 31	6	621	624
June 15 (peak)	6	627	630
June 30	6	621	624

DATE: ~~February~~ 9, 1976

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PUBLIC DEBT
SUBJECT TO LIMITATION
TRANSITION QUARTER
JULY-SEPTEMBER 1976
Based on: Budget Receipts of $82 Billion,
Budget Outlays of $98 Billion,
Off-Budget Outlays of $4 Billion

($ Billions)

1976	Operating Cash Balance	Public Debt Subject to Limit	With $3 Billion Margin for Contingencies
		-Estimated-	
June 30	6	621	624
July 31	6	632	635
August 31	6	642	645
September 30	6	640	643

DATE: February 9, 1976

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PUBLIC DEBT
SUBJECT TO LIMITATION
FISCAL YEAR 1977
Based on: Budget Receipts of $351 Billion,
Budget Outlays of $394 Billion,
Off-Budget Outlays of $11 Billion

($ Billions)

	Operating Cash Balance	Public Debt Subject to Limit	With $3 Billion Margin for Contingencies
		-Estimated-	
1976			
September 30	6	640	643
October 31	6	650	653
November 30	6	659	662
December 31	6	663	666
1977			
January 31	6	665	668
February 29	6	680	683
March 31	6	695	698
April 15	6	703	706
April 30	6	691	694
May 31	6	705	708
June 15 (peak)	6	711	714
June 30	6	694	697
July 31	6	699	702
August 31	6	704	707
September 30	6	707	710

DATE: February 9, 1976

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BUDGET RECEIPTS AND
OUTLAYS BY FUND GROUP

($ Billions)

	Fiscal Year 1975 Actual	Fiscal Year 1976 Estimated	Transition Quarter Actual
Receipts:			
Federal Funds	$187.5	$198.4	$54.8
Trust Funds	118.6	134.8	33.8
Interfund Transactions	-25.1	-35.6	-6.6
Unified Budget	281.0	297.5	81.9
Outlays:			
Federal Funds	238.5	276.9	69.8
Trust Funds	111.2	132.2	34.9
Interfund Transactions	-25.1	-35.6	-6.6
Unified Budget	324.6	373.5	98.0
Surplus or Deficit (-):			
Federal Funds	-51.0	-78.5	-15.0
Trust Funds	7.4	2.5	- 1.1
Unified Budget	-43.6	-76.0	-16.1

DATE: February 12, 1976

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UNIFIED BUDGET MONTHLY
FISCAL YEAR 1976 AND
TRANSITION QUARTER

($ Billions)

	Receipts	Outlays	Surplus or Deficit (-
1975	- Actual -		
July	$ 20.2	$ 31.2	$-11.1
August	23.6	30.6	- 7.0
September........................	28.6	29.0	- .4
October..........................	19.3	32.4	-13.1
November.........................	21.7	29.4	- 7.7
December.........................	26.0	31.8	- 5.8
1976	- Estimated -		
January..........................	25.5	31.9	- 6.4
February.........................	20.4	30.7	-10.3
March............................	17.7	31.9	-14.2
April............................	35.1	33.3	1.8
May..............................	23.3	31.7	- 8.4
June	36.1	29.6	6.6
Fiscal Year......................	$297.5	$373.5	$-76.0
July	22.8	34.3	-11.5
August	26.8	32.2	- 5.4
September........................	32.3	31.5	.8
Transition Quarter	$ 81.9	$ 98.0	$-16.1

DATE: February 12, 1976

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FEDERAL FUNDS MONTHLY
FISCAL YEAR 1976 AND
TRANSITION QUARTER

($ Billions)

	Receipts	Outlays	Surplus or Deficit (-)
1975	- Actual -		
July	$ 13.4	$ 27.5	$-14.0
August	13.0	21.0	- 8.0
September	22.3	20.2	2.1
October	13.6	21.6	- 8.1
November	13.4	20.0	- 6.6
December	19.8	27.2	- 7.4
1976	- Estimated -		
January	18.8	24.0	- 5.2
February	10.0	20.7	-10.7
March	10.4	20.5	-10.1
April	25.2	23.5	1.7
May	10.2	22.0	-11.8
June	28.3	28.7	- .4
Fiscal Year	$198.4	$276.9	$-78.5
July	15.2	27.9	-12.7
August	14.7	21.3	- 6.6
September	24.8	20.6	4.2
Transition Quarter	$ 54.8	$ 69.8	$-15.0

Detail may not add to total due to rounding.

DATE: February 13, 1976

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TRUST FUNDS RECEIPTS,
OUTLAYS AND SURPLUS OR DEFICIT
FISCAL YEAR 1976

($ Billions)

	Receipts	Outlays	Surplus or Deficit (-
Federal Old-Age Survivors, and Disability Insurance Trust Funds	$70.8	$73.8	$-3.0
Health Insurance Trust Funds.....	18.6	17.4	1.1
Unemployment Trust Fund..........	16.7 1/	18.5	-1.8
Railroad Employees Retirement Funds..........................	3.3	3.5	- .2
Federal Employee Retirement Funds..........................	13.0	8.5	4.5
Airport and Airway Trust Funds...	1.1	.8	.3
Highway Trust Funds..............	6.3	6.6	- .3
Foreign Military Sales Trust Fund...........................	6.5	5.9	.6
Veteran Life Insurance Trust Fund...........................	.9	.7	.2
Other Trust Funds................	7.0	5.9 2/	1.1
Total Trust Funds................	$134.8	$132.2	$ 2.5

1/ Includes $8.5 billion advances from general fund.
2/ Includes net activity of trust revolving funds of $-1.1 billion.

Detail may not add to total due to rounding.

DATE: February 12, 1976

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TRUST FUNDS RECEIPTS, OUTLAYS AND SURPLUS OR DEFICIT TRANSITION QUARTER

($ Billions)

	Receipts	Outlays	Surplus or Deficit (-)
Federal Old-Age Survivors, and Disability Insurance Trust Funds	$18.9	$19.9	$-1.1
Health Insurance Trust Funds.....	5.1	4.6	.5
Unemployment Trust Fund..........	3.4 1/	3.7	- .3
Railroad Employees Retirement Funds.........................	.5	.9	- .4
Federal Employee Retirement Funds	2.1	2.3	- .2
Airport and Airway Trust Funds...	.3	.3	*
Highway Trust Funds..............	1.9	1.9	*
Foreign Military Sales Trust Fund..........................	1.7	1.6	.1
Veteran Life Insurance Trust Fund..........................	.2	.1	.1
Other Trust Funds................	1.8	1.6 2/	.2
Total Trust Funds................	$33.8	$34.9	$-1.1

1/ Includes $1.1 billion advances from general fund.
2/ Includes net activity of trust revolving funds of $- .2 billion.
* Less than $50 million.

DATE: February 12, 1976

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OFF-BUDGET AGENCY OUTLAYS MONTHLY FISCAL YEAR 1976 AND THE TRANSITION QUARTER

	Federal Financing Bank 1/	Other 2/	Total
1975	- Actual -		
July	$ .6	*	$ .6
August	.7	$-1.0	- .3
September	.1	.5	.6
October	.5	.8	1.3
November	.6	.3	.9
December	.2	.6	.8
1976	- Estimated -		
January	1.2	.5	1.7
February	.8	.3	1.1
March	.5	.5	1.0
April	.2	.5	.7
May	.1	.5	.6
June	.2	.3	.5
Fiscal Year	$5.6	$ 3.8	$9.3
July	1.8	.1	1.9
August	.7	.4	1.1
September	.4	.8	1.2
Transition Quarter	$2.8	$ 1.3	$4.1

1/The outlays of the Federal Financing Bank reflect only its purchase of Government-guaranteed obligations, not its purchases of agency debt, in order to prevent double counting. Virtually all of the other off-budget activity is financed through debt issued to the Federal Financing Bank.
2/Export-Import Bank, Postal Service and U.S. Railway Association.
DATE: February 13, 1976

OPTIONAL FORM NO. 10
MAY 1962 EDITION
GSA FPMR (41 CFR) 101-11.6

UNITED STATES GOVERNMENT

Memorandum

Department of the Treasury
Washington, D.C. 20220

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TO : Mr. Snyder

DATE: February 12, 1976

FROM : Mr. Cook

SUBJECT: Federal Financing Bank

The Federal Financing Bank has saved the Federal and federally-guaranteed borrowers who use the Bank $340 million in the 20 months of the Bank's existence.

The amount of savings is based on the conservative assumption that the agencies who have borrowed from the Bank on the average could have raised funds in the market at a cost of 1/2 of 1% above marketable Treasury obligations of similar maturities.

Whereas one or two of these agencies who were established in the market, for instance the Tennessee Valley Authority, were able to raise funds at rates reasonably close to Treasury's cost, many of the guaranteed borrowers whose debt was less well known and who raised funds through negotiated offerings paid rates substantially above the Treasury curve.

5010-108

Buy U.S. Savings Bonds Regularly on the Payroll Savings Plan

AMERICAN REVOLUTION BICENTENNIAL 1776-1976

Federal Revenue Estimate Assumptions

The Department of Treasury is responsible for estimating Federal revenues as a basis for budget planning. These estimates are based importantly upon GNP forecasts by a trio of the Treasury, the Council of Economic Advisors and the Office of Management and Budget. The key components for revenue estimating purposes are nominal Gross National Product, personal income, wages and salaries, and corporate profits. As contained in Budget (p. 25), these forecasts are: (in billions)

	Calendar Year	
	1976	1977
GNP	$1,684	$1,890
Personal income	1,386	1,538
Wages and salaries	892	1,001
Corporate profits (after tax)	156	181

Using these general forecasts and specific revenue information obtained from a variety of sources, the Treasury prepares collection estimates.

The estimating process obviously depends upon several factors: (1) the accuracy of the GNP forecasts; (2) changes in the mix of economic results which cause adjustments in estimates of personal income and expenditures, business spending and profits, unemployment, government transfer payments, etc.; (3) the refinement of statistical estimating procedures; and (4) the frequent revision of tax legislation which can be anticipated only in part. As a result, actual receipts always vary from those which are forecast. However, the discrepancy usually is relatively small. Budget estimating errors over the past six years together with 1950 and 1960 are summarized in Table 1.

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PROJECTIONS

SHORT-RANGE ECONOMIC FORECAST

[Calendar years; dollar amounts in billions]

Item	Actual 1974	Forecast 1975	Forecast 1976	Forecast 1977
Gross national product:				
Current dollars:				
Amount	$1,407	$1,499	$1,684	$1,890
Percent change	7.7	6.5	12.4	12.2
Constant (1972) dollars:				
Amount	$1,211	$1,187	$1,260	$1,332
Percent change	−1.8	−2.0	6.2	5.7
Incomes (current dollars):				
Personal income	$1,155	$1,246	$1,386	$1,538
Wages and salaries	763	802	892	1,001
Corporate profits	132	118	156	181
Price level (percent change):				
GNP deflator:				
Year over year	9.7	8.7	5.9	6.2
Fourth quarter over fourth quarter	11.4	6.3	5.9	6.3
Consumer price index:				
Year over year	11.0	9.1	6.3	6.0
December over December	12.2	6.9	5.9	5.9
Unemployment rates (percent):				
Total	5.6	8.5	7.7	6.9
Insured [1]	3.8	7.2	6.3	5.4
Average Federal pay raise, October (percent)	5.5	5.0	4.7	8.6
Interest rate, 91-day Treasury bills (percent) [2]	7.9	5.8	5.5	5.5

[1] Insured unemployment as a percentage of covered employment.
[2] Average rate on new issues within period; the rate shown for 1976 was the current market rate at the time the estimates were made.

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TABLE 1

Budget Estimating Errors

Fiscal year	Overestimate (+) or Underestimate (-) as a Percent of the Actual Figure			
	Estimates made 18 months prior to the end of the fiscal year		Estimates made 6 months prior to the end of the fiscal year	
	Outlays	Receipts	Outlays	Receipts
1950 1/	+4.1	+10.3	+7.8	+1.9
1960 1/	-0.3	-1.7	+1.6	+0.2
1970 2/	-0.7	+2.6	+0.7	+2.9
1971 2/	-5.0	+7.3	+0.6	+3.1
1972 2/	-1.1	+4.3	+2.0	-5.2
1973 2/	-0.1	-4.9	+1.3	-3.1
1974 2/	+0.1	-3.4	+2.3	+1.9
1975 2/	-6.2	+5.0	-3.4	-0.8

Office of the Secretary of the Treasury
Office of Tax Analysis

September 19, 1975

1/ Administrative budget.

2/ Unified budget. The first estimate on a unified budget basis was prepared in January 1968.

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Net Change in Federal Reserve Holdings
of Treasury Securities

($ millions)

	Net Change in Holdings	Net Purchases of Bonds Over 4-1/4%	Net Change in Other Securities
1975			
Jan.	844	28	816
Feb.	-258	82	- 340
Mar.	332	201	131
Apr.	6,428	165	6,263
May	-2,224	3	-2,227
Jun.	-873	109	-982
Jul.	-2,866	---	-2,866
Aug.	663	47	616
Sep.	4,452	124	4,328
Oct.	186	--	186
Nov.	-2,047	244	-2,291
Dec.	2,797	73	2,724
1976			
Jan.	1,948	64	1,884

Office of the Secretary of the Treasury
Office of Debt Analysis

February 11, 1976

FRB Market Purchases of Bonds Issued Under $10 Billion Authority
July 1974 - January 1976
($ millions)

		7%	6 3/8%	6 3/8%	6 1/8%	7 1/2%	6 3/4%	7%	8 1/2%	8 1/4%	7 7/8%	8 1/4%	8 3/8%
Month	Total 1/	Aug 81	Feb 82	Aug 84	Nov 86	Aug 88-93	Feb 93	May 93-98	May 94-99	May 90	Feb 95-00	May 00-05	Aug 95-00
1974													
July	+ 36					7	8	4	16				
Aug													
Sep	+ 35		2	1		2	3	3	24				
Oct													
Nov	+ 25				2	8		7	8				
Dec	+ 22		5	1		3	2	2	9				
1975													
Jan	+ 28		1		2		1		23				
Feb	+ 82				1	15	1	5	12		49		
Mar	+201			1		18	10	21	107		44		
Apr	+165			2		15	2	14	64	52	15		
May	+ 3											3	
June	+109							5	10	45	4	45	
July													
Aug	+ 47					1			2	13	3	5	23
Sept	+124	1				8		4	8	18	2	24	60
Oct													
Nov	+244					1	3		12	17	17	3	191
Dec	+ 73	1	2	1		1	3	1	10	10	2	8	34
1976													
Jan	+ 64	2				1			9	21	1	9	22

Office of the Secretary of the Treasury
Office of Debt Analysis

February 11, 1976

Note: Figures may not add to totals due to rounding.

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Treasury Borrowing Program

During the next nineteen months the Treasury will be required to raise $85-90 billion of new money in marketable securities to refund over $51 billion of maturing marketable securities held by private investors.

In accomplishing this unprecedented financing job, the Treasury will, insofar as its statutory authorities and market conditions permit, make maximum use of the coupon market in order (1) to minimize the build-up in floating, highly liquid short-term debt and (2) to avoid, insofar as possible, increasing the already severe structural problems summed up in the decline in the average maturity of the privately-held marketable debt.

The instruments available to Treasury for these purposes, until such time as its statutory authorities are amended, include:

--13 and 26 week bills, auctioned weekly, in current amounts now in the $7 billion range,

--52 week bills, auctioned every four weeks, in current amounts now in the $3 billion range,

--2-year cycle notes, at the end of each calendar month, which have been auctioned in amounts of up to about $3 billion,

--4-year cicle notes, at the end of each calendar quarter, which have also been auctioned in amounts up to $2.5 billion,

--Refunding issues, typically with 3, 5, or 7-year maturities, which have been auctioned in amounts from $3.5 billion for the shorter issues to $2.5 billion for the longer issues; with an overall limit of around $6 billion in any refunding.

--5-year cycle notes, which have been auctioned on an experimental basis in the first month of a calendar quarter to mature on a regular quarterly refunding date. Use of 5-year cycle notes, however, will likely preclude use of this maturity in regular refundings.

Apart from the auction method, either on a price basis against a fixed coupon or on a yield basis, the Treasury has recently used fixed pricing of a coupon issue; e.g., the 7-year note offered at par in the February 1976 refunding. This technique appears to allow a larger offering to be made than the auction technique by placing more debt directly with final investors, but raises policing problems to assure that the interest attracted is primarily investment interest.

	Estimated Market Borrowing Requirements		
	New Money	Refunding	Total
March 1-June 30, 1976	$19-24	9-3/4	28-3/4-33-3/4
July 1-September 30, 1976	18-1/2	7-3/4	26-1/4
October 1, 1976-September 30, 1977	47-1/2	34-1/4	81-3/4
Total	$85-90	51-3/4	136-3/4-141-3/4

7-Year Note Offering

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The Treasury has been gratified by the market response to a major effort towards achieving significant debt restructuring and reducing the amount of very short-term Treasury debt in the market by issuing a significant amount of longer-term notes.

The seriousness of the debt management problems facing the Treasury today can hardly be overestimated. In addition to $85-90 billion of new money needs over the next nineteen months, the Treasury is faced with refunding $51 billion of maturing coupon issues in the same period. Moreover, the tremendous buildup in the debt, including a $95 billion increase in the privately-held marketable debt in 1975 and the first two months of 1976, has severely impacted the financing calendar and greatly reduced the options for placing new Treasury debt in a constructive fashion.

These problems have been further exacerbated by the exhaustion of the authority to issue additional long-term bonds without regard to the 4-1/4% interest rate ceiling and by the limitation of the maximum maturity of notes to seven years. The prospect, unless these restrictions are eased, is for a further decline in the average maturity of the public debt and for a further increase in the annual refunding burden. The consequence would be further calendar congestion, more difficulty in issuing coupon securities, and, therefore, increasing pressure to resort to the bill market to meet financing requirements, further shortening the average length of the debt and building up an already large, highly volatile pool of extremely liquid short-term Treasury debt in the hands of the public.

The offering of the 7-year, 8% notes at par represented a deliberate decision by Treasury to break away from the traditional pattern of debt offerings in order to, at least temporarily, relieve the structural problem.

Under the auction technique, which has been the standard offering method for Treasury securities since 1972, a considerable distributive burden is placed on the dealer community in its underwriting capacity. Unlike underwriters

for corporate and municipal securities, however, government dealers receive no price concession beyond the marginal advantage afforded them by their close contact with the market and technical expertness. The spread between the average bid on new Treasury issues and the low bid, however, is typically quite small; i.e., 2 to 4/32, which, at best, would represent a price advantage to a dealer of $1.25 per bond, compared to a concession of $5 to $10 to $20 on corporate and municipal issues, depending on the maturity of the security and the credit rating and marketability of the issue.

As a result, while the auction technique is highly efficient for Treasury offerings of moderate size, say, up to $2.5 billion in a single issue and up to $6 billion in a multiple issue offering, the distributive mechanism is overloaded by larger offerings. Thus, a judgment was reached that to sell an issue, even as large as the $3-1/2 billion initially offered, it would be necessary to change the offering technique so as to place more of the debt directly with final investors.

The response to the offering was unexpectedly strong, with more than 105 thousand individual tenders, totalling more than $29 billion, being received. Thus, the amount of the issue was increased to $6 billion, a 71% increase, and the maximum amount awarded to any subscriber was reduced to $200,000.

The subsequent market judgment is that the issue has been, in fact, well placed and that the speculative interest was held to small proportions. Indeed, the major complaint has been that there is an inadequate floating supply in the market to afford normal trading opportunities.

In contrast, the much smaller, much shorter 3-year, $3 billion issue has apparently been much less well placed with a considerable overhang in the market, which appears to confirm the judgment regarding the pricing of the 7-year issue.

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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For information on submitting tenders in the Washington, D. C. area: PHONE WO4-2604

FOR IMMEDIATE RELEASE January 27, 1976

TREASURY ANNOUNCES FEBRUARY REFINANCING

The Department of the Treasury will sell $3.0 billion of 3-year notes, $3.5 billion of 7-year notes and $0.4 billion of 29-year 3-month bonds to refund $4.3 billion of notes held by the public maturing February 15, 1976, and to raise $2.6 billion of new cash.

Additional amounts of the notes may be issued to the Federal Reserve Banks for themselves and as agents for foreign and international monetary authorities and to certain Government accounts in exchange for maturing notes held by them in the amount of $3.8 billion, and to the Federal Reserve Banks as agents for foreign and international monetary authorities for cash. Government account holdings of the maturing notes in the amount of $0.5 billion will not be exchanged for the new issues but may be exchanged for special non-marketable issues.

The securities to be issued will be:

Treasury Notes of Series H-1979 dated February 17, 1976, due February 15, 1979 (CUSIP No. 912827 FG 2) with interest payable on August 15, 1976, and thereafter on February 15 and August 15. These notes will be sold at auction. The coupon rate will be determined after tenders are allotted.

8% Treasury Notes of Series A-1983 dated February 17, 1976, due February 15, 1983 (CUSIP No. 912827 FH 0) with interest payable on August 15, 1976, and thereafter on February 15 and August 15. These notes will be sold at par. Subscriptions will be received subject to allotment.

An additional amount of 8-1/4% Treasury Bonds of 2000-05 dated May 15, 1975, due May 15, 2005, callable at the option of the United States on any interest payment date on and after May 15, 2000 (CUSIP No. 912810 BU 1) with interest payable on May 15 and November 15. These bonds will be sold at auction.

The 3-year notes will be issued in registered and bearer form in denominations of $5,000, $10,000, $100,000 and $1,000,000. The 7-year notes and the bonds will be issued in registered and bearer form in denominations of $1,000, $5,000, $10,000, $100,000 and $1,000,000. Both the notes and the bonds will be available for issue in book-entry form to designated bidders. Payment for the securities may not be made through tax and loan accounts.

The subscription books for the 7-year notes will be open through Tuesday, February 3 except that subscriptions for $500,000 or less will be considered timely received if they are mailed to an official agency under a postmark no later than February 2. Subscriptions must be in multiples of $1,000.

Tenders for the 3-year notes and bonds will be received up to 1:30 p.m., Eastern Standard time, Thursday, February 5. Noncompetitive tenders will be considered timely received if they are mailed to an official agency under a postmark

no later than February 4. Tenders for the 3-year notes must be in the amount of $5,000 or a multiple thereof. Tenders for the bonds must be in the amount of $1,000 or a multiple thereof. Each tender for the 3-year notes must state the yield desired, and each tender for the bonds must state the price desired, if a competitive tender, or the term "noncompetitive", if a noncompetitive tender. Fractions may not be used in tenders. The notation "TENDER FOR TREASURY NOTES OF SERIES H-1979" or "TENDER FOR TREASURY BONDS" should be printed at the bottom of envelopes in which tenders are submitted.

Tenders and subscriptions will be received at any Federal Reserve Bank or Branch and at the Bureau of the Public Debt, Washington, D. C. 20226.

Competitive tenders for the 3-year notes must be expressed in terms of annual yield in two decimal places, e.g., 7.11, and not in terms of a price. Tenders at the lowest yields, and noncompetitive tenders, will be accepted to the extent required to attain the amount offered. After a determination is made as to which tenders are accepted, a coupon yield will be determined to the nearest 1/8 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 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. Tenders at a yield that will produce a price less than 99.501 will not be accepted. Noncompetitive bidders will be required to pay the average price of accepted competitive tenders; the price will be 100.000 or less.

Competitive tenders for the bonds must be expressed in terms of price, in two decimals, e.g., 100.00. Tenders at a price less than 92.76 will not be accepted. Tenders at the highest prices will be accepted to the extent required to attain the amount offered. Successful competitive bidders will be required to pay for the bonds at the price they bid. Noncompetitive bidders will be required to pay the average price of all accepted competitive tenders; the price may be 100.00, or more or less than 100.00.

The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders and subscriptions, in whole or in part, and his action in any such respect shall be final. Subject to these reservations noncompetitive tenders for $500,000 or less for the 3-year notes and the bonds will be accepted in full at the average price of accepted competitive tenders, and subscriptions for the 7-year notes in the amount of $500,000 or less will be allotted in full. Subscriptions over $500,000 for the 7-year notes may be allotted on a percentage basis but not less than $500,000.

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 and subscriptions for the account of customers, provided the names of the customers are set forth therein. Others will not be permitted to submit tenders or subscriptions except for their own account.

Tenders and subscriptions will be received without deposit from commercial and other banks 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, Federal Reserve Banks, and Government accounts. Tenders and subscriptions from others must be accompanied by payment of 5 percent of the face amount of securities applied for. However, bidders who submit checks in payment on tenders or subscriptions submitted directly to a Federal Reserve Bank or the Treasury may find it necessary to submit full payment for the securities with their tenders or subscriptions in order to meet the time limits pertaining to checks as hereinafter set forth. Allotment notices will not be sent to bidders who submit noncompetitive tenders or subscriptions for $500,000 or less.

Payment for accepted tenders and subscriptions for the notes and bonds must be completed on or before Tuesday, February 17, 1976, and in the case of the bonds include accrued interest from November 15, 1975, to February 17, 1976, in the amount of $21.30495 per $1,000 of bonds allotted. Payment must be in cash, 6-1/4% Treasury Notes of Series A-1976 or 5-7/8% Treasury Notes of Series F-1976, which will be accepted at par, in other funds immediately available to the Treasury by the payment date or by check drawn to the order of the Federal Reserve Bank to which the tender or subscription is submitted, or the United States Treasury if the tender or subscription is submitted to it, which must be received at such Bank or at the Treasury no later than: (1) Wednesday, February 11, 1976, 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) Monday, February 9, 1976, 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. Where full payment is not completed on time, the allotment will be canceled and the deposit with the tender or subscription up to 5 percent of the amount of securities allotted will be subject to forfeiture to the United States.

# # #

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TREASURY ANNOUNCEMENT

In view of the substantial public response to the current 7-year note offering, the Treasury reminds investors that it has reserved the right to increase the size of the current offering of 8 percent notes due in 1983 or reduce below $500,000 the maximum amount to be awarded in full.

Consistent with sound debt management principles, either or both of these actions may be taken depending upon the extent of subscriptions received in amounts of $500,000 or less.

February 3, 1976

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MEMORANDUM TO THE PRESS January 29, 1976

The response to the Treasury's financing package announced Tuesday has been highly favorable. To assure that the 7-year 8 percent note, which was announced as a part of the package, attracts investor interest, as distinct from interest of a more transitory nature, the Treasury is raising the downpayment requirement to 20 percent from the initially announced 5 percent.

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FOR 10:00 A.M. RELEASE FEBRUARY 5, 1976

RESULTS OF OFFERING OF 8 PERCENT 7-YEAR TREASURY NOTES

Preliminary figures indicate that approximately 106,000 subscriptions totalling $29.2 billion were received for the offering of $3.5 billion of 8 percent, 7-year Treasury Notes of Series A-1983.

Due to the overwhelming response to the offering, the Secretary of the Treasury has found it necessary to exercise his authority to reduce the amount of notes to be allotted on subscriptions in amounts over $200,000. Accordingly, all subscriptions for $200,000 or less will be alloted in full and subscriptions over that amount will be allotted $200,000.

Approximately $6.0 billion of the notes will be allotted to the public. In addition, $1.9 billion of the notes have been allotted to Government accounts and Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities.

Department of the TREASURY NEWS

'IINGTON, D.C. 20220 TELEPHONE 964-2041

FOR IMMEDIATE RELEASE

February 5, 1976

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RESULTS OF AUCTIONS OF 3-YEAR NOTES AND 29-1/4-YEAR BONDS

The Treasury has accepted $3.0 billion of the $4.4 billion of tenders for the 3-year notes, Series H-1979, and $0.4 billion of the $0.7 billion of tenders for the 29-1/4-year 8-1/4% bonds maturing May 15, 2005, received from the public for the notes and bonds auctioned today.

The range of accepted competitive bids for the notes was as follows:

Lowest yield	7.00% 1/
Highest yield	7.09%
Average yield	7.05%

The interest rate on the notes will be 7%. At that rate, the above yields result in the following prices:

Low-yield price	100.000
High-yield price	99.761
Average-yield price	99.867

The range of accepted competitive bids for the bonds was as follows:

	Price	Approximate Yield	
		To First Callable Date	To Maturity
High	102.14	8.04%	8.05%
Low	101.42	8.11%	8.12%
Average	101.75	8.08%	8.09%

The $3.0 billion of accepted tenders for the notes includes 15 % of the amount of notes bid for at the highest yield and $0.5 billion of noncompetitive tenders from the public accepted at the average yield.

The $0.4 billion of accepted tenders for the bonds includes 68 % of the amount of bonds bid for at the low price and $25 million of noncompetitive tenders from the public accepted at the average price.

In addition, $ 1.7 billion of tenders for the notes and $0.2 billion of tenders for the bonds were accepted at the average yields/prices from Government accounts and from Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities.

1/ Excepting 4 tenders totalling $2,510,000

WS-631

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UNITED STATES DEPARTMENT OF TREASURY

Washington, D. C.

PRESS CONFERENCE

Held by:

EDWIN H. YEO

Under-Secretary for

Monetary Affairs

and

RALPH M. FORBES

Special Assistant to

the Secretary

and

EDWARD P. SNYDER

Director, Office of

Debt Analysis

4:00 p.m.
Tuesday, January 27, 1976

Treasury Building
Room 4121
15th and Penn. Avenue, NW
Washington, D. C.

The above-entitled press conference was convened, pursuant to notice, at 4:10 p.m.

ASSISTANT SECRETARY YEO: We have I think an interesting and important job to do today. I am going to go slowly because we have a good many numbers to discuss.

First, our total requirements through the end of June. In other words, our requirements for the period January June, 1976, are in the range of $38 to 43 billion of borrowing from the public.

Market borrowing is in a range of $35 to 40 billion, the difference being essentially savings bonds. Through yesterday we had announced new cash financing totaling $8.6 billion. This includes the weekly bill to be settled on January 29 and the two-year note which will be settled on February 2.

Taking our first set of assumptions, the $38 to 43 billion, market borrowing $35 to 40 billion, deducting what we have announced through yesterday, gives you a net balance in terms of market borrowing from now through the end of June in the range of $26 to 31 billion.

The $26 to 31 billion range, coincidently, covers the amount of net borrowing we have before us to get through our low point in April.

We have some temporary borrowing to do in June at our low point, but our net cash needs in the last 2-1/2 months of the fiscal year, based on our present estimates -- I would like to emphasize that -- are quite moderate.

The exact amount is really dependent on what sort of end-of June balance we wish to arrive at. I think that if you take the combination of what we have done plus what we are going to announce, plus the concept involving the use of cash management bills to smooth out financing needs, you can see that we have a large but ~~really~~ readily manageable debt management task before us.

As a matter of fact, we have already achieved a significant amount in terms of meeting with or dealing with this job.

Looking ahead, one of our objectives will be to minimize pressures on the bill market, making as much use as possible of the two- and four-year cycle notes, and we are also giving serious consideration to establishing a five-year note cycle.

This would be during the first month of each quarter. You could take a -- you could view our January financing as a start.

Now for the financing, we are planning on raising $6.3 billion of new money financing in February. We will need somewhere between $9 and $11 billion the first half of March. This amount is substantial, but the requirement can be met quite readily through the use of the two-year note cycle, well established within the market structure; four-year note cycle; and additions to the weekly and annual bills and cash

management bills in the form of additions to late April or late June.

From mid-March through the April low point we estimate our needs between $12 and $13 billion of new money for borrowing.

As you know, there is a two-year note maturing at the end of March, and as I mentioned, the possibility of a five-year note issued in early April. The balance of requirements can be met through bill additions and further additions to regular bills, and further cash management bills.

Today we are announcing a $700 million addition to the weekly bill which settles on February 5 and the terms of the re-funding which settles on February 16.

There is a total of $4.4 billion maturing on February 16, and we will be offering $6.9 billion of new securities in three issues. This will raise $2-1/2 billion in new money, and bring the total amount through this announcement since the start of the year to $11.8 billion.

So you can see we have a rather, I think, good start.

The three re-funding issues include the following: $3 billion of a three-year note due February 15;$3-1/2 billion of a seven-year note due February 15, 1983; and $400 million in the reopening of outstanding eight-and-a-quarters of 5-15, 2,000 and 2005.

The three-year note and the reopened bond will be auctioned on Thursday, February 5. The three-year note auction will be a yield auction. The bond auction will be a price auction, since the coupon is already established.

The seven-year note will be offered at par with an 8 percent coupon, with the books open through Tuesday, February 3.

Now if you don't mind, it is probably redundant, but I would like to go over this again a little faster.

Our total requirements through the end of June, $38 to $43 billion of borrowing from the public. Market borrowing total is in the range of $35 to $40 billion, with the difference being savings bonds.

Through yesterday we had announced new cash financing totaling $8.6 billion. That includes a weekly bill settled on January 29, a two-year note which will be settled on February 2. As a result, we have a balance of net market borrowing from now through the end of June in the range of $26 to $31 billion.

The $26 to $31 billion range for market borrowing covers the amount of net borrowing. We still have before us to get through the low point in April.

QUESTION: Mid-month?

ASSISTANT SECRETARY YEO: Yes.

While we will have to do some temporary borrowing

to handle our June low point, our cash needs in the last 2-1/2 months of the fiscal year appear to be quite moderate.

I mentioned that one of our objectives will be to continue to minimize pressures on the bill market using the [illegible] and four-year note cycles, and that we are considering establishment of a five-year note cycle.

I mentioned that we are planning on raising $6.3 billion in February and the re-funding, and in the weekly one-year bills, the weekly and one-year bills, and that we will have to raise $10 billion. I gave you a range of $9 to $11 billion, which I think is a better way to approach it, in the first half of March.

In terms of our financing, $3 billion of a three-year note, $3-1/2 billion of a seven-year note due February 1[illegible], 1983, $400 million in the reopening of the outstanding eight-and-a-quarters, 5-15, 2,000 and 2,005, a three-year note and the bond auction on Thursday, February 5, the note at yield auction, the bond at price auction because of coupons established, the seven-year note offered at par with an 8 percent coupon, with the books open through Tuesday, February 3.

Incidentally, on our re-funding, the settlement is February 17, not the 16th, which I mentioned.

This represents an outline plan for dealing with our financing needs this half. We think that it is important that we use the bill market, but use it in such a way that we are

not totally dependent on it.

We think that it is important that we continue to use our 2, 4, and possibly 5-year note cycles. But I would b less than candid if I told you that that was the solution to our overall debt management challenges, because if you have look at our developing maturity structure, you can see that we ar starting to fill up slot after available slot.

It is for this reason that we have asked Congress for additional long bond authority. It is for this reason th we have asked that notes be redefined from seven-year maturi to ten-year maturity.

What we are seeking to construct is a balanced de structure, one that will not provide a legacy for the future n terms of massive amounts of short-term finance resulting in the Treasury being in the market constantly in very, very signif cant size.

I personally think that a debt structure that involved very considerable amounts of short-term maturities results in increased volatility, reduced efficiency, and over the course of events, a higher net interest cost to be paid by the American public.

I think that we have seen over the last two years both domestically and internationally, the effects -- advers effects -- of market volatility, which in part resulted from heavy reliance, not just on the part of the Treasury, but on part of most borrowers -- heavy reliance on short-term finance.

We are using a pricing sale on the seven-year note with the objective of eliciting the maximum interest, and max- response. It is related to another problem, which is that we are going to have to increase the size of amounts of individual maturities.

On the present basis we are exhausting the calendar. We think that the eights at par represent an attractive invest- ment from the standpoint of potential buyers and an attractive financing medium for the Treasury.

In terms of one of our concerns, the longer-run effects on our system of thrift intermediaries, the challenge is to move in the direction of a debt structure that contributes to, among other things, less interest rate volatility, rather than tends to facilitate it.

That is our financing, and I will try to answer any questions you might have.

QUESTION: Can you explain why you are not auctioning that seven-year note on a yield basis?

ASSISTANT SECRETARY YEO: I am not auctioning it on a yield basis because we think that we can elicit a larger response by pricing it, putting it out wherever one can see it.

We have the feeling that there are institutional buyers and non-institutional buyers that from time to time can benefit from the use of this particular technique.

QUESTION: Looking ahead, can you estimate whether the borrowing needs in the last half of the calendar year wil be greater or smaller than the first half?

ASSISTANT SECRETARY YEO: I would just as soon not get into borrowing needs in the second half of the calendar year, Ed. I can say that I would expect that taking the seco half of Calendar 1975 and the first half of Calendar 1976, that we will have completed the largest fiscal year financing that is prospective, assuming that the policies that we advocate in terms of the budget are agreed to by the Congress.

In other words, we are in a sense thinking in term of fiscal year. We are well on our way to completing a very large financing task that confronted us at the start of Fiscal '76.

QUESTION: What is borrowing totaling in the first half of the fiscal year?

ASSISTANT SECRETARY YEO: 48.

QUESTION: And just a small point -- the amount that is maturing on February 15 -- is that $4.4 or $4.3 billi

ASSISTANT SECRETARY YEO: 4.3.

UESTION: You said that the total through this announcement would be $11.8 billion. If you add the $8.6 billion plus the $2.6 billion you are announcing today plus the $700 million of additional weekly notes for next week, you ge $11.9 billion. Which one should we use?

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ASSISTANT SECRETARY YEO: That is because you used the 4.3. It balances.

QUESTION: Did I understand you to say that for the remainder of February it is this announcement and bills and that is it?

ASSISTANT SECRETARY YEO: That is correct.

QUESTION: Also -- just a matter of memory -- did you suggest -- was there a five-year note sold in January?

ASSISTANT SECRETARY YEO: Yes.

QUESTION: So that could be the start of a cycle?

ASSISTANT SECRETARY YEO: Yes. We announced the five-year note at the end of last year. I don't want to labor the point, but this is necessary, given the large use of the two-year cycle and the four-year note cycle, and while we are making a very decided effort to produce a balanced financing program, we are still of course using the bill market heavily

QUESTION: Will you go over how you get the $11.8 billion?

ASSISTANT SECRETARY YEO: The $8.6 billion that we announced, $700 million in bills, $2.5 billion in terms of the financing.

QUESTION: So the first paragraph should be changed to 2.5 instead of 2.6?

ASSISTANT SECRETARY YEO: It depends on how you round. Ed will give you the figure.

MR. SNYDER: The amount of maturing securities publicly held we have been carrying in our own minds as a 4.4, and the Fed in its operations from time to time has picked up some coupon issues, and I suppose some of the agencies in their trust accounts have picked up some of the stuff, too. It is very close to 4.35, so you pay your money and take your choice.

ASSISTANT SECRETARY YEO: 4.35 is the precise figure.

QUESTION: So if you use 4.4, then we should have ~~4~~2.5 in the net?

ASSISTANT SECRETARY YEO: Yes, sir. Why don't we just agree on that?

QUESTION: ~~2~~4.4 and 2.5?

ASSISTANT SECRETARY YEO: Yes.

QUESTION: We will change the release.

QUESTION: I don't quite understand how, with the seven-year notes, this receiving subscriptions subject to allotment, works. Can you give me a brief description of that?

ASSISTANT SECRETARY YEO: We are announcing to the public that investors with a thousand dollars or multiples of $1,000 can subscribe to a seven-year note with an 8 percent coupon placed as par, and the subscriptions are taken by the various Reserve Banks and by financial institutions that in effect submit those subscriptions for their customers.

So that a person -- say that you wanted to invest

in one of our 8 percent seven-year notes, you would go to your bank or Federal Reserve Bank and tender your subscription.

We set it out in detail in the announcement that you have -- the procedure.

QUESTION: If I want to buy just $1,000 in one bond and there was an allotment of 50 percent or something, what happens?

ASSISTANT SECRETARY YEO: It is up to $500,000.

QUESTION: I see.

QUESTION: You are assuming that you will get enough subscriptions to make the $3.5 billion?

ASSISTANT SECRETARY YEO: Yes, sir.

QUESTION: What happens if you get more than that?

ASSISTANT SECRETARY YEO: After the initial $500,000 we allot on a pro rata basis. Let me give you an example.

We are offering 3.5, and let's say just as an example, we had a billion-and-a-half in subscriptions allotted in full. On top of that we had $4 billion and that would mean a 50 percent allotment.

QUESTION: Why did that 1.4 get a full allotment?

ASSISTANT SECRETARY YEO: Because we have indicated that subscriptions up to --

QUESTION: I see -- okay. So the small investor is pretty well assured of getting the full amount --

ASSISTANT SECRETARY YEO: Exactly. The idea is to

give the smaller investor who is not in the position to gauge the ebb and flow of interest, not in a position to really estimate what sort of allotments might be made -- it gives him an opportunity to subscribe and not be concerned about what he is going to receive.

In other words, if he subscribes for $50,000 in 8 percent notes, he is going to get 50,000 8 percent notes.

QUESTION: What are seven-year securities presently yielding in the market?

ASSISTANT SECRETARY YEO: About 7.72, 7.73.

QUESTION: Won't this push all those up to the 8 percent level?

ASSISTANT SECRETARY YEO: Well, we are selling $3-[illegible] billion in notes. The market will adjust -- it can adjust three ways -- up, down, and unchanged.

The point is this -- that I think generally the market expected a smaller issue for the purposes, for the reasons that I have mentioned. We think it is important to have a good start on our financing needs, and I think that post this financing, investors can or will perceive that a la[illegible] part of the job, a significant part of the job, has been done.

Gradually, but in retrospect a large part, a significant part completed, so that we do not have a need that is conjectural in terms of how it can be met.

We described how it can be met and we have already

done a significant part of it.

I might also say that through the April low point that additional coupon financing will be short of the seven-year area.

QUESTION: Four would be the most?

ASSISTANT SECRETARY YEO: Five; maybe a five.

I think the Wire Services might want to -- if we are clear, the Wire Services might want to --

QUESTION: Since it is so complicated, can you give us a little more than five minutes?

ASSISTANT SECRETARY YEO: Sure. About 10 of?

QUESTION: 10 of is fine.

ASSISTANT SECRETARY YEO: Is there nothing more?

Thank you.

(Whereupon, at 4:40 o'clock p.m. the press conference was concluded.)

HYPOTHETICAL INTEREST SAVINGS
FROM ISSUING BONDS
(millions of dollars)

FY	Total Budget Outlays	Interest on Public Debt	Net Interest Cost of Hypothetical Bonds	Gross Interest Cost on Hypothetical Bonds	Less: Interest Savings on Reduced Notes
1966	$ 134,652	$ 12,014	$ ---	$ 14.8	$ 14.8
1967	158,254	13,391	- 0.2	85.8	86.0
1968	178,833	14,573	- 0.9	182.9	183.8
1969	183,548	16,588	- 9.6	302.0	311.6
1970	196,588	19,304	- 30.2	413.4	443.6
1971	211,425	20,959	- 52.1	605.9	658.1
1972	231,876	21,849	- 19.5	691.3	710.7
1973	246,526	24,167	- 7.7	711.3	718.9
1974	268,392	29,319	- 20.1	731.6	751.7
1975	324,601	32,165	- 61.5	731.6	793.1
1976	373,535e	37,700e	- 79.5	731.6	811.1
Total	$2,508,230	$242,029	-$281.2	$5,202.1	$5,483.3

Office of the Secretary of the Treasury
Office of Debt Analysis

February 15, 1976

Details may not add to totals because of rounding.

HYPOTHETICAL[1/] AND ACTUAL BOND SALES TO PRIVATE INVESTORS
AND EFFECT ON GROSS FINANCING REQUIREMENTS
($ billions)

Calendar Year	Per Year: Bond Sales Assumed	Per Year: Bond Sales Actual	Per Year: Bond Sales Total	Per Year: Gross Financing	Cumulative: Bond Sales Assumed	Cumulative: Bond Sales Actual	Cumulative: Bond Sales Total	Cumulative: Gross Financing
1966	$1.663	$ 0	$1.663	$ 0	$ 1.663	$ 0	$ 1.663	$ 0
1967	1.719	0	1.719	- .381	3.382	0	3.382	- .381
1968	2.216	0	2.216	- 1.198	5.598	0	5.598	- 1.579
1969	1.498	0	1.498	- 1.358	7.096	0	7.096	- 2.937
1970	2.523	0	2.523	- 2.221	9.619	0	9.619	- 5.158
1971	1.389	1.000	2.389	- 2.585	11.008	1.000	12.008	- 7.743
1972	.294	3.321	3.615	- 1.770	11.302	4.321	15.623	- 9.513
1973	.303	1.114	1.417	- 1.916	11.605	5.435	17.040	- 11.429
1974	0	1.613	1.613	- 2.864	11.605	7.048	18.653	- 14.293
1975	0	3.307	3.307	- 1.754	11.605	10.355	21.960	- 16.047

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1/ Assumed sales are equal to 10% of actual notes issued in each quarterly financing in which no bonds were actually sold.

EFFECT ON GROSS REQUIREMENTS
QUARTERLY FINANCINGS, OF HYPOTHETICAL BOND SALES
($ Billions)

Calendar Year Quarter		Gross Financing Requirements Actual	With Assumed Bonds	Reduction	Calendar Year Quarter		Gross Financing Requirements Actual	With Assumed Bonds	Reduction
1966:	1	$ 7.4	$ 7.4	$0	1971:	1	$11.0	$10.4	$ .7
	2	1.4	1.4	0		2	4.2	3.5	.6
	3	4.2	4.2	0		3	5.5	5.3	.2
	4	3.5	3.5	0		4	8.6	7.5	1.1
		$16.6	$16.6	$0			$29.3	$26.7	$2.6
1967:	1	$ 4.0	$ 4.0	$0	1972:	1	$ 4.0	$ 3.4	$ .7
	2	4.7	4.7	0		2	1.8	1.1	.6
	3	4.0	3.7	.2		3	8.2	7.7	.5
	4	4.9	4.8	.1		4	2.9	2.9	0
		$17.6	$17.2	$ .4			$17.0	$15.2	$1.8
1968:	1	$ 8.1	$ 7.9	$ .2	1973:	1	$ 3.5	$ 3.0	$ .5
	2	6.1	5.9	.2		2	2.5	1.2	1.3
	3	5.5	5.3	.2		3	2.3	2.1	.2
	4	3.7	3.1	.6		4	3.8	3.8	0
		$23.4	$22.2	$1.2			$12.2	$10.2	$1.9
1969:	1	$ 3.5	$ 3.1	$ .4	1974:	1	$ 4.1	$ 3.6	$ .4
	2	4.3	3.8	.5		2	4.2	3.6	.7
	3	2.8	2.4	.4		3	4.6	3.9	.7
	4	5.8	5.8	0		4	4.9	3.9	1.0
		$16.3	$15.0	$1.4			$17.9	$15.0	$2.9
1970:	1	$ 4.9	$ 4.9	$0	1975:	1	$ 5.8	$ 5.3	$ .5
	2	7.2	6.0	1.1		2	5.1	4.8	.4
	3	8.0	7.5	.4		3	5.9	5.0	.8
	4	7.4	6.7	.7		4	3.5	3.4	.1
		$27.5	$25.2	$2.2			$20.3	$18.5	$1.8
					1976:	1	$ 9.6	$ 9.2	$ .4

Office of the Secretary of the Treasury
Office of Debt Analysis

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HYPOTHETICAL MATURITY STRUCTURE
WITH ASSUMED BOND ISSUES
($'s Billions)

Calendar Year Quarter		Actual Quarterly Maturities	Hypothetical Maturities	Reduction
1976:	1	$4.4	$3.9	$ .5
	2	4.1	3.0	1.1
	3	4.6	3.6	1.0
	4	4.0	3.7	.3
1977:	1	2.1	1.7	.4
	2	4.4	3.7	.7
	3	3.3	2.9	.4
	4	2.4	1.8	.6
1978:	1	5.0	4.1	.9
	2	6.0	5.2	.8
	3	4.5	3.9	.6
	4	4.6	3.9	.7
1979:	1	3.1	3.1	---
	2	1.8	1.8	---
	3	2.8	2.6	.2
	4	2.3	2.1	.2
1980:	1	1.6	1.6	---
	2	1.7	.4	1.3
	3	1.7	1.4	.3
	4	1.1	1.1	---

Calendar Year Quarter		Actual Quarterly Maturities	Hypothetical Maturities	Reduction
1981:	1	$ 2.8	$ 2.5	$ .3
	2	2.0	2.0	--
	3	.4	.4	--
	4	2.7	2.3	.4
1982:	1	1.7	1.7	--
	2	1.4	1.3	.1
	3	1.9	1.6	.3
	4	2.4	2.3	.1
1983:	1	6.1	6.1	--
	2	1.2	1.2	--
	3	---	---	--
	4	---	---	--
Later:		17.3	28.9	11.6

Office of the Secretary of the Treasury
Office of Debt Analysis

February 15, 1976

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR RELEASE AT 4:00 P.M. February 17, 1976

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $6,600,000,000 , or thereabouts, to be issued February 26, 1976 as follows:

91-day bills (to maturity date) in the amount of $2,900,000,000, or thereabouts, representing an additional amount of bills dated November 28, 1975, and to mature May 27, 1976 (CUSIP No.912793 ZJ 8), originally issued in the amount of $3,411,890,000, the additional and original bills to be freely interchangeable.

182-day bills, for $3,700,000,000, or thereabouts, to be dated February 26, 1976, and to mature August 26, 1976 (CUSIP No.912793 A6 3).

The bills will be issued for cash and in exchange for Treasury bills maturing February 26, 1976, outstanding in the amount of $6,433,165,000, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,472,145,000. 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 non-competitive 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 Standard time, February 23, 1976. 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

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(OVER)

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 February 26, 1976, in cash or other immediately available funds or in a like face amount of Treasury bills maturing February 26, 1976. 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.

Department of the TREASURY NEWS
NGTON, D.C. 20220 TELEPHONE 964-2041

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Contact: L.F. Potts
Extension 2951
February 17, 1976

OR IMMEDIATE RELEASE

TREASURY ISSUES DUMPING FINDING WITH RESPECT TO BIRCH 3-PLY DOORSKINS FROM JAPAN

Assistant Secretary of the Treasury David R. Macdonald ınnounced today that he was issuing a dumping finding with :espect to birch 3-ply doorskins from Japan. The finding will)e published in the Federal Register of February 18, 1976.

On October 15, 1975, the Treasury Department determined :hat birch 3-ply doorskins from Japan were being, or likely :o be, sold at less than fair value within the meaning of :he Antidumping Act, 1921, as amended.

On January 12, 1976, the U.S. International Trade Com- ıission advised the Secretary of the Treasury that an industry .n the United States was being injured by reason of the im-)ortation of birch 3-ply doorskins from Japan sold, or likely :o be sold, at less than fair value.

After these two determinations, the finding of dumping ıutomatically follows as the final administrative requirement .n antidumping investigations.

Imports of the subject merchandise from Japan during :alendar year 1975 were valued at roughly $8.7 million.

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he Department of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR RELEASE UPON DELIVERY

STATEMENT BY THE HONORABLE EDWIN H. YEO III
UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS
BEFORE THE TASK FORCE ON TAX EXPENDITURES AND OFF-BUDGET AFFAIRS
OF THE HOUSE BUDGET COMMITTEE
WEDNESDAY, FEBRUARY 18, 1976, 11:00 AM

I am pleased to appear this morning to contribute to the Task Force's consideration of the Exchange Stabilization Fund (ESF). The ESF was established by Act of Congress in 1934 to make particular resources available to the Secretary of the Treasury for the purpose of stabilizing the exchange value of the dollar. In addition to the appropriated capital of the ESF, all income earned by the fund was to be retained and to be available for the purposes of the fund. Losses must be financed out of the fund. The Secretary was specifically authorized by statute to engage in transactions in foreign exchange, gold, securities and other instruments of credit for the account of the fund. Congress has also explicitly acknowledged, on several occasions, the Secretary's authority -- as necessary and appropriate to fulfillment of the purposes of the ESF -- to finance certain administrative and personnel expenditures from the fund.

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In establishing the ESF, Congress recognized that a high degree of flexibility and discretion would be required for the Secretary to effectively fulfill the purposes for which the Fund was established. Specifically, the Fund was placed "under the exclusive control of the Secretary of the Treasury, with the approval of the President, whose decisions shall be final and not be subject to review by any other official." The Congress has also recognized that operations for the account of the ESF are likely to be highly sensitive, requiring a substantial degree of confidentiality. Most recently, in 1970 when the Congress enacted legislation authorizing GAO auditing of the administrative expenses of the ESF, it explicitly recognized the sensitivity of the Fund and the need for continuing confidentiality with respect to operational transactions of the Fund, as distinct from administrative accounts. This need for confidentiality of currency operations is considered imperative by other governments which have similar funds for exchange stabilization purposes. The ESF, therefore, was given a status which enabled it to operate with flexibility, speed and sensitivity to the delicate nature of the transactions involved.

Over the years the ESF has been used in a number of ways, directed to the basic purpose of stabilizing the dollar. We have described ESF operations in some detail in answers provided to written questions submitted by the Committee. Generally stabilization operations undertaken for the account of the ESF are designed to offset temporary pressures upon the dollar in world exchange markets. To enable the Treasury to perform these market operations, ESF funds are used to acquire foreign currencies which then can be used in market operations as the need arises. In particular instances the Treasury has entered into specific exchange agreements with foreign countries which were attempting to keep their currencies convertible into dollars at reasonable exchange rates. The ESF has also played a role in our pursuit of stabilization policies through the International Monetary Fund (IMF). The major portion of the original appropriation to the ESF was used for the initial U.S. subscription to the IMF in accordance with the Bretton Woods Agreement Act of 1945. Currently, the ESF holds and conducts transactions in Special Drawing Rights. This ESF function was specifically authorized by Congress in the Special Drawing Rights Act of 1968.

Future Operations of the ESF

ESF operations in the future will employ the same range of market techniques as characterized use of the ESF in the past. However, these future operations must be consistent with and supportive of international monetary policy as it has substantially evolved since the early 1970's. The essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, and that sustains sound economic growth. This is stated explicitly in the proposed amendments to the Articles of Agreement of the International Monetary Fund agreed upon in Jamaica by the IMF Interim Committee last month and soon to be presented to the Congress for ratification. By fostering orderly underlying economic and financial conditions and an international monetary system that does not tend to produce erratic disruptions, we can best assure orderly exchange arrangements.

We live in a world in which underlying economic and financial conditions have been particularly unstable for several years. Inflation rates in major industrial countries have been inordinately high; they have varied widely among countries; food and raw material prices have fluctuated dramatically; and the OPEC cartel has quintupled the price of oil in less than two years. Changes such as these in world economic and financial conditions have required rapid and unanticipated changes in our capacity for study, for analysis, and for international consultations and negotiations.

The understandings reached at Jamaica will require an intensification of the exchange of information and analysis of underlying economic and financial factors among finance ministries of major countries and close continuing consultations on the policies being pursued by individual countries. In addition, consistent with our obligations under the amended

IMF Articles of Agreement, the Secretary will need the capability to counter erratic movements of exchange rates. In pursuit of our international monetary objectives, the financial resources of the ESF will be indispensable. The Secretary must have resources which can be utilized flexibly, as the exigencies of the moment may require, in a way that will avoid provoking or facilitating disruptive speculative activity in the markets.

Operations to combat disorderly markets will be conducted in cooperation with foreign governments and their central banks. In order to cooperate with the U.S. in such operations these governments must have confidence that the information which they share with us on a confidential basis will be kept confidential. If such information or the decisions of the Secretary of the Treasury with respect to transactions through the ESF were to become public prematurely, it would not only be disruptive to markets and to foreign governments, but would totally hamper the use of the fund by the Secretary of the Treasury for its intended purpose.

The new international monetary system established by the Jamaica agreements, calls for cooperative actions to counter erratic fluctuations in the foreign exchange markets. The Treasury and the Federal Reserve System, in close collaboration, may engage in exchange market intervention for this purpose. In addition, upon Congressional authorization of U.S. participation in the Financial Support Fund and the entry into froce of the Support Fund Agreement, the ESF will also be used to meet the obligations of the U.S. to make immediate transfers to the Support Fund.

Administrative Control and Management of the Fund

Since the ESF was first established, it has been recognized that the Secretary would need to have competent expert staff and administrative support to successfully formulate and execute U.S. stabilization policy, and that the required staff would be funded from the ESF itself. In today's interdependent world, effective operations in the broad area of stabilization policy require an organization equipped to (a) develop information on and analyze foreign activities in the monetary, exchange, trade, and development fields, and other matters bearing on the U.S. external payments position; (b) assist in formulating U.S. policy positions on international financial issues, including the evolution of the international monetary system; and (c) implement those policies.

In furtherance of the proper discharge of his authority to manage and administer the Stabilization Fund, the Secretary has applied clear and precise standards of public administration. An annual budget for ESF administrative expenditures is submitted to the Secretary for his approval.

Our current procedures and practices with regard to the recruiting, promotions, and salaries of personnel employed by the fund, or hired as consultants, are the same as those of the Civil Service Commission. Departmental orders issued by the Secretary set forth strict criteria for determining which personnel positions in the Treasury are eligible for funding from the ESF. The GAO has recently conducted a thorough examination of our practices concerning personnel, including the critieria for determining ESF financing. The GAO examination, which concluded that Fund resources could appropriately be used in accordance with these criteria, resulted in a report submitted to your Task Force in November 1975.

The personnel management controls mentioned above have produced excellent results not only in terms of the quality of work performed but also in keeping proper limits on the size of the administrative expenditures and staff. An unusual staff increase was required in FY-75 as a result of a series of major changes in the world economic situation, which we have discussed at some length in response to one of the Committee's written questions. I am pleased to inform the Committee that the FY-76 budget of the Fund has been revised and, pursuant to a recent reorganization and consolidation in the international activities of the Treasury, we have been able to maintain for FY-76 the same number of authorized positions as for FY-75. This decision has enabled us to reduce FY-76 expenditures to $18.3 million, $1.6 million below the total which appeared in the Federal budget documents for FY-77. Although the budget for FY-77 has not been finalized, we expect to be able to keep the size of the staff and real expenditures within the FY-76 levels.

In addition to the personnel standards mentioned above, an extensive system of financial and accounting reviews is applied by the Secretary to the conduct of the Exchange Stabilization Fund. Controls are exercised by means of a comprehensive accounting and internal audit system, an annual administrative budget, and an annual post-expenditure audit review carried out by a committee of auditors appointed by the Secretary from bureaus not connected in any way with the Stabilization Fund. The report of the Audit Committee is included in the Annual Report on the Exchange Stablilization Fund which the Secretary submits each year to the Congress. The Fund's balance sheet and income and expense statement are published four times a year in the Treasury Bulletin.

Public Law 91-599 enacted in 1970 provided for an audit of the Stabilization Fund's administrative expenses to be performed by the General Accounting Office at any time the Comptroller General wishes. The administrative accounts have been so audited,

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and no significant problems were cited in the GAO report of audit issued on June 20, 1974.

I think you will agree, Mr. Chairman, that although the administration of the Exchange Stabilization Fund involves a trust and an element of discretion, this does not mean an absence of accountability. Indeed the information available about U.S. foreign economic policies, including the Stabilization Fund, already far exceeds that supplied by other major governments.

Conclusion

Mr. Chairman, the Treasury recognizes the importance of maintaining open and full communication with the Congress on all matters of policy, especially the budget process. Secretary Simon and I have both consulted extensively with key Congressmen and Senators on the nature of the reform of the international monetary system, and I believe that the Congress is in agreement with the Administration on the objective of exchange stability and its attainment through the achievement of greater underlying stability of economic and financial factors as outlined in the new international monetary accord reached in Jamaica. Yet, I believe it is also clear that in order for the Treasury to be free in fulfilling its obligations to the Congress and the American people in the area of international monetary operations and economic stability, it is necessary for ESF operations to be handled in a confidential and responsible manner.

We believe we have maintained firm control over operations of the ESF as contemplated by the Congress. At the same time, we continue to believe that the original Congressional intent of providing the Secretary of the Treasury with maximum flexibility as well as insuring confidentiality in ESF's activities continue to be essential.

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The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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ADDRESS BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
TO THE NEW YORK CHAPTER
THE PUBLIC RELATIONS SOCIETY OF AMERICA
NEW YORK CITY, FEBRUARY 18, 1976

It's a special pleasure for me to appear before this distinguished communications group for several reasons. For one thing, it's nice to see so many smiling faces in Fun City. On my last few visits I detected a distinct chill in the air -- perhaps because of the hard, serious business that brought me here during New York's fiscal crisis.

It was a difficult time for all of us and no one had an easy role to play. As far as my own role was concerned, I would say that I felt I had a duty to be honest and forthright about the situation as I saw it in this great but troubled city. I told the truth as I saw it, even though I realized it wouldn't make for very pleasant listening.

But, today, I come to praise New York City, not to bury it. And I want to express my personal admiration for the way in which the people and the administration of this great municipality are facing up to a problem that demands the best effort from all of us. It won't be easy, but New York can and will be restored to economic health.

You, as communicators, can help by explaining the issues and educating the public. For if my three years in Washington have taught me anything at all, it is the vital importance of your speciality -- good communications.

The success of public policy, even more than the success of a commercial product, is directly dependent on the communications ability of those who advocate it. In fact, one of the biggest problems we face today in government is the paradox of too many good communicators selling bad policies and too many bad communicators selling good policies. A rhetorical spellbinder could sell ice to eskimos.

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Some of the advocates of free enterprise and fiscal responsibility, on the other hand, are so stuffy and naive about communications that they'd have trouble peddling Alka-Selzer on New Year's morning. There isn't a better product on the political market than the free enterprise system. But it just isn't being sold with enough savvy and imagination in this politically competitive age we live in.

Washington, it has been said, is the only city on earth where sound travels faster than light. As the late Vince Lombardi might have put it, in Washington, communication isn't everything, it's the only thing.

During the past three years I have developed a healthy respect and appreciation for the real professionals in the field. In fact, I have a feeling that I'm here today partly because of some conniving on the part of Treasury's former Public Affairs Director, Jim Sites, and Texaco's Bob Kelly, another former bureaucrat -- and a good one, I hastily add! And now that Jim has joined the NAM, Treasury has a great replacement in Bill Rhatican, who recently came over from Commerce and who, I know, will be glad to lend any of you a hand at any time.

Since public relations, as we understand it, is practiced only in democratic societies, I suppose it's only natural, as we near the end of our great democracy's second century, to think about the impact of public relations on our future.

Perhaps the most significant -- and distressing -- fact confronting this country today is closely related to your field. I refer to the decline in public confidence in our institutions. Instead of observing our Bicentennial on the upbeat, we find our nation in a mood of deep and widespread distrust of many of the very elements that made our society great. Hardly any group -- business, government, the press, education, labor -- enjoys the credibility and trust it once did.

Many people sensed this decline in public confidence long before the pollsters confirmed it. George Shultz, a former Secretary of the Treasury, has summed up the problem pretty well: "We need moorings in our society," he points out, but "We have let go of many old moorings and we do not have new ones to replace them."

This decline in public confidence has been building for a long time. Many different things have contributed to it: Vietnam, Watergate, and the over-promising and under performance of government. But, today, it involves far more than government. It now seems to pervade every facet of our social structure and poses a threat to the system that has enabled this country to achieve the greatest prosperity and the highest standard of living ever known.

One of the institutions whose credibility has lost the most ground is business -- or what I prefer to call free enterprise. Today the American private sector is re-examining itself to determine not only what has caused this loss of confidence but also what it can do to regain it.

One opinion researcher says the major concern facing business is to overcome the public's alienation and cynicism. I'm not sure I agree. I certainly don't agree with those who allege there is something basically wrong with the American enterprise system itself.

Part of the problem, I believe, is that many people are misinformed and misled on the economic issues. In other words, the problem is one of communications. Too much is happening too fast. People have trouble keeping up and our society gets too little accurate information about what is really going on in the business sector. According to a recent study by the Opinion Research Corporation, the key issues on which the public is most misinformed are the level and trend of corporate profits and their inter-relationships with prices, wages, unemployment and inflation -- a major part of the system of economic causes and effects that influence their daily lives. They also found that people were misinformed about antitrust problems, monopolistic practices and competition and the relations between corporations and governmental regulatory agencies.

If that worries you, there's more. Some of you may recall the report last year by the Commerce Department and the Advertising Council, which portrayed the average American as a virtual economic illiterate who perceives our economic system almost solely in terms of his or her own personal situation rather than in its broad functional aspects.

This is only human -- but it is also dangerous.

People usually fear what they don't understand. And people tend to reject what they fear. So we shouldn't be surprised if they're tempted to unknowingly embrace programs -- and quack economic remedies -- that are destructive to our system. Which raises the basic question of whether or not our system is worth preserving. Perhaps the fairest way to judge is by performance. Here are some of the measurable standards of performance of the American economy in the post-World War II era:

-- Since the late 1950s, real purchasing power of Americans has jumped by 40 percent, average family income has risen to over $13,000 a year, 20 million new jobs have been created, and we have cut the number of people below the poverty line in half.

-- Our farmers harvest more than twice as much grain with fewer workers compared to a generation ago.

-- Medical science has added 10 years to our lives over this period.

-- Our economic abundance has made it possible for us to give $110 billion in food and economic aid to less fortunate nations since the end of World War II.

-- And Americans today have more leisure time for study, recreation and self-improvement than any society in recorded history. We continue to spend about 90 percent of our personal disposable income on ourselves.

No other country -- no other system -- has achieved so much for its people. Yet these tremendous achievements are the product of the same free-market system that now finds itself under attack.

Where does it stand today? For all the talk about excessive profits, it's a system that, on the average, offers a profit incentive of less than five cents on the dollar, a small reward for all the effort and risk-taking that goes into developing and operating a successful business.

Nevertheless, it remains the real productive source of our nation's wealth, as well as that of each individual American.

Despite the growing influence of government over our lives, this system produces the food we eat, the goods we use, the clothes we wear, the homes we live in.

It is the source of five out of every six jobs in America, and it pays the taxes to provide most of the rest of the jobs in our all-too-rapidly expanding public sector.

It is the foundation for defense security for ourselves and most of the Free World.

It is the productive base that pays for government spending to aid the elderly, the jobless, the poor, the dependent and the disabled. Indeed, far from being the anti-human caricature painted by political demagogues, the American private sector is in reality the mightiest engine for social progress and individual improvement ever created.

In a nutshell, the values we live by -- all of the material and spiritual things about our country that make it unique and make us so proud to be Americans -- could not exist without the free enterprise system.

If the prospect of seeing a system like that go down the drain doesn't worry you, let me call your attention to a syndicated column that Charles Bartlett wrote on December 26: "More than 10 years ago," Mr. Bartlett said, "Arthur Koestler wrote that a loss of incentive was ailing Britain far more than its loss of empire, and the glummest aspect of today's scene is the bowed spirit of a creative, courageous, ebullient people."

If that can happen to a nation that once was one of the proudest bastions of free enterprise, we are in no position to assume that it can't happen here.

Every generation hopes it will leave its children a better world. But there is no guarantee of endless prosperity in the United States any more than in any other country. Prosperity doesn't happen by accident. Tamper with its source and the shock is felt throughout our entire society.

And I am convinced that, today, the private sector -- indeed, our very society -- is enduring the greatest series of shocks and challenges since the 1930s. In my opinion the threat can be traced directly to the explosive growth in government and the ominous concentration of power on the Potomac. Today government spending at all levels accounts for some 38 percent of our gross national product. If recent growth patterns continue, it will reach 60 percent before the end of this century.

It is my firm belief that any government that taxes away more than half of what people earn has robbed them of a great part of their economic freedom. And can there be any doubt that when our economic freedoms are destroyed, our personal and political freedoms will not long survive them?

The head of one of our major corporations says it's no longer just a challenge. In the New York Times' annual economic roundup last month, Richard Riley, the President of

Firestone Tire and Rubber Company, was reported to have pronounced free enterprise already dead. I shudder to think how many other business leaders share in that counsel of despair. If they give up, who is left to uphold economic freedom?

Yet the same article quoted another executive as saying that unless something is done to halt "the systematic destruction by federal and state government of the ability to make profits, the word 'corporation' will be something to be studied....along with the buggy whip."

Now no one would seriously question the role of government in safeguarding such areas as health and education. But the layer upon layer of regulations that government has piled on all aspects of the private sector, and its proliferation of programs and administrative devices has seriously hobbled the American businessman -- especially the small businessman, the very backbone of our free enterprise system. Every business in America, from the little shop around the corner to General Motors is being buried under a growing load of federal paperwork and requirements to the tune of $20 billion a year.

The men and women who run this country's private industry are your clients. You work with them daily. Both you and they know there is justification for some of the charges lodged against their industries. Most of them recognize that they must put their own houses in order by correcting these faults. And most realize that failure to do so would surely contribute to the further undermining of the system they profess to cherish.

But survival requires more than internal reform, and that is where you become so important.

Even the misinformed consumers who were studied in that survey by Opinion Research Corporation said they had no wish to destroy our free enterprise system. They said they still consider business a progressive force, but they would like to see it "cleaned up."

According to the same pollsters -- and here I quote: "The pressure is on corporations to overcome misconceptions about their activities while correcting abuses for which they are responsible."

The public relations profession, it seems to me, has its work cut out. It's a big job and a critical one. There is an urgent need for leadership in helping to restore the faith of the American people in their economic system, as well as in government, and I don't know of any group of professionals better qualified to do it than you.

It's been said that communications is the web holding civilization together -- the central nervous system of any organized society. It's also the only means of perpetuating the traditional values handed down by our forefathers which give our civilization stability and continuity.

Never has that function been more important than today. It is largely up to you to communicate the great story of freedom -- to dispel the confusion that has made free enterprise a dirty word; to let our lawmakers and leaders in government know they cannot let the system that generates our wealth, our strength, and our freedom be destroyed. If ever communication of the highest professional caliber was desperately needed, it is NOW; if ever there was an assignment that challenged your profession to the core, it is this one.

Too many in government have too long acted on the assumption that good economics is not good politics. We must show them the error of their way. We must make it politically attractive to vote for, not against, responsible economic policies. Our lawmakers must be convinced that this is what the public wants. For they know better than anyone that the public attitude of today is the public statute of tomorrow.

Given the facts about the very real threats to our economic system, I for one have no doubt about what the public's reaction will be. But the public must know them in order to act on them.

The people have a right to know how government restrictions are undermining individual and industry initiative. They must learn how our government's tax and spending policies are sopping up capital needed for investment and the creation of jobs.

They must understand that runaway spending and unending deficits fuel inflation -- a silent thief that picks every American's pocket, undermines public confidence in the future and turns the desperate to government for still more illusory help.

In short, the job before you -- if you hope to preserve this system of ours -- is to convince both the public and its leaders in Washington that government just can't go on wringing the neck of that marvelous goose that lays those golden eggs.

This is not a question of liberals versus conservatives or Democrats versus Republicans; it is a matter of sense against nonsense, freedom against oppression. There is no doubt whatever in my mind that you can do this job. But all of us must be united in our resolve;

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. To set a high moral and ethical standard by eliminating any practices in our own organizations and operations that may be questionable,

. To square practices with principles by refusing government subsidies, quotas, handouts, bailouts or other inducements that offer an illusory, empty promise of security in exchange for sacrifices of freedom, and

. To initiate and, in some cases, redouble our efforts to inform and educate the public about the benefits and realities of the private enterprise system.

Given this commitment, the public relations profession can create a real understanding of how the private enterprise system benefits individuals and groups, and of its absolute essentiality to progress, prosperity... and, above all, our freedom.

Sages throughout history have placed freedom at the top of all the things we hold sacred. Our founding fathers built a new nation around that concept and, ever since, freedom has been synonymous with America itself.

One way to ensure our freedom is through education. As public relations professionals, you counsel corporate leaders who provide millions of dollars each year to America's educational institutions and foundations. It is fundamental to America's strength to continue that generosity. I would advise, however, that you counsel your bosses and your clients to take a close look at the teaching policies of those schools and foundations being considered for corporate gifts. Find out if the subjects of that generosity are really assisting in the fight to maintain our freedoms or if they're working to erode them -- and urge that judgments be made accordingly. Otherwise the largesse of the free enterprise system will continue to finance its own destruction.

This, ladies and gentlemen, is the crucial theme that must be communicated broadly and deeply into the national consciousness: The American production and distribution system is the very wellspring of our nation's strength --the source of present abundance and the basis for our hopes of a better future. America can solve almost any of its pressing problems if it preserves and continues to improve this immensely productive system. And in this process, we'll also be preserving the freedoms that made it all possible.

This is one P.R. campaign none of us can afford to lose. And you, more than anyone else can help us to win it.

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e Department of the TREASURY NEWS
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FOR RELEASE ON DELIVERY

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STATEMENT OF THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE THE SENATE BANKING COMMITTEE
FEBRUARY 19, 1976, 2:00 P.M. EST

Mr. Chairman and Members of the Committee:

I am here today in my capacity as Chairman of the Emergency Loan Guarantee Board to address certain issues you have raised about outstanding guaranteed loans to the Lockheed Aircraft Corporation. Your primary concern is the ability of Lockheed to repay guaranteed notes in an orderly fashion. That, of course, is also the primary concern of the ELGB, Mr. Chairman, you have stated that the board should require a phase-out of the loan program by mandating steady reductions in the amount of outstanding loans. For the reasons I will explain, the Board feels that such an approach is not only impractical but inconsistent with the intent of the original 1971 loan guarantee legislation.

The goal of that legislation was to assist Lockheed through a liquidity crisis. The proponents of the program persuaded Congress that passage of the legislation would avert the impact of a Lockheed failure upon the economy while not posing a grave risk to the Federal purse. In recognition of Lockheed's longer-term borrowing requirements and the expected fluctuation in its cash needs, the Emergency Loan Guarantee Board was given great discretion and flexibility in administering the program. The program was designed to restore Lockheed to a position that would afford it access to normal private credit markets. The desirability of granting the ELGB wide-ranging authority is evident from the developments that have occurred since 1971. To cite an important example--because of a sharp drop-off in their business, the failure of certain airline customers to make final payment for and take delivery of Tri-star aircraft last year prevented Lockheed from paying off as originally planned a large segment of its outstanding guaranteed loan obligation. This is the sort of development that could not have been anticipated at the outset.

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Your suggestion of a rigid repayment schedule is more consistent with the approach taken by Congress in dealing with the New York City fiscal crisis. In the case of New York City, while Federal assistance was similarly intended to bridge the gap until access to private capital markets could be regained, different factors were present which motivated Congress to insist upon less flexible repayment terms. New York City had been living beyond its means for some time and had a fundamental and growing budget gap between revenues and expenditures. In order to restore market confidence in the City, a strict financial plan was developed by the City and the State calling for the achievement of a balanced budget over three years. The only Federal assistance required was to cover seasonal financing needs during the three-year adjustment period. The legislation that Congress passed and the credit agreement that we entered into with New York City were tailored to meet that seasonal need. Thus, there is a requirement in the law that specific sources of repayment be identified at the time each loan is made as well as a requirement that all loans be repaid in the fiscal year in which they are extended. New York City indicated that this type of seasonal financing arrangement would enable it to return to the capital markets by 1978, and Congress and the Administration agreed.

In contrast, the purpose of the Lockheed program was to restore the financial health and viability of the company over the long term. Because of uncertainties as to such matters as the timing of product sales and cash receipts inventory needs and general business trends in the aerospace industry, it was felt inadvisable to require Lockheed to adhere to a rigid repayment schedule when the ELGB program was set up in 1971. For the same reasons, a rigid repayment requirement at this time could well impair Lockheed's ability to regain its financial health.

I think it appropriate that I say a few words about the activities that have recently been reported in the press. I will then focus on the repayment question.

I am sure you will agree that my remarks before this committee last August left no doubt in anyone's mind about my views, and the views of the Loan Guarantee Board, on the issue of bribes and other improper payments. I condemned in the strongest possible terms all improper payments made by Lockheed. The ELGB does not condone bribery in any way, shape or form. The fact that a firm's competitors may engage in such practices does not make the practices, in any way, less odious.

I am a strong advocate of the American system of free enterprise and of a competitive economy. When a business seeks to obtain orders or make sales through bribes and kickbacks, it not only undermines competition in the marketplace, it seriously erodes the reputation of the American business community. This cannot be tolerated.

Since last summer, Lockheed has worked, at our behest, and under our supervision, to put an end to all improper practices. Lockheed's Board has adopted a set of rigid controls over payments and over the hiring of consultants and commissioned agents to assure that no improper payments occur in the future. The ELGB is closely monitoring the implementation of that policy by Lockheed. With respect to improper payments previously made, the ELGB's principal concern has been to assess the effect of the disclosure of such payments on future and existing foreign orders for Lockheed products. The primary factor bearing upon this is, of course, the extent to which Lockheed will be required to disclose publicly the names of all countries in which payments were made and the identities of those who received payments. The ELGB has concluded that this kind of detail is not necessary for it to perform its function of evaluating Lockheed's ability to repay its guaranteed borrowings.

The Emergency Loan Guarantee Board has taken a number of important and decisive steps since learning that Lockheed had been making improper foreign payments. We requested from Lockheed information about the payments in order to assess their impact on the guarantee program. The ELGB insisted that Lockheed cease all improper payments immediately, and Lockheed agreed to do so. The Company also instituted certain procedures to prevent its officers or agents from again becoming involved in improper marketing activities. The ELGB reviewed those policy measures and required certain modifications. As Lockheed develops further procedures to implement its new policies, the ELGB will continue to review the adequacy of such safeguards.

Lockheed's Board has established a flat prohibition against the payment of any commissions directly or indirectly to foreign government officials or to political organizations. Any officer or employee found circumventing this rule will be dismissed. Lockheed's Board has also ordered that no corporate funds are to be maintained outside of normal channels to prevent the setting up of secret "slush" funds.

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Lockheed has agreed to certify each month to the Emergency Loan Guarantee Board that both these requirements are being properly followed. In addition, Lockheed has set up a committee of outside directors to investigate the Company's prior activities. Finally, I should note that at a board of directors' meeting last Friday, important changes were made in Lockheed's top management. I might add parenthetically that I have been acquainted with Bob Haack for some time, and I personally am pleased by his being named Chairman of Lockheed at this time. This management change can be a significant first step in rebuilding public confidence in the Company.

On its part, the ELGB is presently considering amending its agreements with Lockheed and the lending banks. The new amendments would cause the making of further improper payments to be an event of default. The Amendments would also set up a formal monitoring system to assure, to the extent possible, that no wrongful payments are made in the future.

The ELGB also comtemplates that it will require a special accounting from the committee of outside directors recently set up by Lockheed's Board to investigate the Company's improper activities. The Directors' committee will use independent resources to investigate and fully account for all past improper transactions. The ELGB will evaluate the nature and scope of that investigation and require a special report about its findings. We will require a further accounting if one is warranted.

Finally, with respect to the issue of disclosure, I think it is important to note that Lockheed has turned over all subpoenaed documents relating to foreign payments and bribery to the Securities and Exchange Commission. This has been done under a court order which requires that that information not be made available by the SEC to anyone outside the agency pending action by the court.

Mr. Chairman, in your letter of February 13, you requested that I provide a number of documents. These have been provided to your staff. You also asked that I furnish you with the Board's assessment of the impact of a Lockheed collapse on the economy. The Board itself has not made such an assessment. However, last fall as part of the staff's consideration of the Board's options in connection with the improper-payments problem, the staff sought an analysis along these lines from the Treasury Department's research staff. Since several months have elapsed and major changes in the economy have occurred in the interim, I have instructed my staff to obtain a new analysis. I will be pleased to furnish you this new analysis on its completion.

The Emergency Loan Guarantee Board staff has just returned from Lockheed's headquarters in California, so we have timely reports on issues of concern to this committee. Meetings were held with Lockheed management as part of our regular monitoring function through which the Company's financial projections are reviewed and evaluated. While at Lockheed, the staff also sought to assess the possible impact of recent newspaper stories about foreign payments made by Lockheed on the Company's future. We are continuing to obtain information that will enable us to evaluate how sales of particular product lines to foreign countries might be influenced by disclosure of improper payments. While we will monitor further public disclosures of improper payments, the ELGB does not consider detailed information about individual transactions necessary to carry out its mission.

Mr. Chairman, in your letter to me of February 12, you urge that the ELGB take immediate steps to require a phase-out of the guaranteed loan. You urge this to prevent a "Hobson's choice" in 1978 -- extending the guarantee further or bankrupting Lockheed. In point of fact, the course you propose would quite likely only force us to settle sooner on one alternative of that dilemma -- bankrupting Lockheed. In considering your suggestion, we should keep in mind the original objective of the statutory program -- the rehabilitation of Lockheed to avoid the economic impact of a major corporate failure.

The United States has only been experiencing economic recovery since April 1975. Over the last two years, Lockheed, which is so dependent on a healthy commercial airline industry, was particularly hard hit by the recession. In spite of this, the Company was able to show small operating net profits. As the airline industry benefits from improved economic circumstances, Lockheed's prospects should be greatly enhanced. However, the Company's overall situation is uncertain because of the impact that disclosure of improper payments could have on existing and future orders for Lockheed products.

Mr. Chairman, I do not believe that the approach you propose is appropriate. In view of present conditions and uncertainties, requiring Lockheed to adhere to a strict repayment schedule would be the equivalent of attempting to squeeze "blood out of a turnip". We cannot predict with certainty that repayment money will be available to Lockheed in specific future periods of time. Lockheed's ability to ultimately generate sufficient cash to repay the guarantee notes can be achieved only if the Company is successful in maintaining its business base. Any imposition of restrictions such as you propose would create additional risks to Lockheed's ability to operate in its present form. This in turn could discourage existing and new customers from placing orders with Lockheed, thus, further decreasing the probability of an orderly termination of the guarantee program. The key here is that Lockheed must regain the confidence of all sectors of the public including the government, customers, suppliers, and other company creditors. Based on Lockheed's financial projections, we believe that there is a reasonable prospect that the company will be able to return to the private capital markets by the time that the guarantee period expires.

I recognize that we do not know what impact on Lockheed's operations will occur as a result of the foreign-payments disclosures that have been made. We do not yet know whether order cancellations might result from detailed disclosures about improper payments. The Board and its staff will continue to monitor these events closely. There are many uncertainties. The improper-payments question has placed some clouds on the horizon. These clouds, by no means however, necessarily spell the demise of Lockheed.

Mr. Chairman, in your letter of February 12 calling for a rigid phase-out of the guaranteed loan program, you made reference to the fact that the repayment schedule has been modified several times. You cite the GAO report on the guarantee program in making this observation. I think there may be a basic misunderstanding here. We are not really dealing with a repayment schedule. The arrangement that was set up for Lockheed through the guarantee legislation was not intended to operate like a consumer loan for a new car. It is not a loan that is to be paid off in installments. While there is an expectation that over time Lockheed will be able to scale down the amount of its guaranteed borrowings, this is not a strict formal requirement.

I think what the GAO may have been focusing upon was Lockheed's December 1974 forecast for debt repayment, which also was described in the Loan Guarantee Board's most recent annual report covering the period August 1974 through July 1975. The report indicates that in its December 1974 forecast, Lockheed projected reducing borrowings under the loan Guarantee program by about forty million dollars during 1975. As it turned out, last year Lockheed was unable to reduce its borrowings under the program below the $195 million level that pertained at the year's outset, largely because of postponement by airline customers of earlier agreed-to delivery dates. The airlines were hard hit, first by increased fuel costs, and then by traffic declines caused by the recession.

The important distinction that must be recognized here is that we are dealing with a corporation's financial projection and not with a repayment plan in the sense of a formal loan repayment schedule. All corporations make projections about their financial position over future periods of time. Such is necessary for sound corporate planning. It is true that as part of its evaluation of the loan guarantee program, the Guarantee Board and its staff look closely at Lockheed's financial projections. The projections are used to assess both policy with regard to continuation of the loan guarantee and the possible modification of its conditions. However, the financial projections cannot be regarded in any sense as a requirement that Lockheed reduce the amount of its outstanding loans at the projected rate.

Lockheed's inability to meet its financial forecast during 1975 was caused mainly by factors external to the firm. In fact, Lockheed's business in certain areas exceeded forecast expectations. Lockheed's cash problems since 1974 have been closely related to the financial problems of the airline industry. Airlines have defaulted on purchase orders and have deferred delivery of some aircraft, with a serious impact on the Company's anticipated cash flow. All of this is without any practical recourse being available to the company, since its commercial airframe business is closely tied to the fate and fortune of its airline customers. Some of these situations are now clearing up and if deliveries can be made as now anticipated, Lockheed's cash-flow situation will benefit. The point I want to make is that Lockheed's inability to repay forty million dollars last year, as it had originally hoped, was largely caused by external factors not evident to Lockheed when it made its projections in December 1974.

It is Lockheed's practice to do a completely new forecast annually. The Company's latest forecast, which still has not been finalized, was made available to the ELGB for the first time last week. I must point out that the effects of the recent disclosure of Lockheed's improper payments are not and cannot be taken into account in that forecast, and the ELGB does not believe they are fully assessable unless and until the current uncertainties are resolved.

This new forecast indicates that guaranteed borrowings will trend downward as was expected by Lockheed and the ELGB during 1975. In fact, the forecast now projects repayment by the end of 1977 of $150 million of the $195 million of guaranteed debt with the remaining $45 million to be repaid in 1978. Based on a preliminary assessment, the ELGB is of the opinion that the forecast is reasonable, although I must reemphasize that it does not take into account the potential impact of disclosures of the details of past foreign payments. The forecast does, however, provide some cushion which could be applied against contingencies. If Lockheed is in fact able to reduce the guaranteed borrowings substantially over the next two years as it has forecasted, it seems reasonable to me to anticipate that Lockheed will have access to private capital sources by the time that the Government Guarantee program ends.

Another factor that I think merits your consideration is the Government's collateral. Our most recent analysis shows that the value of the underlying collateral for the Government's loan continues to cover adequately the Government's potential exposure in this program. This opinion was concurred in by the Comptroller General in his January 1976 report.

Thus, we are looking at a situation where the amount of guaranteed loans outstanding has dropped from a high of $245 million to $195 million, has been steady recently, and should begin to decline in the near future, while the the value of the Government's collateral fully covers the Government's potential exposure. In view of this, it would be unwise to shift to the rigid repayment schedule you are suggesting, possibly causing a default by Lockheed and bringing about the very bankruptcy dislocations that the whole program was set up to avoid.

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FOR IMMEDIATE RELEASE UPON DELIVERY

STATEMENT OF SIDNEY L. JONES
ASSISTANT SECRETARY OF THE TREASURY FOR ECONOMIC POLICY
BEFORE THE SUBCOMMITTEE ON FINANCIAL MARKETS OF
THE SENATE FINANCE COMMITTEE
FEBRUARY 19, 1976

Mr. Chairman and Members of this Subcommittee:

I welcome this opportunity to discuss the process of capital formation, financial institutions and possible incentives for encouraging capital investment. These topics are of fundamental importance in establishing national economic priorities. Experiences with sharp cyclical swings, unprecedented double-digit inflation, unacceptable levels of unemployment and uncertainties about the future adequacy of raw materials and productive capacity have created increased concern about our national economic prospects.

Adequate capital formation is required for economic growth, creation of job opportunities, moderation of price increases and maintaining our competitive position in international markets. However, capital investment is only one of the diverse claims against the national output. The quantity and type of capital formation in the future will depend upon what national priorities are established and what time periods are used for planning economic policies. The challenge of achieving capital formation goals can be met but success will not be automatic and major policy changes are required to: (1) eliminate the chronic Federal deficits which divert resources and disrupt financial markets; (2) reverse the long-term decline of business profits which are the basic incentive for new investment and an important source of financing; and (3) provide a positive tax environment which is not biased against savings and investment.

I. Capital Investment Background

Economic growth depends upon: (1) the accumulated stock of productive assets; (2) the pace of new capital

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investment; (3) the application of advanced technology; (4) the quality of the national labor force -- its education, training, discipline and commitment; (5) the available infrastructure of transportation, communication, financial institutions and services; (6) access to raw materials; (7) managerial skills; and (8) the organization of the economic system. The mix of these economic factors varies for each country and changes over time as substitutions occur. However, most analysts agree that a strong rate of new capital investment is required to sustain economic growth.

The United States retains a position of economic leadership because it has had a favorable mix of the important economic variables, along with political stability and improving social mobility. The absolute amount of gross private domestic investment has grown rapidly over the years, as summarized in Table 1, and should begin to improve in 1976 following the declines in spending caused by the recession. Nevertheless, it is unrealistic to assume that the historical patterns of investment and productivity will be adequate to meet the economic priorities of the future. A review of the performance of the U.S. economy indicates several areas of concern.

First, during the decade of the 1960's, the United States ranked 17 in a list of 20 industrial nations belonging to the Organization for Economic Cooperation and Development (OECD) as to the average annual growth rate of real output (see Table 2).

Second, a study prepared by the Treasury Department indicates that total U.S. fixed investment as a percent of national output during the time period 1960 through 1973 was 17.5 percent using OECD definitions for comparing the different countries. The U.S. figure ranks last among a group of eleven major industrial nations. Furthermore, the gap between the level of private fixed investment in the U.S. economy, measured as a share of national output, and the commitments of other industrial nations tended to increase over time. When only nonresidential investment is considered the total amounts are lower but the relative position of the United States is not changed. As discussed below, the low ranking of the United States is the result of several basic characteristics of our economic system. However, it is a useful signal for calling attention to fundamental concerns about the undesirable levels of inflation, unemployment and productivity over the past decade.

Investment as Percent of
Real National Output 1960-73*

	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
U.S.	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.

Source: U.S. Department of the Treasury

Third, the United States also ranks last in a list of seven major industrial nations as to the average annual rate of growth of manufacturing output per manhour and gains in the gross domestic product per employed person from 1960 through 1973. During that period the amount of "real" capital investment per additional civilian employee declined and the historical U.S. advantage in "real" output per employed civilian compared to other industrial nations significantly narrowed. 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 productive capacity as a basis for raising the general standard of living. Inadequate capital investment limits new job opportunities and leads to inflation as productivity fails to rise as rapidly as labor and materials costs.

Productivity Growth, 1960-1973
(Average Annual Rate)

	Gross Domestic Product per employed person	Manufacturing output per manhour
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	6.4
United Kingdom	2.8	4.0
11 OECD Nations	5.2*	6.1

* Average for 6 OECD countries listed.

Source: Department of the Treasury

Fourth, there have been many specific examples of production bottlenecks resulting from inadequate capacity during periods of economic expansion. During the period of wage and price controls extending from August 1971 until June 1974 the Cost of Living Council became increasingly concerned about the prospects for inflation resulting from raw materials shortages and inadequate productive capacity in several basic industries. Current statistics concerning the utilization of existing plant capacity suggest that extensive slack exists in the system since the operating rate was 70.8 percent in the fourth quarter of 1975. However, it should be recognized that this figure can change rapidly as economic recovery occurs. It should also be emphasized that the concept of operating at 100 percent of physical capacity is misleading. Over the last fifteen years government figures indicate that manufacturing capacity utilization averaged 83 percent despite some periods of intense output. The highest figure reported during those fifteen years was 91.9 percent in 1966. Most companies need to preserve some reserve capacity to handle unexpected output requirements and to accommodate maintenance and replacement needs. Changing labor and material costs -- particularly energy prices -- must also be considered in evaluating the actual adequacy of existing plant and equipment. While it is unlikely that widespread productive capacity bottlenecks will develop during the next few months of economic recovery, achievement of the Nation's longer-term economic goals will require increased capital formation.

Fifth, the financial markets have also experienced considerable strain as the combination of private financing needs and public claims have increased rapidly. Corporations have traditionally relied on retained earnings and capital consumption allowances for approximately two-thirds of their financing requirements. However, in 1974 nonfarm nonfinancial corporate businesses required $101.8 billion of external funds out of total financing needs of $183.3 billion, or 55.5 percent. It is estimated that over 80 percent of the rise in corporate long-term funds of $270 billion over the past decade involved the sale of debt issues. This strong preference for debt issues -- particularly the influence of tax laws which allowed interest payments to be deducted from taxable income -- has brought about a doubling of the debt-equity ratios. The resulting fixed charges, consisting of payments of principal and interest charges, have made corporate financial positions less liquid and less flexible in reacting to the adversities of company problems and the general pressures caused by economic recessions.

Fortunately, these problems have been recognized and major efforts are now underway to correct the liquidity and solvency positions of American businesses. Considerable progress has been made already and companies are clearly intent on continuing the correction process. The major factor in this adjustment has been the sharp improvement in corporate profitability beginning in 1975 which is expected to be continued this year. This important turnaround follows a long period of deteriorating profits beginning in the mid-1960's and lasting until last year. For example in 1965 the adjusted after tax domestic profits of nonfinancial corporations represented 6.8 percent of total national income; by 1973 that figure had declined to 3.3 percent. Similarly, adjusted after tax profits of nonfinancial corporations as a percent of gross product originating in nonfinancial corporations fell from 10.2 percent in 1965 to 5.1 percent by 1973. Finally, over the same period the rate of return on capital investment declined from 10.1 percent to 6.1 percent.

These figures partially explain the loss of investment incentives and financing problems that have occurred. A major factor in the achievement of our national capital formation goals will involve a continued recovery of business profits necessary for encouraging future investment and for providing an important source of financing.

The five problem areas described above do not mean that economic progress in the United States has not occurred. In fact, over the past fifteen years the U.S. economy has increased the real output of goods and services by 60 percent; the real income of the average American has risen by over 50 percent; the number of Americans living in families with incomes below the poverty level has declined to 10.2 percent of the population; and 20 million new jobs have been created.

In describing the relatively slower rate of capital investment in the United States and the disappointing productivity figures, it should be recognized that there are many factors that influence a nation's level of investment.

First, the unusually large size of the U.S. economy and its relatively advanced stage of development, particularly the accumulated total of previous capital investments, creates a different investment environment. Having already developed an impressive productive capacity it is to be expected that our rate of additional growth would be lower than the development rates of other nations who are still striving to achieve our relatively advanced level of economic activity.

Second, the U.S. economy has traditionally emphasized consumption which has contributed to strong demand for goods and services leading to sustained output, employment and investment. In 1975 personal consumption totaled $963 billion, or 64 percent of the total gross national product and government purchases of goods and services amounted to $331 billion, or 22 percent. By way of comparison gross private domestic fixed investment was $112 billion, or 7.5 percent of the GNP (this figure does not include residential construction or inventory spending). Personal and government consumption outlays have long dominated the GNP so that gross savings flows required for private capital investment have been relatively low in the United States throughout the postwar period.

A third, important factor affecting the pattern of U.S. investment, compared with other nations, is the relatively large share of total capital outlays committed to the services category, which includes housing, government and other services. Our heavy investment in the services category emphasizes consumption but moderates the expansion of productive capacity relative to other nations (see Table 3).

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 from 1960 to 1971 was committed to

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replacement needs, compared to the United Kingdom, 61 percent; Canada, 52 percent; France, 54 percent; West Germany, 53 percent; and Japan, 31 percent. This 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 heavy replacement requirement does provide a continuing opportunity to introduce new technology into the U.S. economy. However, the replacement outlays do not add to the net total productive capacity of our economy.

Fifth, many countries provide a diversified group of government incentives to encourage investment. Basic industries are frequently controlled by foreign governments and special financial and operating assistance may be provided to preferred private companies to assist in thier 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 but there are some Federal programs which provide direct financial support through the Economic Development Administration, the Small Business Administration and some 169 different government credit programs. The Federal Government particularly influences capital investment through its budget decisions and specific legislative requirements involving safety, health and environmental goals. Total government spending at the Federal, State and local levels now represents over one-third of the total GNP and its actual influence is even broader since it frequently provides captial grants to stimulate new projects, extensive funding of research and development and other specific incentives. The wide array of government credit and incentive programs emphasizes the mixed nature of the current U.S. economy.

In summary, four major points concerning private fixed domestic investment should be emphasized:

1. Captial investment is a fundamental factor in national economic development and the absolute level of such spending has been very large in the U.S. economy over the years.

2. Other industrial nations have tended to allocate a substantially larger share of their national output to new capital formation in recent years and the gap has tended to increase.

3. There are several underlying economic reasons for the relatively low position of the United States as to capital formation commitments as a share of total economic

output but a review of these moderating influences provides only an explanation, not a solution.

4. The quantity and quality of capital investment in the United States should not be evaluated in terms of simplistic comparisons with other nations, historical patterns or some arbitrary growth goals. Instead, the adequacy of capital outlays can only be judged in terms of the achievement of our basic economic goals of creating more jobs for a growing labor force, the relative stability of prices, the productivity of our workers and the degree of progress in meeting specific environmental, safety, health and resource development objectives.

II. Future Capital Formation Needs

The dynamic nature of the U.S. economy makes it impossible to predict the exact amount of future capital needs. The pattern of economic growth can only be estimated in gerneral terms and actual events are often much different than expected. The relationship of capital investment to future output is particularly difficult to predict because capital/output ratios change over time. Some industries will require more capital per unit of output in the future and others will require less. The replacement rate of existing assets will also change as labor and materials costs -- particularly energy prices -- affect the mix of production factors. Unexpected private capital demands will undoubtedly develop and anticiapted claims may moderate or completely disappear. In short, the timing and magnitude of actual investments will likely be quite different from the current projections.

Despite the forecasting difficulties, it is possible to identify two basic trends: (1) total private domestic investment will be very large compared to historical totals as the economy grows from the current level of output of $1-1/2 trillion to over $3 trillion by the mid-1980's; and (2) the relative share of private investment in new plant and equipment as a claim against the total GNP will have to rise to achieve the desired national economic goals. Both of these basic trends were recently identified in a major study prepared by the Bureau of Economic Analysis of the Department of Commerce for the Council of Economic Advisers which was published last month in the Economic Report of the President (see pages 39 to 47). The major conclusions of that study are attached to this testimony. Table 4 summarizes the shift in business fixed investment as a share of GNP from an annual average of 10.4 percent in 1965-70 and in 1971-74 to an annual average of 12.0 percent during the time period 1975-80. For the entire decade of the 1970's the growth rate is estimated to be 11.4 percent but the rate must be accelerated to compensate for the sluggish pace of investments during the 1974-75 recession. In Table 5 some cumulative estimates of the dollar amounts -- stated in constant 1972 dollars -- required during the decade of the 1970's are indicated for a series of different assumptions involving changing capital to output ratios for different industries and fulfillment of existing pollution control and energy resource development goals. Once again, it should be emphasized that actual events may be significantly different from the specific percentages and dollar figures indicated but the massive amounts of capital required and the necessary acceleration of future business capital investment to a level above the growth rate of the recent past are clear. The policy conclusions of the Council of Economic Advisers are particularly significant:

> "If ratios of fixed investment to GNP substantially in excess of 10 percent are unattainable, full employment cannot be achieved by 1980 at capital-output ratios and productivity growth rates as high as those projected with the assumption that the environmental and energy goals are to be met. Whether full employment can be achieved at all by 1980 under these conditions depends first, of course, on the reliability of the previous estimates, and then on the ease of input substitution and on the flexibility of relative factor prices. If the estimated capital requirements are not met, the 1980 output level could be lower than projected, owing to lower productivity or lower employment, or both. Alternatively, goals concerning pollution control and energy independence might have to be scaled down. Either of these possibilities seems far less desirable than providing incentives to raise the share of investment in GNP." (_Economic Report of the President_, January 1976, p. 46.)

This summary statement provides a basic reference point for evaluating our future business capital requirements: If we are to achieve our output and employment goals with more stable prices along with specific environmental and and energy resource development objectives the pace of capital formation must be accelerated. The magnitude of the necessary tilt toward investment is not large in percentage terms but in the multi-trillion dollar economy of the near future the dollar amounts involved will be large.

Several studies attempting to forecast business capital investment requirements have also been prepared by private companies and university scholars and their basic conclusions are summarized in Table 6. The private-sector forecasts use a different time frame covering the mid-1970's to mid-1980's period, use current dollars to incorporate the anticipated impact of inflation and frequently add residential construction outlays to the business investment total to estimate total private domestic fixed investment. Nevertheless, the general conclusions are consistent with the Bureau of Economic Analysis findings and the interpretation of the Council of Economic Advisers that the achievement of the Nation's basic economic goals will require a shift toward increased capital investment to provide the several trillion dollars of funds needed.

III. Government Policies

Future fiscal and monetary policies will have a major impact on the achievement of the capital formation goals. In farticular, inflation must be better controlled and the governemnt must avoid disrupting the capital markets if the private sector is to acquire the necessary investment funds. A balancing of the Federal budget over time is a necessary prerequisite to achieve the goals discussed above.

Unfortunately, the Federal Government will have reported a deficit in sixteen of the past seventeen years ending with FY 1977, as summarized in Table 7. During the single decade FY 1968 through FY 1977, the cumulative Federal deficits will total $267.5 billion. Net borrowings for supporting over one hundred "off-budget" Federal programs are expected to total another $229.2 billion during that single decade. The Federal Government will have usurped a total of $496.7 billion out of the capital markets during a 10-year period ending with FY 1977. But the most disconcerting point is the upward momentum of Federal outlays which will have risen from $268 billion in FY 1974 to $374 billion this fiscal year, a jump of 40 percent in just two fiscal years. Another large increase in Federal outlays will occur in FY 1977 as President Ford has asked for a budget that would limit spending to $395 billion. Part of this sharp increase in outlays is the result of "automatic stabilizers", such as unemployment compensation benefits, responding to recession problems but most of the added spending has become part of the permanent programs of government and will extend out into the future. Government spending -- both for temporary stimulus and permanent programs -- has increased at a rate that is creating serious resource allocation problems which will not conveniently disappear as the current recovery soon moves into its second year. We must recognize the basic reality that when the combination of public and private demands for goods and services exceeds the underlying productive capacity of the system the inevitable result is an overheating of the economy followed by inflation and eventually economic recession.

The strong 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 public claim by shifting resources away from the private sector. This simple guideline has been frequently violated as total demand has been stimulated beyond the capacity of the economic system twice within the past decade creating an unfortunate boom and recession sequence with severe inflation and unemployment distortions. The escalation of government spending levels summarized in Table 7 has seriously eroded our fiscal flexibility and the lagged impact of past spending decisions will affect the allocation of resources far into the future. In summary, the achievement of private domestic fixed investment goals will require more realistic and sustainable government 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. Several major tax policies play a major role: (1) the corporate income tax, including the existing approach of levying taxes at the corporate level on earnings and again on the recipients of dividends; (2) the investment tax credit; (3) depreciation guidelines; and (4) other tax incentives designed to encourage investment for specific purposes, such as the President's proposal for accelerated depreciation for the construction of plants and purchase of new equipment in high unemployment areas. The Secretary of the Treasury and other Treasury officials have frequently presented testimony on all of these fundamental tax policy issues. Rather than repeating their views in this general statement about the importance of capital formation, I refer the Committee's attention to the benchmark statements presented by Secretary William E. Simon on July 8 and July 31, 1975 before the House Ways and Means Committee.

IV. Summary

As the United States continues the relatively strong cyclical recovery that began last April it is important that economic policies increasingly focus on longer-term goals. 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 resulted from the creativity and productivity of the system. Continued prosperity, however, cannot be taken for granted; it must be earned. We must be willing to allocate more of our resources to current investment rather than to current consumption to prepare for the future. The logic of this recommendation is not based on any arbitrary investment level assumed to be necessary to avoid some "capital shortage" or on statistical comparisons with other nations or earlier time periods. Instead, the required emphasis on investment reflects the Nation's fundamental economic goals of reducing both inflation and unemployment, improving productivity, remaining competitive in international markets and achieving specific environmental, safety and resource-development objectives. With so many unfulfilled current needs this is a difficult concept for some to accept because they would prefer current consumption. However, our potential ability to achieve all of our economic goals will be unnecessarily restricted if we fail to prepare for the future. The simple truism that we cannot consume more than we produce needs to receive greater attention in the dicussion of national priorities.

TABLE 1

Gross Private Domestic Fixed Investment, 1950-1974 (Billions of dollars)

PART A. Nominal Dollars

Year	Total	Nonresidential Structures and Producers' Durable Equipment	Residential Structures
1950	$47.0	27.1	19.9
1951	48.9	31.1	17.7
1952	49.0	31.2	17.8
1953	52.9	34.3	18.6
1954	54.3	34.0	20.3
1955	62.4	38.3	24.1
1956	66.3	43.7	22.6
1957	67.9	46.7	21.2
1958	63.4	41.6	21.8
1959	72.3	45.3	27.0
1960	72.7	47.7	25.0
1961	72.1	47.1	25.0
1962	78.7	51.2	27.4
1963	84.2	53.6	30.6
1964	90.8	59.7	31.2
1965	102.5	71.3	31.2
1966	110.2	81.4	28.7
1967	110.7	82.1	28.6
1968	123.8	89.3	34.5
1969	136.8	98.9	37.9
1970	137.0	100.5	36.6
1971	153.6	104.1	49.6
1972	178.8	116.8	62.0
1973	203.0	136.5	66.5
1974	202.5	147.9	54.6
1975p	197.5	148.7	48.8

PART B. Constant 1972 Dollars

Year	Total	Nonresidential Structures and Producers' Durable Equipment	Residential Structures
1950	83.2	50.0	33.2
1951	80.4	52.9	27.5
1952	78.9	52.1	26.8
1953	84.1	56.3	27.8
1954	85.2	55.4	30.2
1955	96.2	61.2	35.1
1956	97.1	65.2	31.9
1957	95.7	66.0	29.7
1958	89.6	58.9	30.6
1959	101.0	62.9	38.1
1960	101.0	66.0	35.0
1961	100.7	65.6	35.1
1962	109.3	70.9	38.4
1963	116.8	73.5	43.2
1964	124.8	81.0	43.8
1965	138.8	95.6	43.2
1966	144.6	106.1	38.5
1967	140.7	103.5	37.2
1968	150.8	108.0	42.8
1969	157.5	114.3	43.2
1970	150.4	110.0	40.4
1971	160.2	108.0	52.2
1972	178.8	116.8	62.0
1973	191.4	131.3	60.1
1974	172.2	127.5	44.7
1975p	149.0	112.4	36.6

Source: Department of Commerce, Bureau of Economic Analysis

TABLE 2

Average Annual Rate of Change in Real Growth for Member Nations of OECD, 1960-70

(percent)

Japan	11.1
Greece	7.6
Portugal	6.3
Yugoslavia	6.7
France	5.8
Italy	5.6
Canada	5.2
Finland	5.2
Australia	5.1
Netherlands	5.1
Norway	5.0
Belgium	4.9
Denmark	4.9
West Germany	4.8
Austria	4.8
Iceland	4.3
Ireland	4.0
U.S.	4.0
Luxembourg	3.3
United Kingdom	2.8

Source: Organization for Economic Development and Cooperation.

TABLE 3

Output and Investment by Sector
1969-1971 Averages (Current price percents)

	United States	France	Germany	United Kingdom	Canada	Japan
PARTITION A	Sector Percentage of Total Output:					
Agriculture	3.0	5.9	3.2	2.6	3.9	7.3*
Mining	1.6	0.8	2.2	1.4	3.4	0.9
Manufacturing	30.3	45.3	50.4	33.5	26.6	43.0
Utilities	2.3	1.8	2.3	2.8	2.4	2.0
General Services	62.8	46.2	41.9	59.7	63.7	46.8
(Dwellings)	(5.4)	(4.5)	(3.8)	(2.3)	(3.3)	(NA)
(Government)	(14.7)	(8.8)	(9.4)	(10.1)	(14.0)	(3.1)
(Other Services)	(42.7)	(32.9)	(28.7)	(47.3)	(46.4)	(NA)
Total	100	100	100	100	100	100
	Sector Percentage of Total Investment:					
Agriculture	3.8	4.6	5.3**	2.6	5.5	5.9
Mining	1.0	.7	1.3	1.5	7.5	.9
Manufacturing	19.7	27.8	25.2	23.8	16.6	26.8
Utilities	5.2	3.9	5.0	8.6	9.4	3.9
General Services	70.3	63.0	63.2	63.5	61.0	62.5
(Dwellings***)	(19.9)	(26.3)	(22.2)	(15.1)	(21.5)	(17.9)
(Government)	(20.4)	(12.8)	(9.9)	(15.9)	(17.9)	(24.9)
(Other Services)	(30.0)	(23.9)	(31.1)	(32.5)	(21.6)	(19.7)
Total	100	100	100	100	100	100
PARTITION B	Sector Ratios: Investment Percentages Divided by Output Percentages					
Agriculture	1.3	0.8	1.7	1.0	1.4	0.8
Mining	0.6	0.9	0.6	1.1	2.2	1.0
Manufacturing	0.7	0.6	0.5	0.7	0.6	0.6
Utilities	2.3	2.2	2.2	3.1	3.9	2.0
General Services	1.1	1.4	1.5	1.1	1.0	1.3
(Dwellings)	(3.7)	(5.8)	(5.8)	(6.6)	(6.5)	(NA)
(Government)	(1.9)	(1.5)	(1.1)	(1.6)	(1.3)	(8.0)
(Other Services)	(0.7)	(0.7)	(1.1)	(0.7)	(0.5)	(NA)

Source: OECD, National Accounts of OECD Countries, 1960-71.

* Output averages of Japan are for 1969-70

** Investment averages of Germany are for 1967-68.

*** Investment in owner-occupied dwellings. For Canada, France and the United Kingdom the figure is from residential investment, which differs slightly from the former category.

TABLE 4

TABLE 4.—*Share of business fixed investment in gross national product: historical data and projected requirement, selected periods, 1965–80*

Item	1965–70	1971–74	1975–80	1971–80
	Billions of 1972 dollars			
Cumulative gross national product (GNP):				
Actual	5,999.3	4,674.5		
Projected			[1] 8,254.6	12,929.1
Cumulative business fixed investment:				
Actual	623.4	486.8		
Projected capital-output (c/o) ratios			[3] 986.6	1,473.4
Fixed 1970 c/o ratios:				
Actual law[2]			[3] 844.5	1,331.3
Pre-1970 law[2]			[3] 796.6	1,283.4
	Percent			
Business fixed investment as percent of GNP:				
Actual	10.4	10.4		
Projected c/o ratios			12.0	11.4
Fixed 1970 c/o ratios:				
Actual law[2]			10.2	10.3
Pre-1970 law[2]			9.7	9.9

[1] Derived from GNP projections in 1958 dollars provided by the Department of Labor, Division of Economic Growth.
[2] "Actual Law" contains pollution control expenditures pursuant to the 1970 Clean Air Amendments and to the 1972 Federal Water Pollution Act Amendments, while "Pre-1970 Law" does not contain these expenditures.
[3] Derived by subtracting actual investment in 1971–74 from the estimate of investment required during 1971–80.

Note.—The 1965–74 data in this table have not been revised to the new benchmark data used elsewhere in this Report since the projections were made before the new data were available. However, using the new data, business fixed investment as percent of GNP would have been the same for 1965–70 as shown in the table (10.4 percent) and slightly lower for 1971–74 (10.2 percent instead of 10.4 percent).

Sources: Department of Commerce (Bureau of Economic Analysis) and Department of Labor (Division of Economic Growth).

(As published in the Economic Report of the President, January 1976, page 44)

TABLE 5

TABLE 5.—*Factors affecting the cumulative total business fixed investment required from 1971 through 1980, by major industries*

[Billions of 1972 dollars]

Factor	Total	Agriculture, forestry, and fisheries	Mining	Construction	Manufacturing	Transportation	Communication	Electric, gas, water, and sanitary services[1]	Services[2]	Other[3]
Fixed 1970 capital-output (c/o) ratios, pollution control requirements limited to pre-1970 law	1,283.4	68.5	48.5	29.5	292.2	134.7	101.1	209.5	173.8	225.7
Add for actual Pollution Control Laws passed in 1970 and 1972	47.8	....	.9	.5	29.5	.6	.0	14.2	.3	1.8
Add for industries with c/o ratios increasing for reasons other than the achievement of greater energy independence	118.2	10.3	4.2	.0	35.3	5.3	.4	.4	62.4	.0
Add for industries with decreasing c/o ratios	−36.0	−.0	−21.8	−.0	−13.2	−.0	−.0	[4] −1.0	−.0	−.0
Add for additional capital required for greater energy independence	57.9	.0	49.0	.0	.0	.0	.0	8.9	.0	.0
Add for increase in pollution control investment induced by additional investment in energy	2.0	.0	.4	.0	[5] .2	.0	.0	1.3	.0	.0
Total business fixed investment required	1,473.4	78.8	81.2	30.0	344.0	140.6	101.4	233.3	236.5	227.5

[1] Includes production by both public and private enterprises.
[2] Consists of hotels and lodging places, personal and repair services, business services, automobile repair and services, amusements and medical, educational services and nonprofit organizations.
[3] Consists of wholesale and retail trade and finance, insurance and real estate.
[4] Increase in discard rate in gas utilities due to energy considerations would produce this decline unless offset by $1.0 billion higher investment required for greater energy independence.
[5] Although the outputs and capital-output ratios of petroleum refining and related industries are not assumed to change in the process of achieving greater energy independence, the substitution of lower-grade domestic crude for higher-grade imported crude causes some additional pollution control expenditures in petroleum refining.

Note.—Detail may not add to totals because of rounding.

Source: Department of Commerce, Bureau of Economic Analysis.

(As published in the Economic Report of the President, January 1976, page 45)

TABLE 6

ACTUAL AND PROJECTED INVESTMENT AS A PERCENT OF GNP

	Average 1965-1974	NYSE[1/]	Bosworth Duesenberry Carron[2/]	Friedman[3/]	G.E.[4/]	DRI[5/]	Chase Econometrics [6/]
Gross private domestic investment	15.1	16.4	15.5	15.8	15.8	15.7	15.9
Non-residential fixed	10.4	12.1	11.3	11.5	11.4	11.0	11.8
Inventory	1.0	0.3	0.8	0.8	0.4	0.8	0.8
Residential	3.8	3.9	3.5	3.5	4.0	3.8	3.3

1/ The New York Stock Exchange, The Capital Needs and Savings Potential of the U.S. Economy: Projections Through 1985, September 1974. Figures shown are based on cumulative projections in current dollars, 1974-1985.

2/ Barry Bosworth, James S. Duesenberry, and Andrew S. Carron, Capital Needs in the Seventies, The Brookings Institution, 1975. Figures shown are based on estimates for 1980 in current dollars from Table 2-12, p. 39 (note the constant dollar 1980 figures in Table 2-11 project gross private domestic investment as 15.8 percent of GNP).

3/ Benjamin M. Friedman, "Financing the Next Five Years of Fixed Investment" in President's Authority to Adjust Imports of Petroleum, Public Debt Ceiling Increase; and Emergency Tax Proposals; Hearings before the Committee on Ways and Means, House of Representatives, January 1975, pp. 710-726. Figures shown are based on 1975-79 averages of current dollar projections.

4/ Reginald H. Jones, "Capital Requirements of Business, 1974-85," Testimony submitted to Subcommittee on Economic Growth, Joint Economic Committee, May 8, 1974. Figures shown are based on cumulative projections in current dollars, 1974-1985.

5/ Data Resources, Inc., Summer 1975, "Special Study: The Capital Shortage." Summary table on inside cover. 1985 data only, current dollars, standard forecast.

6/ Chase Econometrics August 1975. "The Next Ten Years: Inflation, Recession and Capital Shortage." 1984 data only, current dollars. Table, page #1 of 14. No recession run.

TABLE 7

FEDERAL BUDGETS

CHANGES IN THE UNIFIED BUDGET OUTLAYS

BY FISCAL YEAR, 1961-1977

(dollars in billions)

Fiscal Year over Preceding Year	Federal Outlays	Dollar Increase	Percentage Increase	Surplus or Deficit
1961	$ 97.8	$ 5.6	6.1	-3.4
1962	106.8	9.0	9.2	-7.1
1963	111.3	4.5	4.2	-4.8
1964	118.6	7.3	6.1	-5.9
1965	118.4	-0.2	--	-1.6
1966	134.7	16.3	13.8	-3.8
1967	158.3	23.6	17.5	-8.[illegible]
1968	178.8	20.5	13.0	-25.[illegible]
1969	184.5	5.7	3.2	+3.2
1970	196.6	12.1	6.6	-2.8
1971	211.4	14.8	7.5	-23.0
1972	231.9	20.5	9.7	-23.2
1973	246.5	14.6	6.3	-14.3
1974	268.4	21.9	8.8	-3.5
1975	324.6	56.2	20.9	-43.6
1976(est)	373.5	48.9	15.1	-76.0
1977(est)	394.2	20.7	5.5	-42.9

Source: Economic Report of the President, January 1976, Table B-63, p.245.

1e Department of the TREASURY NEWS
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FOR IMMEDIATE RELEASE

REMARKS OF WILLIAM M. GOLDSTEIN
DEPUTY ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY
AT THE
27th ANNUAL INSTITUTE ON OIL AND GAS LAW AND TAXATION
DALLAS, TEXAS
FEBRUARY 20, 1976

The Administration's policy on oil and gas taxation is part of its broader policies on energy and the economy. A year ago, the Nation was experiencing its worst recession since the 1930's. A major contributing factor in the country's economic difficulties was the arbitrary quadrupling of oil prices by the OPEC following the 1973-74 embargo. Clearly, top priorities were to end the nation's vulnerability to oil import disruption and to restore its economic health.

Considerable progress has been made toward achieving both goals. The Energy Policy and Conservation Act, which President Ford signed into law in December, permits the removal of controls on domestic oil prices at the end of 40 months. This action alone should increase domestic production by more than one million barrels a day by 1985 and reduce daily imports by about 3 million barrels.

The health of the economy also has improved. The recession turned around last spring. The 1974 inflation rate of over 12 percent was cut to less than 7 percent in 1975. And real gross national product is expected to grow by over 6 percent this year.

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As President Ford said last month with respect to the economy, "Last January most things were rapidly getting worse. This January most things were slowly but surely getting better."

Today, let us consider the role which oil and gas tax policy has played and may play in the broader context of energy and economic policy in general. I shall begin by discussing the legislative developments of the past year, first with respect to energy and then with regard to capital formation.

In January 1975, President Ford proposed a plan to achieve National energy independence. The plan was designed to reduce overall energy consumption, cut energy imports, and increase domestic energy production. To achieve these goals, the President proposed to rely on what Treasury Secretary Simon has called "the most neutral and least bureaucratic system available" -- the free market system of fixing prices. Primary elements of the proposal were decontrol of oil and gas prices and taxes and tariffs to restrain demand, discourage imports and prevent windfall profits.

In developing this tax pricing package, the Administration was guided by a fundamental need to assure an adequate return on investment. As debate on energy policy continues, the Administration will continue to be sensitive to return on investment.

The 1975 Energy Policy and Conservation Act established an oil pricing formula that permits the gradual phasing out of controls on domestic oil. While it is true that the new energy law lowers crude oil prices in the short run, the President has pointed out that "over time, this legislation removes controls and should give industry sufficient incentive to explore, develop and produce new fields in the Outer Continental Shelf, Alaska, and potential new reserves in the lower 48 States."

President Ford has expressed an intention to use his power under the new law to expedite decontrol. Responding to concerns that the energy industry might be subject

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indefinitely to governmental controls, the President has said:

> "As one who believes that minimizing governmental interference in the marketplace is essential to a strong economy and more jobs, I share those concerns. Accordingly, I pledge that I will work to ensure that by the end of 40 months, governmental controls over domestic oil prices will be fully phased out."

Like oil decontrol, deregulation of the price of new natural gas has a high priority. The President proposed such deregulation a year ago and recently called for immediate Congressional action. The Senate has acted favorably and the House has voted to end gas price controls for most smaller producers. Unfortunately, however, the House has also voted to extend controls for large producers to cover intrastate, as well as interstate, sales of gas. A House-Senate conference is expected to be the next step. The Administration continues to support full decontrol for new natural gas.

With the initial pricing features of the Energy Policy and Conservation Act now established, proposed tax features are likely to become the subject of debate. The mood of the Treasury Department, in general, is to wait and see how the new policy is working. It will be necessary to assess carefully the results of legislative and administrative actions already taken. Acting too quickly could jeopardize their success.

This is one reason why the Administration can be expected to oppose the House-passed tax on business use of oil and gas. H.R. 6860, the energy bill which the House approved in mid-1975, is still pending before the Senate Finance Committee and will be discussed during tax reform hearings to begin next month. This bill would impose an excise tax on oil and gas used in business as fuel.

One problem with the proposed excise tax is that many major industrial users of oil and gas would be exempt --an exemption which would cause serious efficiency losses in the business sector. More importantly, even if the tax did

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cover all businesses, it would produce undesirable distortion in petroleum usage by tilting prices of products in favor of non-business uses. As Secretary Simon has said, "Ultimately, the best way to cut down consumption of oil and gas will be to raise prices across the board, as was intended by the President's program, rather than to impose most of the conservation burden on one or two sectors of the economy."

Moreover, any new tax intended as a leveler, or supplement to decontrol, must reflect recent developments. The partial repeal of percentage depletion, as well as increases in the costs of finding and developing new energy supplies, have adversely affected the ability of oil and gas producers to finance increased investments. Last year's changes in the depletion allowance had the net effect of withdrawing about $1.7 billion from oil and gas producers in 1975 alone. New energy tax policy must take this into consideration. The Treasury has consistently maintained that, so long as oil and gas prices are controlled, percentage depletion should be retained. Now that the depletion allowance has been partially repealed, price decontrol should be allowed to compensate for the loss of the incentive formerly provided by the allowance.

In addition to the proposed tax on business use of oil and gas, the House energy bill contains other tax provisions which may be discussed at the forthcoming Senate Finance Committee hearings. Two may be of particular interest to you. The bill would provide 5-year amortization for certain energy-use property, including oil shale facilities. The Treasury opposes this provision. As Secretary Simon has said, "When the technologies for such things as ... shale oil production exist, the economics of business decision-making should suffice to induce their adoption. Where the technologies are lacking, what is needed is research and development - not an investment subsidy."

The Treasury also opposes the House Bill's proposed denial of the investment tax credit for oil- and gas-burning electrical generating equipment. On the other hand, we recognize the desirability of converting to or building new facilities not fired by oil or gas; accordingly, the Administration proposes to provide positive, rather than negative, tax incentives for such conversion and/or construction. As part of our "electric utility package", we would increase the investment credit to 12 percent for generating facilities not powered by oil and gas.

Before leaving the subject of energy-related tax policy, I should mention an administrative matter. The small-producer exemption from repeal of percentage depletion is proving to be difficult to implement. The Treasury published proposed regulations on percentage depletion in October, held hearings in January, and expects to soon finalize the earlier regulations and propose additional rules.

A particularly controversial aspect of the small-producer exemption is the "transfer rule." The law denies the exemption for oil or gas property transferred after December 31, 1974, if the principal value of the property has been demonstrated prior to the transfer. The statute excepts only 2 kinds of transfers from this rule -- transfer by reason of death and transfer pursuant to a section 351 transaction. Congress probably should have excepted additional kinds of transfers, and Treasury is trying to deal with this omission.

Now let me turn to the past year's legislative developments with respect to capital formation.

As with its energy policy, the Administration's economic policy assumes that reliance upon the private sector and free market forces is the most efficient means of achieving the Nation's goals. The Administration seeks to insure sustained economic growth by assuring an adequate supply of capital. New investment helps to provide jobs and increase productivity which, in turn, permits real wages to rise and holds down inflation. Sufficient savings and investment are needed to permit a reasonable rate of growth at full employment levels.

One way to help provide the capital needed for economic expansion is to improve the return on business investment by reducing business taxes. During the past year, the Administration has sought and obtained liberalization of the investment tax credit and reduction of the corporate income tax. The Administration also has proposed plans for integrating corporate and individual income taxes and for broadening stock ownership.

The 1975 Tax Reduction Act increased the investment credit from 7 percent to 10 percent for 1975 and 1976. The estimated annual revenue loss from the Act's changes in the investment credit is $3.3 billion. Of this amount, the Treasury estimates that at least $175 million each year, or about 6 percent, will accrue to the oil and gas industry.

The President has proposed to make permanent the higher investment credit rate of 10 percent. H.R. 10612, the tax reform bill which the House passed in December, would extend the 10 percent rate only through 1980. The Senate Finance Committee will consider this matter in March.

The investment credit is a valuable device for reducing the cost and increasing the supply of capital. By stimulating investment in plants and equipment, the credit tends to increase employment. Such job-creating investment has played an important part in the country's rapid emergence from the recession.

Since its original enactment in 1962, the credit has been modified on 4 separate occasions, has been suspended for 5 months, and has been repealed for 2 years. Turning the credit off and on in this way sharply reduces its effectiveness. It is for this reason, as well as the need to provide for long-run economic growth that the President has proposed to permanently increase the credit to 10 percent.

This Administration has played a major role not only in liberalizing the investment credit, but also in cutting the corporate income tax. Before 1975, the first $25,000 of corporate income was taxed at the rate of 22 percent and income over $25,000 was taxed at 48 percent. The Tax Reduction Act reduced these rates, for 1975, from 22 percent to 20 percent on the first $25,000 of taxable income, and from 48 percent to 22 percent on the second $25,000. Corporate income over $50,000 remains taxable at 48 percent. This one-year cut represented $1.5 billion in tax savings to corporations. The oil and gas industry alone will realize at least $100 million of this total.

Recent legislation extended these corporate tax rate reductions through June 1976, and chances are good that they will be further extended. H.R. 10612, the House-passed tax reform bill, would apply the reduced rates through 1977. The President would make such rates permanent. In addition, the President has proposed to lower from 48 to 46 percent the rate applicable to corporate income over $50,000. The Treasury is also considering the possibility of reducing the tax rate on the second $25,000 of corporate income to 20 percent (at the annual cost of $107 million).

The recent corporate tax cuts will help small business. About 60 percent of the tax savings resulting from the rate reductions will go to corporations with incomes under $100,000. Corporate rate reductions also are a way of helping businesses which are not capital intensive and, therefore, not likely to benefit from the liberalization of the investment credit.

As the Senate Finance Committee considers extending these corporate rate reductions, it is important to emphasize that temporary rate reductions do relatively little to stimulate new investment. On the other hand, permanent reductions would reduce taxes over the life of new investment, increase the corporation's rate of return and, therefore, provide considerable investment stimulus.

The Tax Reduction Act reduced the marginal tax rate for corporations with taxable income under $50,000. To do the same for corporations with income over $50,000, it is necessary to cut the 48 percent rate. The President has proposed this step to make the return from new investment more attractive. In addition, reducing the 48 percent rate would partially relieve the double tax burden on corporate earnings. Corporations paying tax at the 48 percent rate bear the brunt of that burden. A 2-point rate reduction would provide modest relief until the Administration, working with committees of Congress, can achieve integration of corporate and individual income taxes.

Integration would eliminate the double tax which occurs because our system taxes corporate profits first to the corporation and then, when the profits are distributed as dividends or realized upon the sale of stock, to the shareholder. This double tax is unfair to those who must pay it. It also inhibits the flow of capital and discriminates in favor of debt, and against equity, financing.

In July the Administration proposed to the Congress a plan for integrating corporate and individual income taxes. This plan would provide both a deduction for corporations and a credit for shareholders. Corporations would be permitted to deduct about half of the amount of dividends distributed. In effect, this would reverse about one-half of the tax which the corporation had already paid with respect to the distributed earnings. A stockholder credit would compensate for the rest of the double tax on such earnings.

Integration of this type would be quite expensive. At 1977 revenue levels, annual revenues would be reduced by about $14 billion. Because of this cost, integration can only be accomplished gradually. The Administration plan would be phased in over six years, commencing in 1978.

The Administration's integration plan would help provide the capital which our economy needs in order to continue to grow. The plan would also improve the efficiency of capital allocation. Moreover, as Secretary Simon has said, this is the only major tax proposal that comes to grips with the growing imbalance between corporate debt and equity. The Ways and Means Committee's task force on capital formation will turn its attention to integration this week.

Another Administration initiative to promote capital formation is the Broadened Stock Ownership Plan. Last month, President Ford proposed "tax changes to encourage people to invest in America's future, and their own, through a plan that gives moderate income families income tax benefits if they make long-term investments in common stock in

American companies." To encourage broadened stock ownership, a deduction would be allowed for certain funds invested in common stocks. These funds could be invested under plans established either by individuals or by employers for the voluntary participation by their employees. Details of the program are being worked out with the Congress.

With respect to capital formation, I should also mention certain proposals pending in Congress which might have an adverse impact on investment in oil and gas properties. Four provisions of H.R. 10612, the House-passed tax reform bill, raise this concern.

In an attempt to close tax shelters, the bill would impose a limitation on artificial losses, or LAL, on investments in real estate, farming, movies, equipment leasing, and sports franchises. LAL would also apply to intangible drilling and development costs of developmental -- but not exploratory -- oil and gas wells. While Treasury generally supports the basic concept of LAL, which is to match income and deductions from the same property, we also realize that domestic oil production has declined for the past 5 years and natural gas production for the past 2. With the repeal of percentage depletion, the continuation of price controls, and the country's acute need for more energy, the application of LAL to investments in oil and gas wells clearly does not appear to be in the national interest. Accordingly, Treasury will continue to oppose the application of LAL to developmental as well as to exploratory wells.

To supplement the proposed limitation on artificial losses, the House tax reform bill would make certain tax benefits subject to the minimum tax on tax preferences to the extent that they were not deferred under LAL. One of these items would be intangible drilling costs in excess of those that would be deductible if such costs were capitalized and deducted over the life of the well. The Treasury opposes this proposed change in the minimum tax.

To prevent the conversion of ordinary income into capital gain, the House bill also would provide for the recapture of deductions for intangibles. Under the bill,

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gain on disposition of an interest in oil or gas property would be treated as ordinary income to the extent of the excess of the intangible drilling deductions taken with respect to that property over the deductions which would have been allowed had the expenses been capitalized. The Treasury believes that although this proposed rule is consistent with other recapture provisions, we should not permit it to reduce the amount of capital available for oil and gas exploration.

In an attempt to deal with the problem of "leveraging" tax shelters, the House bill also would limit the intangibles deduction with respect to a particular property to the amount which the taxpayer has "at risk". A taxpayer would be allowed a deduction only to the extent of his own equity investment; he would not be considered at risk with respect to his share of any nonrecourse indebtedness. The Treasury opposes the proposed "at risk" limitation. Nonrecourse financing is an accepted financing medium. The Treasury regulation which allows a limited partner to increase the basis of his partnership interest by his share of nonrecourse loans to the partnership is based on the long-standing precedent of the Crane case which should not be selectively repealed.

In part, to deal with the problems which the tax-shelter provisions of the House tax reform bill were intended to correct, the Treasury is looking in new directions. The tax code and regulations now exceed 6,000 pages of fine print. It is clear that the results they produce leave much to be desired in terms of promoting economic efficiency and distributing tax burdens fairly. In an effort to begin to restore equity and confidence in the tax system, Secretary Simon has recently proposed a study of reforming the Federal income tax by of reforming the Federal income tax by eliminating all personal tax preferences and cutting individual tax rates approximately in half. The Treasury has begun this study which I assure you is the subject of at least one more speech. Alternative ways to restructure business taxes and to remove the anti-savings bias of our tax system are simultaneously being considered by our staff.

In conclusion, I would like to be able to tell you that the Administration's tax policy relating to oil and gas is completely settled, comprehensive and precise. It is apparent, however, that our consideration of these important matters is to some extent in a transitional phase. This is because the basic assumptions and background upon which we must act are themselves in a state of flux. For example, the world-wide energy situation varies from day to day. Secondly, the legislative pattern in non-tax energy matters is either untried or uncertain. For example, our most basic energy legislation was a compromise effected less than two months ago and the natural gas legislation is pending, not moving very fast and uncertain as to outcome.

Under the above circumstances, the Treasury will be called upon to react promptly as various changes in the present pattern of taxation of oil and gas are considered by Congress. In arriving at our positions on these matters, we would very much appreciate receiving the counsel of experts such as yourselves. Your views are welcome and their prompt receipt would be most helpful.

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FOR IMMEDIATE RELEASE February 20, 1976 449

RESULTS OF AUCTION OF 21-MONTH TREASURY NOTES

The Treasury has accepted $2.5 billion of the $4.8 billion of tenders received from the public for the 21-month notes, Series Q-1977, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	6.57% 1/
Highest yield	6.64%
Average yield	6.62%

The interest rate on the notes will be 6-5/8%. At the 6-5/8% rate, the above yields result in the following prices:

Low-yield price	100.039
High-yield price	99.925
Average-yield price	99.957

The $2.5 billion of accepted tenders includes 6 % of the amount of notes bid for at the highest yield and $0.4 billion of noncompetitive tenders accepted at the average yield.

In addition, $110 million of tenders were accepted at the average-yield price from foreign and international monetary authorities.

1/ Excepting 1 tender of $90,000.

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BIOGRAPHY

GERALD L. PARSKY

Gerald L. Parsky, Assistant Secretary of the Treasury for International Affairs, is recognized as a key U.S. spokesman on critical global economic and financial issues. Since joining the Treasury in 1971, Mr. Parksy has assumed increasing responsibilities. From the position of Special Assistant to the Under Secretary of the Treasury, Mr. Parsky has, subsequently, served as Executive Assistant to William E. Simon, when Mr. Simon was Deputy Secretary of the Treasury and later Administrator of the Federal Energy Office. Since June 1, 1974, Mr. Parsky has been in charge of Treasury's policy in the trade, energy, commodities and financial resource areas, as well as the United States economic and financial relations with the Middle Eastern Countries.

In addition to these duties, Secretary Simon recently announced that Mr. Parsky will now supervise Treasury policy in the other international economic, financial and monetary areas, including investment, U.S. policy on industrial and developing nations, and U.S. policy on international financial institutions.

After graduating cum laude from Princeton University in 1964, Mr. Parsky taught English at Suffield Academy, Suffield, Connecticut. He attended the University of Virginia Law School, from which he graduated with honors in 1968, and then joined a New York law firm where he practiced corporate and securities law.

For these and other accomplishments, Mr. Parsky was named in 1975, as one of America's Ten Outstanding Young Men by the U.S. Jaycees. At 33, and as the youngest Assistant Secretary in the Treasury Department's history, Mr. Parsky has displayed an ability to deal with a wide range of substantive issues, to negotiate with Middle Eastern and European government leaders, and to work with Congress in developing needed legislative reforms.

Mr. Parsky currently serves as Executive Secretary of the East-West Foreign Trade Board, the Joint U.S.-Saudi Arabian Commission for Economic Cooperation, and represents the United States at the International Energy Agency and the Conference on International Economic Cooperation. In addition, Mr. Parsky participates in the following:

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FOR RELEASE ON DELIVERY

STATEMENT BY THE HONORABLE CHARLES M. WALKER
ASSISTANT SECRETARY OF THE TREASURY
FOR TAX POLICY
BEFORE THE COMMITTEE ON WAYS AND MEANS

February 23, 1976

Mr. Chairman and Members of this Distinguished Committee:

I am pleased to appear before you today to testify on the New York City pension fund legislation, H.R. 11700.

This legislation is part of the overall program to render financial assistance to New York City. On December 9, 1975, the President signed the New York City Seasonal Financing Act of 1975, authorizing the Secretary of the Treasury to loan up to $2.3 billion at any one time to the City of New York in order that the City might maintain its essential governmental services. The Seasonal Financing Act was enacted by Congress with the understanding that the Agreement dated November 26, 1975 between the Municipal Assistance Corporation, several of New York City's commercial banks, five New York City pension funds and the New York sinking funds would take effect. This Agreement, itself, was generally conditioned upon the enactment prior to

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February 1, 1976 of Federal legislation that "would provide, by way of guarantees or otherwise, for the seasonal financing needs of the City over the period from the effective date thereof through a date not earlier than June 30, 1978, in a maximum amount of not less than $2,300,000,000 at any time outstanding."

As part of the New York City Agreement, the five pension funds which entered into the Agreement -- namely, the New York City Employees' Retirement System, the Board of Education Retirement System for the City of New York, the New York City Fire Department Pension Fund, the Teachers' Retirement System for the City of New York, and the New York City Police Pension Fund -- agreed to purchase New York City bonds in the principal amount of approximately $2.5 billion through fiscal 1978 on a scheduled basis. The funds agreed to purchase, prior to January 1, 1976, serial bonds of the City with a face amount of $30 million, bearing interest at the rate of 6 percent a year. All other serial bonds of the City to be acquired by the funds were to bear interest at the rate of 9 percent a year. All of these purchases were conditioned upon receipt of a ruling from the Internal Revenue Service or upon Congressional enactment of legislation to the effect that the purchases would not constitute prohibited transactions or otherwise adversely affect the qualified status of the pension funds for purposes of the Internal Revenue Code of 1954.

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If the pension funds were to lose their qualified status under the Internal Revenue Code simply by reason of the City bond purchases, the income earned by the funds might be subject to Federal income taxation and participants might be required to pay an immediate tax on current plan assets and contributions to the plans.

As governmental retirement plans, the New York City pension funds are exempt from the prohibited transaction rules of the Employee Retirement Income Security Act, the 1974 pension reform law. However, the prohibited transaction rules that were generally applicable to all pension plans under prior law continue to apply to such governmental plans. In general, under those rules, a governmental plan will lose its tax exempt status if it (1) lends any trust assets to a substantial contributor without the receipt of adequate security and a reasonable rate of interest; (2) makes any substantial purchase of securities or other property from a substantial contributor for more than adequate consideration; or (3) engages in any other transaction which results in a substantial diversion of trust income or corpus to a substantial contributor. These prohibited transaction provisions appear in Section 503(b) of the Code.

Moreover, all qualified pension plans, including a governmental plan, must be created or organized for the

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for purposes of making investments, or, after June 30, 1986, considers, for purposes of deciding whether to retain investments held on June 30, 1986, the extent to which the investments will (1) maintain the ability of the City of New York to make future contributions to the fund and to satisfy the City's future obligations to pay pension and retirement benefits, and (2) protect the source of funds to provide retirement benefits. For purposes of the legislation, the acquisition or holding of any bond of the Municipal Assistance Corporation on or after August 20, 1975, and before November 26, 1975, will be deemed to have been acquired or held pursuant to the Agreement.

The latter provisions are required to cover the Municipal Assistance Corporation obligations purchased by the pension funds prior to November 26, 1975, in connection with the overall program to enable New York City to maintain its essential governmental services, and to cover New York City bonds retained by the pension funds following their acquisition pursuant to the Agreement. In addition, the language makes it clear that the Service may not disqualify the New York City pension funds under the prohibited transaction and exclusive benefit rules simply because they take the enumerated factors into account in making an investment decision.

Moreover, H.R. 11700 establishes reporting requirements and procedures with respect to the effectiveness of amendments to or waivers pursuant to the Agreement. No amendment to the Agreement having any bearing upon the qualified status of the pension funds and no waiver pursuant to the Agreement can take effect for purposes of H.R. 11700 until the Secretary of the Treasury has determined that the taking effect of such amendment or waiver is not inconsistent with (1) maintaining the ability of the City to make future contributions to the funds and to satisfy the City's future obligations to pay pension and retirement benefits, and (2) protecting the source of funds to provide retirement benefits. Moreover, the trustees or administrators of each fund must furnish to the Secretary of the Treasury annual reports and such additional information as the Secretary may reasonably require from time to time. This information will then be furnished to the Chairman of the House Committee on Ways and Means and to the Chairman of the Senate Finance Committee.

Given these important safeguards, the Treasury Department strongly supports the New York City pension legislation as part of the overall program to render financial assistance to the City of New York and to implement the New York City Seasonal Financing Act.

I appreciate the opportunity to appear before your Committee and will be glad to answer any questions that you might have.

ne Department of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR RELEASE UPON DELIVERY

STATEMENT BY THE HONORABLE GERALD L. PARSKY
ASSISTANT SECRETARY OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON FOREIGN COMMERCE AND TOURISM
SENATE COMMITTEE ON COMMERCE
MONDAY, FEBRUARY 23, 1976, 11:00 a.m.

International Investment Survey Act of 1975

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to present to this Subcommittee our views on international investment and on the International Investment Survey Act of 1975, S.2839, International investment has received considerable attention during the past two years both in the Congress and the Executive Branch, and there are several basic principles that lie at the heart of our policy in this area:

1. We should rely on the private market as the most efficient means to determine the allocation and use of capital in the international economy.
2. Foreign investment in the United States is beneficial, and, subject to limited restrictions, should continue to be

welcomed as healthy for our economy.

3. Although we must be aware of not imposing undue burdens on the private sector, adequate information on international investment should be made available to all branches of the Government and to the public.

The basic purpose of the legislation you are considering relates to the third principle, namely, to make sure that our information on U.S. international investment is adequate and to assure that our legal authority to collect this information is clear and unambiguous. The Treasury Department concurs in such objectives. We do not believe that such legislation should be viewed as in any way weakening our commitment to the free flow of investment capital. Rather, we view it as a desire to ensure that all the necessary facts are available so that sound policy can be developed.

U.S. Policy Toward Investment

This morning, I would like to briefly review with you our policy in this area and to assess this legislation in light of that policy. Our basic policy toward foreign investment in the United States and U.S. investment abroad has reflected an "open door" approach. That is, we offer no special incentives for inward or outward investment and, with a few internationally recognized exceptions in the

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case of inward investment, we impose no special barriers to international investment. Furthermore, foreign investors are generally treated equally with domestic investors once they are established here, and national treatment for our investors abroad is a basic tenet of our policy toward other countries.

In light of certain changes in international economic affairs, including in particular the rapid growth in the hands of a few governments of funds available for investment abroad, some people have questioned our policy with regard to foreign investment in the United States. In part as a result of this concern, the Foreign Investment Study Act of 1974, which was initiated by this Committee, was passed, calling for more information. The Treasury and Commerce Departments are now gathering information on foreign portfolio and foreign direct investment and final reports to Congress are due in April.

With respect to foreign portfolio investment in the United States, the preliminary findings of the Treasury Department are that this investment as of end-1974 totaled about $ 60 billion, of which $23 billion was in the form of stocks and $37 billion in the form of bonds and other long-term debt. These amounts are expected to increase somewhat when we make our final computation but not significantly. Our estimates prior to the benchmark survey were that foreign holdings of stocks were $18 billion and holdings of bonds and other long-term debt were about $38 billion.

We have found that the bulk of these holdings were by persons resident in a few European countries and Canada and were well diversified among various U.S. industries. The holdings of the oil-producing countries accounted for less than 4 percent of the total.

In addition to undertaking these studies, the Administration conducted a thorough review of our policy toward inward investment and concluded that no change was necessary or warranted. Consequently, we will oppose any new restrictions on foreign investment. This conclusion is based on our findings that: (a) the amounts of investment are not significant in relation to the U.S. economy; (b) there is no evidence that foreign investors are abusing or misusing their investments in this country; (c) our safeguards against possible abuses are adequate; and (d) the benefits from an "open-door" policy far outweigh any possible disadvantages.

The published data on foreign direct investment inflows into the United States show figures of $2.7 billion in 1973, $2.2 billion in 1974 and $0.9 billion in the first three quarters of 1975. However, these figures drop significantly in each year, when one set of transactions -- those associated with the foreign purchase of a U.S.-incorporated company, whose entire operations are abroad -- are excluded. Of the remaining amounts a major part, of course, represented capital inflows into companies that were already foreign-controlled.

The flows of foreign portfolio investment into U.S. securities (excluding U.S. Government issues) fell from $4.1 billion in 1973 to $0.7 billion in 1974 and rose to $3.9 billion in 1975 with the recovery of our stock market.

Although these figures indicate more foreign interest in investment in U. S. stocks, there is no evidence of any trend toward takeover of important segments of U. S. industry by foreign interests. According to reports to the Securities and Exchange Commission and other sources of information there has been no unusual foreign activity in this regard in recent years.

OPEC Investment

Despite this, special concern has often been expressed about OPEC countries and their potential for future investment. I believe such concern is not warranted. Some of the alarming estimates of long-run OPEC financial accumulations made during the last two years have been drastically reduced. Our latest estimate of the peak investment accumulation by all these countries is about $200 billion in 1980. We believe that the peak rate of new investments in any one year was in 1974 when it amounted to about $60 billion. Of the approximately $42 billion in total accumulations by OPEC countries in 1975, about $5.5 billion was placed in long-term investments in the United States. Although that was an increase of about $4 billion over 1974, virtually all of that investment was of a portfolio nature. Attached is a table providing our most recent estimate of OPEC's investment pattern for 1974 and 1975.

Looking ahead, we believe that the oil producing countries will place an increasing proportion of their investments in longer-term debt and equity instruments. Although investments will continue to be placed in the United States, we must take account of the fact that the rate of new investment by the oil producers outside their own countries will decline as they are able to absorb more internally.

With respect to the policies these countries are pursuing, the managers of OPEC funds have indicated to us that they have no desire to gain or maintain control over major segments of the U.S. economy. Many of these countries have participated in our markets for years, have been responsible investors, and have always sought to abide by our laws. They are following diversified investment objectives similar to any institutional investor, and while there may be some additional cases of major investments, I do not believe that any of the major OPEC investors would consider any moves in this area which would be against the U.S. national interest.

Administrative Action

At the same time that our review concluded that no additional limitations on investment were warranted, we did decide to institute certain administrative measures to supplement our existing laws and regulations. Last May a new high-level committee was created to assess the impact of foreign investment in this country and to review national interests. Also a new office of Foreign Investment in the United States was created in the Commerce Department. We have also advised all foreign governments contemplating a major direct investment in the United States to seek consultation with the United States Government on the prospective investment.

I personally have discussed this policy with the major potential governmental investors in the Middle East and found a broad acceptance of the concept of consultations as long as it is applied to all governments on a nondiscriminatory basis, and we view the policy that way. We believe this process of consultations to be far preferable to any legislative proposals for formal screening or prenotification mechanisms. Our approach is much more selective, involving only those few major direct investments that may raise important public policy issues. Our interest is not to raise any new barriers to foreign investments but to provide a mechanism by which a foreign government can learn of the U. S. Government's views on a prospective major direct investment before it is undertaken. Therefore, the process will minimize the possibility of misunderstandings or future investment disputes. Such consultations will thus prove beneficial to the prospective investors as well as to the United States.

Authority to Collect Data and S.2839

Inherent in this overall approach is a belief that we should not make basic departures from a long-standing and wise policy on the basis of conjecture. Rather, we should make sure we have

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all the relevant information. S. 2839 is put forward on the same premise, namely, that we must have the basic data on outward as well as inward investment in order to understand the implications of this investment for our current policy. Again, we strongly support this approach to this important area.

The Government has, of course, been collecting data of the kind envisioned in this bill for many years. However, as you have noted, Mr. Chairman, our current authority to collect it is deficient in some respects and I would like to give the Committee some background on this.

Presently, international investment data is collected under the authority of several statutes. There is no single, unified authority for the data collection and studies as contemplated by S.2839. The present laws relied on by the Departments of Treasury and Commerce are Section 5(b) of the Trading with the Enemy Act, Section 8 of Bretton Woods Agreements Act, and the Foreign Investment Study Act of 1974, which expires April 26, 1976.

Of these, the Bretton Woods Agreements Act is the most broadly used as a legal basis for collection of data by the Office of Statistical Reports in Treasury and the Bureau of Economic Analysis in Commerce. However, the authority of the Act is subject to an inherent limitation. Under its authority, the President is authorized to collect data only in the detail essential to comply with requests for information from the IMF. Presently, the IMF requests submission of balance-of-payments and international investment position data from member nations and the Bretton Woods Agreements Act has been relied on by Treasury and Commerce for the collection of such data.

Under Executive order 10033, the National Advisory Council on International Monetary and Financial Policy (NAC) in consultation with the Office of Management and Budget, must approve reporting requirements which are proposed for issuance under the Bretton Woods authority. Since the Bretton Woods authority is strictly limited to the collection of data essential to respond to IMF requests, the NAC cannot approve reporting requirements which go beyond the IMF's stated needs. It was on this basis that, in 1974, the NAC was forced to disapprove a number of items on a Commerce proposed survey questionnaire on direct investment abroad. The NAC expressed no disapproval of the Commerce proposal in substance, it simply could not fairly conclude that all of the information to be sought was necessary to comply with IMF requests.

Section 5(b) of the Trading with the Enemy Act contains broad regulatory and reporting authority over a wide variety of international transactions. The statute, along with the Bretton Woods Agreements Act, is one of the authorities cited for the Treasury foreign exchange reporting system. However, the statute is operative only in time of war or national emergency. While several past national emergency declarations remain in effect, they were not proclaimed for purposes of data collection on international investment. In this regard, the National Emergencies Act presently pending in Congress arises out of some Congressional views that emergency powers statutes should not be used as a legal basis for actions or programs of permanent or indefinite duration. Among other matters, the proposed Act would require a study of whether Section 5(b) should be retained in its present form as an emergency powers statute. Thus, Section 5(b), despite its breadth, is not the most suitable or certain basis for the full range of ongoing collection and study activities called for by S.2839.

In sum, we are relying on a patchwork of laws to accomplish tasks which could be authorized by a single omnibus measure such as the bill we are considering today. Even more important is the fact that, despite the complementary and even overlapping quality of the existing statutes, deficiencies in our collection authority for certain purposes still remain and should be cured by new legislation. There is, therefore, a clear need for an unambiguous and permanent authority to collect data on international investment.

Given this need, the question is how can we best provide for it? In some important respects, I believe that S2839 could be improved, and I would like to offer some general suggestions as to the kinds of changes I feel should be effected.

The bill as now drafted would give the Secretary of Commerce authority to survey and analyze information on portfolio as well as direct investment. As you know, the Treasury Department has been collecting and publishing the data on international investment other than direct investment for many years and is currently doing the part of the inward investment study which relates to foreign portfolio investment in the United States. We see no reason to change this arrangement at the present time. Since this is to be permanent legislation, however, it might not be advisable for particular agencies to be designated to carry out each of the specific tasks. It is certainly our current intention that the Commerce Department and the Treasury Department will continue to collect data on direct and other investment respectively. Nevertheless, I would suggest that either the authority be given to the President or that the Commerce and Treasury Departments be designated to collect and analyze information on direct and other investment respectively but with the proviso that the President can change these designations at a later time if for some reason he finds it desirable.

Another point I would like to note is that the bill as it is written is intended to provide authority to collect data on outstanding amounts of investment no less often than every 10 years but it does not appear to give authority to the Government to collect data on transactions. As you know, the Commerce and Treasury Departments have for many years been collecting data on foreign investment transactions on a monthly or quarterly basis, and I would hope

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the Committee would agree that it is desirable to continue these programs. As noted earlier, these data are being collected under the Bretton Woods Agreements Act which probably provides a firmer legal basis than for detailed surveys of outstanding amounts. Nevertheless, there is some ambiguity as to how much information we can collect under this authority, and we believe that this would be an opportune time to clarify this by having the new legislation authorize the collection of data on all capital transactions, both short-term and long-term, as well as on outstanding amounts.

The bill as it is now structured would authorize and mandate studies of international investment no less frequently than every ten years, and it spells out with considerable specificity what information should be collected and the kinds of analyses to be done.

The difficulty with trying to be too specific in permanent legislation of this kind is that we cannot foresee precisely what kinds of information will be topical and desirable in the years ahead. Too much specificity can work to our disadvantage in two ways. First, it could mandate the collection and analysis of some kinds of information which would be costly to provide yet not of particular interest at the time the studies are being done. Secondly, it could raise doubts about the legal authority to collect some kinds of information which may be of great interest at some future time but which were not specified in the Act because the need for them was not foreseen at the time the legislation was drafted.

It is also important to bear in mind that the private business community is now required to supply a vast amount of information to the Government. The cost to them in supplying this information and the cost to the Government in processing and analyzing it is considerable, and we should seek to minimize such costs. Therefore, I would recommend that the legislation contain strong language to the effect that the information gathering activities be carried out in a manner which will reduce as much as possible the cost and inconvenience to private firms.

In this connection, I should point out that a comprehensive survey of U.S. portfolio investment abroad would raise serious problems, both in terms of the cost to the private sector in supplying the information and the intrusion into the privacy of individuals that would be required if a comprehensive census were done as we did in the case of inward portfolio investment. For these reasons, we would recommend against this kind of survey. Instead, we propose that the Treasury Department first do an assessment of the probable validity of our current estimate of the outstanding amount of U.S. portfolio investment abroad on the basis of our data on portfolio transactions and on what we learn from our inward portfolio study as to the processes and mechanisms of international portfolio investment. On the basis of these findings we can then decide whether it would be worthwhile to undertake a limited survey of U.S. financial institutions.

Conclusion

In conclusion, I would emphasize that there is a need to provide for clear and permanent authority to collect a broad range of information on international investment on a continuing basis and assure that information on international investment will be adequate to meet the needs of the Government, the Congress and the public in this important area. S.2839 would provide such authority. We would like to work closely with the Committee and its staff on the changes suggested in my testimony as well as other changes which would be aimed at avoiding unnecessary costs to the Government and the private sector.

Current Treasury Staff Estimates of
OPEC Surpluses and Investment Pattern

	1974		Preliminary 1975	
	$ Billion	Percent of Total	$ Billion	Percent of Total
In United States	11 1/4	19	6 1/4	15
In Euro-banking market	22 1/2	37 1/2	7	17
(incl. UK banks, other European banks, and offshore banks)				
Other to United Kingdom	7 1/2	12 1/2	1/4	1/2
Other to Developed Countries	5 1/2	9	7	17
IFI Financing and IMF Oil Facility	3 1/2	6	4	9 1/2
Other to LDC's (incl. grants)	4	6 1/2	6 1/2	15
All other	5 3/4	9 1/2	11	26
TOTAL	60	100	42	100

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FOR IMMEDIATE RELEASE

February 23, 1976

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2.9 billion of 13-week Treasury bills and for $3.7 billion of 26-week Treasury bills, both series to be issued on February 26, 1976, were opened at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing May 27, 1976			26-week bills maturing August 26, 1976		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	98.780	4.826%	4.97%	97.387 a/	5.169%	5.40%
Low	98.766	4.882%	5.03%	97.356	5.230%	5.46%
Average	98.769	4.870%	5.01%	97.369	5.204%	5.43%

a/ Excepting 1 tender of $600,000
Tenders at the low price for the 13-week bills were allotted 100%.
Tenders at the low price for the 26-week bills were allotted 98%.

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Received	Accepted	Received	Accepted
Boston	$ 106,875,000	$ 88,875,000	$ 50,495,000	$ 46,495,000
New York	3,587,485,000	2,138,035,000	4,088,800,000	2,812,200,000
Philadelphia	24,590,000	24,590,000	12,545,000	12,545,000
Cleveland	148,875,000	123,875,000	143,165,000	133,165,000
Richmond	31,945,000	29,945,000	59,625,000	53,625,000
Atlanta	44,785,000	42,785,000	28,075,000	28,075,000
Chicago	293,475,000	169,975,000	295,635,000	236,435,000
St. Louis	51,520,000	32,520,000	51,140,000	42,140,000
Minneapolis	35,725,000	25,725,000	37,430,000	34,430,000
Kansas City	36,630,000	34,630,000	39,390,000	37,380,000
Dallas	38,400,000	37,400,000	26,540,000	26,540,000
San Francisco	297,110,000	152,110,000	257,485,000	237,225,000
TOTALS	$4,697,415,000	$2,900,465,000 b/	$5,090,325,000	$3,700,225,000 c/

b/ Includes $ 382,915,000 noncompetitive tenders from the public.
c/ Includes $ 188,880,000 noncompetitive tenders from the public.
1/ Equivalent coupon-issue yield.

WS-668

Department of the TREASURY NEWS
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FOR RELEASE ON DELIVERY

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STATEMENT BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE
THE SENATE SUBCOMMITTEE ON APPROPRIATIONS
FEBRUARY 24, 1976
10:00 A. M.

Mr. Chairman and members of the subcommittee:

I am pleased to be here with you today to consider the Department of the Treasury budget requests for operating appropriations during fiscal year 1977.

Let me introduce my associates - Mr. Donald Alexander, Commissioner of IRS; Mr. David Macdonald, Assistant Secretary for Enforcement, Operations, and Tariff Affairs; Mr. Warren Brecht, Assistant Secretary for Administration; Mr. David Mosso, Fiscal Assistant Secretary; and Mr. Arthur Kallen, Director of my Office of Budget and Finance.

Mr. Chairman, the members of this subcommittee have always worked with the Department in a highly cooperative spirit. I fully intend that I and officials of the Department will continue the same effective and harmonious relationship that has characterized our joint efforts in the past.

As your schedule indicates, the Treasury bureau heads will appear later before this Committee to justify their individual requests in detail. I would, however, like to insert for the record our usual detailed Treasury bureau addenda. At the conclusion of my statement, I will be pleased to discuss any matters relating to the bureaus which the Committee may wish to review with me.

With your permission, Mr. Chairman, I would like to make a short general statement on the overall economic situation and the Administration's total budget, before discussing the Treasury Department's FY 1977 budget.

WS-664

In our Collection activities we ancitipate being able to collect almost $.5 billion from delinquent returns. In addition, over $2.9 billion in delinquent accounts will be collected in FY 1977, although our inventory of unpaid accounts is expected to increase. In the Audit of tax returns, we will be examining approximately 2.39 million returns, which is not far different from last year's program of 2.42 million examinations. The rate of coverage of full examinations will decline from 2.5 percent to 2.4 percent in part because of a growth in tax return filer population. We are also making in our Service Centers 1.8 million adjustments for items on tax returns, up from 1.4 million in 1976. This increase is due mainly to a higher level of activity in the Information Returns Matching and Unallowable Items Programs. We expect to process 600,000 more tax returns, with 211 less average positions, in the IRS data processing operations.

In our Fiscal Service we anticipate a volume of 666 million checks issued, 777 million paid, and 1.2 million check claims. Savings bonds issues and retirements in 1977 are expected to reach an estimated 289.6 million pieces, an increase of 6 million over 1976. Transactions in other Treasury securities are expected to reach 12.5 million in 1977, which is .5 million above the 1976 level.

We expect a total production of almost 16 billion coins at the Mint, which is an increase of over 1.9 billion from the prior year.

We expect to increase our level of Compliance enforcement in the Office of Revenue Sharing by a modest amount.

In the Bureau of Alcohol, Tobacco and Firearms, we are proposing no new program initiatives, but we do expect to carry out fully the President's Concentrated Urban Enforcement Program which was approved for three cities by the Congress in the 1976 supplemental. This program is a four-pronged approach to significantly reduce the criminal misuse of firearms in a number of the Nation's major metropolitan areas.

The Secret Service will receive and investigate 237,000 cases involving counterfeiting, check and bond forgeries, protective intelligence, and other criminal and non-criminal matters, a 9.8 percent increase over the 215,852 cases in fiscal year 1976.

And, finally, we anticipate that the Customs Service will be handling an increased number of persons entering the country -- 267 million, up 4 percent from FY 1976 -- as well as starting their new responsibilities under the generalized system of preference, as provided by the Trade Act of 1974. With 319 less positions, we will need to be vigilant to prevent a denigration in the level of inspection quality or interdiction capability.

1977 Budget Summary

Overall, the President's budget for the Department of the Treasury requests budget authority of $56,335,284,000 for FY 1977 -- an increase of $5,842,918,000 over 1976. Of this increase, $7,300,000,000 is for interest on the public debt. Incidentally, I might note that the FY 1977 interest payment on the public debt is estimated at $45 billion -- a compelling reason to make every effort to stem the rising cost of the Federal Government. $187,500,000 of the increase is for Revenue Sharing, $14,172,000 for operating accounts, with an offsetting reduction of $1,658,754,000 in all other accounts. Funds for the Department's operating programs have been held essentially level at $2,575,797,000, an increase of only $14,172,000 over 1976. As I noted earlier, this apparent increase largely reflects the effect of the October pay raise.

Our net outlays for the Department are estimated at $56,309,963,000, of which $45,000,000,000 is for interest on the public debt; $6,548,504,000 is for Revenue Sharing; $2,575,356,000 is for the Department's operating programs; and $2,186,103,000 is for all other accounts, such as interest on IRS refunds, Customs collections in Puerto Rico, Claims, Judgments and Relief Acts, and the expenses for administering the New York City Seasonal Financing Fund.

The budget provides for a reduction of 2,172 average positions for the operating accounts for a FY 1977 total of 110,668 compared with 112,840 in 1976. We have made every effort to economize, in keeping with the need to reduce Federal Government spending; we are convinced that we can increase our productivity, so as to continue to carry out our responsibilities. We expect a minimal reduction in the quality of our service or level of enforcement as compared to FY 1976.

One reason for confidence in our ability to meet the 1977 budget challenge has been the fine support given the Department by this Committee over the past several years. While we are reducing our average positions this year, in the longer run context, I believe the Department has fared well in obtaining the resources needed to meet its workload. For example, the five-year period 1971-1976, Treasury increased average employment from 87,384 to 112,840. With this solid base, I believe this year's budget, combined with careful management attention, will enable us to do our job.

I would like to insert Table 2 into the record to show the relationship between our average position and dollar requirements, as well as Table 3, which provides the detailed derivation of Treasury's "Proposed Authorized Level for 1976". I would also like to insert for the record a new analysis we have prepared called the "Treasury Budget in Brief". This describes the highlights of the increases and decreases for our 1977 request.

Mr. Chairman, the budget before you is a lean request. The minor program increases have been substantially offset by program reductions and other cost-saving actions. We have reduced employment by 2,172 average positions and held the line on resource requirements while at the same time providing for the accomplishment of the projected FY 1977 workload increases.

I shall, of course, welcome the opportunity to answer any questions you may have. Thank you.

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THE DEPARTMENT OF THE TREASURY
Annual Appropriations for Treasury Department for 1976
and Estimated Requirements for 1977
(In Millions of Dollars)

	1976 Proposed Authorized Level 1/	1977 Budget Estimate	Change over 1976
Regular Operating Appropriations:			
Office of the Secretary	27.7	27.0	-.7
Office of Revenue Sharing	3.0	3.8	.8
Federal Law Enforecement Training Center (Salaries and Expenses)	12.0	8.5	-3.5
Bureau of Government Financial Operations:			
Salaries and Expenses	131.7	147.2	15.5
Government Losses in Shipment	.7	.5	-.2
Eisenhower College Grants	1.0	-	-1.0
Hoover Memorial Fund	7.0	-	-7.0
Bureau of Alcohol, Tobacco and Firearms	109.7	125.3	15.6
U. S. Customs Service	319.1	324.1	5.0
Bureau of the Mint:			
Salaries and Expenses	41.2	43.2	2.0
Construction of Mint Facilities	3.4	-	-3.4
Bureau of the Public Debt	105.6	114.5	8.9
Internal Revenue Service:			
Salaries and Expenses	45.8	46.7	.9
Accounts, Collection and Taxpayer Service	791.7	789.9	-1.8
Compliance	854.0	834.9	-19.1
Total, IRS	1,691.5	1,671.5	-20.0
U.S. Secret Service	108.0	110.3	2.3
TOTAL, Regular Operating Appropriations	$2,561.6	$2,575.8	14.2

NOTE: Amounts are rounded and do not add to total.

1/ Includes pay increases authorized by Executive Order 11881 effective October 1, 1975, and program supplementals for the Bureau of the Public Debt and the Bureau of Government Finanical Operations.

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January 13, 1976

Table 2

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THE DEPARTMENT OF THE TREASURY
Comparative Statement of Average Positions
Fiscal Years 1976 and 1977
(Direct Appropriations Only)

	1976 Authorized Level	1977 Estimate	Change over 1976
Regular Annual Operating Appropriations:			
Office of the Secretary	816	839	+23
Office of Revenue Sharing	104	123	+19
Federal Law Enforcement Training Center	256	240	-16
Bureau of Government Financial Operations	2,518	2,557	+39
Bureau of Alcohol, Tobacco and Firearms	4,062	4,573	+511
U. S. Customs Service	13,255	12,936	-319
Bureau of the Mint	1,934	1,925	-9
Bureau of the Public Debt	2,499	2,539	+40
Internal Revenue Service:			
Salaries and Expenses	1,874	1,771	-103
Accounts, Collection and Taxpayer Service	44,248	42,567	-1,681
Compliance	38,042	37,221	-821
Total, IRS	84,164	81,559	-2,605
U. S. Secret Service	3,232	3,377	+145
TOTAL, Regular Annual Operating Appropriations	112,840	110,668	-2,172

760090
January 13, 1976

THE DEPARTMENT OF THE TREASURY

Derivation of "Proposed Authorized Level for 1976"
(in thousands of dollars)

1976 Appropriation		$2,465,859
Supplemental Appropriation (P. L. 94-157) 1/		16,000
Proposed Supplementals:		
1. Pay Increase:		
a. Classified	$62,248	
b. Wage Board	452	
		62,700
2. Program:		
a. Public Debt - Provides for increased reimbursement to the Federal Reserve Banks (3,746), increased reimbursement to paying agents for redemption of savings type securities (276), reimbursement to U. S. Postal Service for increased mailings of securities (1,348), increased cost of space and services (1,123). ----------------------	6,493	
b. Government Financial Operations - to provide for reimbursement to the U. S. Postal Service resulting from the postal rate increase ----------	10,573	17,066
Proposed Authorized Level for 1976------------------------------		2,561,625

1/ Includes $5.5 million for the Bureau of Alcohol, Tobacco and Firearms (Concentrated Urban Enforcement) and $10.5 million for Secret Service (Protection of Foreign Dignitaries).

760091
January 13, 1976

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ADDENDUM

BUREAU STATEMENTS

Office of the Secretary

The Office of the Secretary provides for functions that are directly attributable to the Secretary of the Treasury as a major policy advisor to the President and for executive direction of the Department. The Office assumes primary responsibility for the direction and coordination of all Treasury activities, and direct responsibility for formulating and recommending domestic and international economic, tax, fiscal and monetary policies. The appropriation also funds general maintenance, and major repairs and improvements to the Main Treasury and Annex Buildings.

The appropriation request for fiscal year 1977 is $27 million and 839 average positions. The estimate is $.7 million less and 23 average positions more than the authorized level for fiscal year 1976. The major elements which comprise this change are $.5 million for repair and improvements to the Main Teasury and Annex Buildings, $.4 million and 16 average positions for new and increased program responsibilities, 7 average positions and $1.9 million for increases to maintain the 1976 level of operations in 1977, offset by a reduction in the repairs and improvements program and other nonrecurring equipment costs and savings of $3.6 million.

A total of 21 new positions is being requested for the staffs in the various supporting organizations of the Office of the Secretary. These include six positions in the Office of Debt Analysis, one position in the Office of Tax Analysis, two positions in the Office of the Assistant Secretary (EO&TA), eight positions in the Office of Equal Opportunity Program, one position in the Office of the General Counsel, one position in the Office of Personnel, and two positions in the Office of Administrative Programs. This request represents the minimum needs necessary to accomplish our mission of providing guidance, direction, and overall supervision for the many functions of the Department.

Office of Revenue Sharing

The Office of Revenue Sharing was established to implement the General Revenue Sharing Program as authorized by Title I of the State and Local Fiscal Assistance Act of 1972 (P.L. 92-512). Through General Revenue Sharing, $30.2 billion from federally - collected individual income tax receipts is being returned over a five-year period to nearly 39,000 recipient governments. The Office of Revenue Sharing assumes responsibility for the distribution of revenue sharing monies, maintaining detailed accounting records, insuring compliance with the requirements and provisions of the law, and reporting at regular intervals to Congress, recipient governments, and the general public on the revenue sharing program.

The appropriation request for fiscal year 1977 is $3.8 million and 123 average positions. The estimate for fiscal year 1977 is $.8 million and 19 average positions higher than the authorized level for fiscal year 1976. The major elements that comprise this increase are $.4 million and 13 average positions for increased program responsibilities, and $.4 million and six average positions to maintain the 1976 level of operations in 1977.

A total of 21 new positions is being requested for the Compliance Division, and will improve the civil rights and financial compliance programs as required by the General Revenue Sharing Act.

Federal Law Enforcement Training Center

Salaries and Expenses

The request for the Federal Law Enforcement Training Center for FY 1977 is $8.5 million, a decrease of $3.5 million and 16 average positions from the FY 1976 appropriation. This is net of the following items: an increase of $115 thousand for plant operations; an increase of $1.0 million for increases to maintain the current level (within-grades, annualization of pay costs, etc.); and a decrease of $4.7 million for one-time costs related to the move to Glynco, Georgia; decreases in training projections; and other nonrecurring costs.

The eight-week Criminal Investigator School (C.I.S.) will continue to provide basic training for new agents of the 24 participating agencies and, on a space-available basis, to personnel from other Federal organizations. It is estimated that the C.I.S. will train 659 students in FY 1977.

The Police School (PS) will continue to provide basic training in police techniques and enforcement law for recruits from ten Federal law enforcement agencies. The full course for recruits attending the Police School is a 12-week program. In addition, the staff of the Police School conducts some special 8-week and 5-week classes.

The Center conducts full-time driver training on a temporary course which will be used until the permanent course is constructed.

Advanced, In-Service, Refresher and Specialized (AIRS) driving training is also conducted for requesting agencies, and the Center is moving further into this area. The curriculum includes training in high-speed driving, defensive driving, and skid recovery techniques. In addition, firearms training is also conducted on behalf of the Center with 1,562 students to be trained in FY 1977.

Construction

No appropriation is requested for this account. The Center has been authorized to spend $28 million for permanent construction at Glynco, Georgia. These funds will come from amounts previously appropriated by the Congress.

The Master Plan for the Glynco facility is currently being finalized. It will call for utilizing **some or all of the** permanent buildings and facilities now in use at Glynco, as well as construction of new facilities. The first priorities for additional construction under the Master Plan are the completion of dormitories begun, but not completed, by the Navy; and the construction of a modern, up-to-date, indoor firing range. New construction to house additional classrooms and training support activities is also planned as part of the Master Plan -- as well as a permanent driving range facility for our Driver Training program. In addition, other renovation, demolition and upgrading of the facility will be undertaken consistent with our approved Master Plan.

Bureau of Government Financial Operations

Salaries and Expenses

The 1977 estimate for the Bureau of Government Financial Operations is $147.2 million -- a net increase of $15.5 million above the 1976 level. Of this increment, $9.2 million is for the annualization of the recent postal rate increase. Outlays for equipment which will provide service and benefits in future years total $2.8 million -- $1.6 million for the purchase of equipment and $1.2 million for the rental of equipment with a purchase option.

Other increases totaling $6.2 million are necessary for financing incremental workloads, additional functions and those increases necessary to maintain in 1977 the current levels of employment and operations. Offsetting reductions for nonrecurring equipment purchases, compensation for one less workday, and management savings other than those reflected in the workload areas, amount to $2.7 million.

An increase of 18 million brings the total volume of issuances, primarily checks, to 666 million for 1977. The Bureau expects to pay 777 million Government checks and to reconcile such payments against issues reported by disbursing officers. In addition, an increase of 107 thousand check claims over the 1976 level will bring total claims for lost, stolen and forged checks to 1.2 million. Productivity increases of over 2% are anticipated in all work volume areas.

Government losses in shipment

This self insurance account covers losses in shipment of government property such as coins, currency, securities and losses in connection with the redemption of savings bonds. An appropriation of $500 thousand is requested in 1977 to cover these losses.

Bureau of Alcohol, Tobacco and Firearms

The appropriation request for the Bureau of Alcohol, Tobacco and Firearms for fiscal year 1977 totals $125.3 million, an increase of $15.6 million over the proposed authorized level for fiscal 1976. Of this increase, $13.3 million is for program increases, $9.7 million is for maintenance of current operating levels with a $7.4 million offset for nonrecurring costs.

The program increase of $13.3 million is requested to fund the balance of the Concentrated Urban Enforcement (CUE) program to combat illegal traffic in firearms and explosives. This program was requested by the President in his June 1975 message on crime and was authorized by Congress in Public Law 94-157, which provided funds to implement the program in three of the eleven cities contemplated. This program has four basic objectives. The first is to trace guns seized in crimes to determine the channel of illegal gun commerce. Second is the investigation and elimination of major illegal sources of weapons. Third, is the use of concentrated enforcement techniques to perfect cases against persons using firearms and explosives in criminal activities. Four, expanded dealer compliance efforts will be made to assure stricter conformity to Federal firearms and explosives laws.

An intensive effort will also be undertaken to deny terrorists and organized criminals access to explosives through a nine point enforcement program.

The bureau regulation of the legal alcohol and tobacco industries will assure collection of proper taxes which are projected at nearly $8.2 billion in fiscal 1977.

U. S. Customs Service

The budget request for the Customs Service is $324.1 million. This level reflects a net increase of $5.0 million over the FY 1976 proposed authorized level. No program increases have been requested; however, the Service is requesting $16.0 million to maintain current levels, offset by a reduction of $11.0 million for nonrecurring one-time costs, equipment, and program reductions.

The Customs Service is continuing their intensified efforts in all areas of their enforcement responsibility. In fiscal year 1975, Customs expended 240 more work-years on special enforcement than the previous year. This includes the areas of general enforcement, smuggling, fraud, cargo surveillance, added inspections of vessels, cargo and persons, and a wide range of laws and regulations of other Government agencies.

In the area of drugs, Customs is facing the worst smuggling problem since the days of prohibition. We are in the midst of a resurgence in drug usage, especially heroin abuse. Reflecting this increase is an increase of 416 percent in heroin sezied to date in fiscal year 1976. The President in his statement of December 26, 1975, said, "Drug abuse is a tragic national problem which saps our Nation's vitality. It is also a major contributor to our growing crime rate. All of us must redouble our efforts to combat this problem". The Customs Service is the interdiction force at our borders, and, as such, will play a major role in this new Presidential initiative. The Customs Service is meeting the challenge of processing on-going workload, increasing responsibilities and limited resources, with many improved procedures: selectivity in inspection of passengers, and in technological assists through the use of X-ray equipment, communications systems, computers, aircraft, helicopters, boats and other devices.

The economic downturn beginning in fiscal year 1974 has caused reductions in the traditional workload indices of the Customs Service. However, in fiscal year 1976 Customs workloads are again on the rise, reflecting improved economic factors.

The Customs Service continues to experience increases in workload that are not captured by traditional workload measures. Tasks mandated by Congress through recent legislation, such as the Trade Act, and by the President through the Executive Order process, have placed additional burdens on the Customs Service. The tasks I refer to include the Trade Act, the Freedom of Information and Privacy Acts, and the Executive Orders dealing with labor management relations and oil importations.

In line with the Administration's policy of reducing Federal employment and expenditures, some Customs programs in fiscal year 1977 will decrease. However, the Service will make every effort to hold the program effect to a minimum.

Bureau of Engraving and Printing

The Bureau of Engraving and Printing designs and produces United States currency, postage stamps, Public Debt securities, and miscellaneous financial and security documents.

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 incidental to work and services performed, including administrative expenses.

For fiscal year 1977 the bureau estimated a delivery requirement of approximately 2.9 billion Federal Reserve Notes. Actual production for the current fiscal year will approximate 3.1 billion notes, as compared with 2.8 billion notes delivered in fiscal year 1975. Savings to the Federal Reserve System, estimated at $27 million in the next 5 years, led to the announcement by the Secretary of the Treasury on November 3, 1975, that the Bureau of Engraving and Printing would commence production of $2 Federal Reserve Notes and that the first day of issue would be April 13, 1976, the anniversary of Thomas Jefferson's birth.

Accordingly, the Bureau started production of a new $2 Federal Reserve Note on November 18, 1975. The design of the $2 note features a portrait of Thomas Jefferson on its face and a rendition

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of the painting, "The Signing of the Declaration of Independence", by John Trumbull, on its back.

Current plans call for production of 400 million notes by June 30, 1976, with 225 million available for issuance on April 13, 1976. It is anticipated that 400 million notes will approximate annual requirements.

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Bureau of the Mint

Salaries and Expenses

The appropriation request of the Bureau of the Mint for fiscal year 1977 is $43.2 million, an increase of $2 million over the authorized level for fiscal year 1976. This increase will provide additional production of 1.9 billion coins raising the total annual production to 15.8 billion. Included in our 1977 coin production is a reserve inventory to prevent recurrence of the just ended one-cent shortage which has been with us for the last two years.

In fiscal year 1977 the Philadelphia Mint will produce coinage strip. The Denver Mint has been converted to a coining operation only. Denver's strip fabrication equipment was removed and replaced by coining equipment, enabling us to increase coin production.

Construction of Mint Facilities

To assure the coinage capability needed to meet the increasing coin needs of the Nation, it is essential that we replace the Mint at Denver with a new and modern facility. The new Mint will be needed by no later than 1980 if we are to meet anticipated demand of the future.

Under the terms of the Act of Congress of August 20, 1963, authority for the appropriation of Mint construction funds expired June 30, 1973. In the 93rd Congress, the Department proposed legislation authorizing the appropriation of the funds needed for the new Mint and extending the time during which funds could be appropriated to September 30, 1983. However, the legislation had to be resubmitted to the 94th Congress.

Requests for additional funds to begin construction of a new Mint has been postponed until authorizing legislation is enacted.

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Bureau of the Public Debt

The request for the appropriation "Administering the Public Debt" for fiscal year 1977 is $114.5 million, an increase of $8.9 million above the authorized level proposed for fiscal year 1976. This appropriation finances operations of the Bureau of the Public Debt, estimated at $102.3 million, and the U. S. Savings Bonds Division, estimated at $12.2 million.

The workload of the Bureau of the Public Debt is expected to remain at a high level in 1977. Savings bond issues and retirements are expected to reach 289.6 million pieces, an increase of 6 million over projected 1976 totals. Transactions in other Treasury securities have continued to rise and are expected to increase in 1977.

The major program increases requested for the Bureau relate to these projected workload increases and would provide for additional personnel, supplies, and security stock, and for increased reimbursements to the Federal Reserve Banks, the Postal Service, and paying agents. It is also necessary to further automate the registered accounts operation in order to keep pace with increases in registered security activity. Other program increases are requested to enable the Bureau to increase productivity in future years.

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Internal Revenue Service

The Internal Revenue Service budget request for fiscal year 1977 totals about 81,500 average positions and $1.671 billion. These are decreases of approximately 2,600 average positions and $20 million from the adjusted fiscal year 1976 levels. The total decreases are net of program and cost increases offset by program reductions.

The proposed decreases are a direct response to the President's program to reduce federal expenditures, and do not signal a decrease in workload or responsibilities for the tax administration system.

Taxpayer Service

The fiscal year 1977 request for Taxpayer Service totals over 4,000 average positions and $122.8 million, a decrease of some 150 average positions and $1 million. This funding will permit assistance to over 40 million taxpayers.

Collection

The fiscal year 1977 budget for Collection proposes a level of some 11,400 average positions and about $230 million, a decrease of over 1,200 average positions and $13.2 million. Prior experience indicates application of these resources should permit the collection of approximately $2.9 billion in overdue taxes.

Audit

The proposed FY 1977 Audit program totals about 27,500 average positions and some $591 million, a reduction of some 520 average positions and some $13 million. This level of funding should permit a total Audit program of some 4.2 [1/] million returns, with a coverage rate under current

1/ 2.4 million is used in calculating audit coverage and 1.8 million is additional Service Center contacts for the Information Returns program and the Unallowable Deduction program.

plans of about 2.4 percent, a decrease from the 2.5 percent expected for fiscal 1976. Experience suggests that approximately $5.3 billion in additional tax should be recommended and some $4.5 billion in additional tax and interest should be assessed.

Employee Plans

The Employee Plans activity, created as a result of the Employee Retirement Income Security Act (ERISA) of 1974, is budgeted for more than 1,350 average positions and almost $30.5 million, an increase of about 170 average positions and $2.7 million. These resources should enable the Service to process approximately 160,000 of an estimated 350,000 determination requests expected to be filed under ERISA in FY 1977 as well as operate a reduced examination program and a delinquent returns program. The development and issuance of standard plans for practitioners and standard paragraphs and model plans for applicants should help in securing plan approvals.

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U. S. Secret Service

The appropriation request for the U. S. Secret Service for fiscal year 1977 is $110.3 million, a $2.3 million increase over the proposed authorized level for fiscal 1976. Essentially, the request maintains fiscal 1976 level of activities, but does provide for two program increases. One is for travel associated with expanded foreign dignitary protection during the Bicentennial, and the second is $2 million for payments to state and local governments for protection under extraordinary circumstances of Foreign Diplomatic Missions and places of temporary domicile, as recently authorized by Public Law 94-196.

The number of counterfeit, forged check and bond, protective intelligence, and other criminal cases to be investigated is expected to grow from 215,852 in fiscal 1976 to 237,000 in 1977, an increase of nearly 10 percent. The number of these cases to be closed is expected to increase by nearly 6 percent, from 138,852 in fiscal 1976 to 146,500 in 1977. The Service made 9,318 arrests in connection with these types of cases in fiscal 1975, a 21 percent increase over 1974.

The Service's protection of foreign dignitaries visiting this country is expected to increase in 1977. The number and frequency of such visits is expected to be at least 25 percent higher than 1976.

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR RELEASE UPON DELIVERY

STATEMENT BY THE HONORABLE CHARLES M. WALKER
ASSISTANT SECRETARY OF THE TREASURY
FOR TAX POLICY
BEFORE THE HOUSE BUDGET COMMITTEE
TASK FORCE ON TAX EXPENDITURES

FEBRUARY 24, 1976

Mr. Chairman and Members of this Distinguished Committee:

The proposed electric utility tax program is important not only as a stimulus to construction of additional facilities by electric utilities, but also as a means to minimize imports of foreign oil and to insure adequate electric capacity in the several years ahead. The construction activity will help put many people back to work in the near term, and in the longer run, will help insure that economic expansion will not be limited by energy shortages. In sum, the program is highly important to the national economy.

The proposals represent the recommendations of the President's Labor-Management Committee, and the President has endorsed them. The need for this legislation has not lessened since last July 8 when Secretary Simon urged its adoption in testimony before the House Ways and Means Committee. The reasons he gave are still valid. In summary, they are:

1. Financing difficulties have prevented the construction, or completion, of badly needed nuclear and coal fired plants.

2. The need to minimize our dependence on foreign oil demands adoption of means to increase electric generating facilities fueled otherwise than by petroleum products.

WS-666

3. The energy shortage must be met. Insufficient electric power will inhibit construction of new manufacturing and commercial facilities. This cannot be allowed to happen.

Before reviewing the six elements of the proposed electric utility tax program, I would like to set out briefly the way tax incentives operate in the private sector of the economy. While we are talking this morning only about the regulated electric utility industry, the underlying concepts are the same throughout the private economy.

Each economic unit within an industry employs factors of production to produce goods and services which it sells to others. If it is to continue to produce and sell these goods and services, it must receive in the market place revenues sufficient to cover the costs it must incur for the productive factors it employs.

In simplified form, the relevent factors are as follows (these are presented in tabular form in a footnote as a visual aid to those who may be reading these remarks)*/:

Industry's total revenue is derived from the quantity of units sold times the price per unit. From this is taken the amount paid in the purchase of labor, fuel and services,

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*/ Total Revenue....................	Quantity sold X price
less: Purchases of labor, fuel, and services.........	Man-hours employed, quantities of fuel used X prices
Equals: Cost of capital services	
1. Replacement of plant and equipment used-up........	Quantity of capital goods X its price
2. Interest to creditors........	Borrowed funds X interest rate
3. Return to equity	
a. Income tax	
b. After-tax return........	Equity capital X rate of return

that is, the man hours employed and the quantities of fuel used, times the price paid for each. That leaves an amount which is known in the aggregate as the cost of capital services. This, in turn, is comprised of three elements: First, the amount needed to replace the plant and equipment used up in the production of the units sold. That is the quantity so used times its price. Second, is the amount of interest paid to creditors; that is, the amount of borrowed funds times the interest rate. Third, is the return to the equity invested. This, in turn, is comprised of two elements: first, the income tax due and second, the after tax return to the investor; that is, the equity capital times the rate of return.

For electric utilities, the fraction of total cost per unit of output which represents the cost of capital services is unusually high, which is the reason why the industry is often referred to as "capital-intensive." In recent years, capital costs have accounted for upward of 40 percent of the total cost of producing and distributing electric energy. And with the sharp rise in fuel costs which have been experienced in the past 3 years, it is to be expected that extensive substitution of capital for other resource costs will take place. Coal burning and nuclear power plants, for example, which utilize less costly fuels, entail much more capital per megawatt-hour of productive capacity than do oil and gas burning installations.

We may use the above analysis to recapitulate the problems of the electric power industry which Mr. Rosenberg covered in his testimony and to address the solutions proposed in the 6-point utilities package recommended by the President. When fossil fuel prices started their rapid rise in mid-1973, the consequence for electric utilities, whose rates are regulated, was a shrinkage in the residual cash-flow labelled "cost of capital services" in the foregoing analysis. This reduced the return to equity and made increasingly difficult the simultaneous (1) maintenance of dividend payments which were needed to continue to attract and hold equity capital, (2) payment of interest on obligations to bond-holders, and (3) carrying out of investment programs to replace existing capacity as well as to add additional capacity needed to meet forecast growth in demand for electric power. This squeeze on the electric power industry resulting from what is commonly called "regulatory lag" or the slow adjustment of allowable prices to reflect changed cost conditions was exacerbated by two other factors: the actual costs of replacement capital were pushed-up by inflation while the allowances for this portion of capital cost embedded in utility rate structures remained unchanged; and interest rates on refunding and new issues of bonds rose to incorporate the inflation premium. For many utility companies the resultant drop in realized return to equity owners was so severe that dividend payments were suspended and/or construction programs were cancelled or suspended.

It is true that the problems visited on the utility sector differed only in degree from those faced by the entire private sector. Unregulated businesses were also caught in a cash-flow squeeze as their costs rose more rapidly than the prices they could recapture in the market. But, in the unregulated sector, restoration of balance between prices and costs has been quicker, not only because price regulation procedural lags are generally absent, but also because their capital costs are generally a smaller fraction of total costs.

It may also be comprehended from the analysis how income tax investment incentives work. If the income tax burden is reduced--and this may be done by a wide variety of means, some of which are included in the 6-point utilities program--the initial impact is an increase in after-tax return to equity. If this occurs during a period of profits squeeze, the obvious result is a diminution of the squeeze, an opportunity to maintain a higher rate of investment outlay to keep up the productive capacity of the squeezed industry. If the tax burden reduction occurs in a more normal economic situation, the result is to make additional investment more attractive while simultaneously supplying funds to business firms with which they may undertake the additions to capacity. But whatever the circumstances under which a tax burden reduction takes place, the ultimate result is a reduction in the cost of employing capital and, hence, in the total costs which must be recovered in the prices paid for output. In the unregulated sector of the economy, competition restores the balance between resource costs and product prices; in the regulated sector, governmental authorities assume responsibility for restoring balance.

I would now like to turn to the specifics of the proposals before you. As I discuss each of them, I will attempt to give an estimate of both the revenue and cost of capital services impact.

1. Title I of the proposed legislation would increase the investment tax credit permanently to 12 percent for all electric utility property except generating facilities fueled by petroleum products. Section 46 of the Internal Revenue Code presently grants utilities, like other taxpayers, a maximum investment tax credit of 10 percent. Although the 10 percent credit is scheduled to revert to lower rates at the end of this year, the President has proposed the higher rates be made permanent.

2. Also under present law utilities, like other taxpayers, are entitled to investment tax credits as they make progress payments on long-term construction projects. However, the Tax Reduction Act of 1975 provided a 5-year phase-in of construction progress payment credits so that entitlement to the full investment credit at the time a progress payment is made will not occur until 1980. The proposed legislation would give electric utilities full, immediate investment tax credits on construction progress payments for construction of property that takes 2 years or more to build, except generating facilities fueled by petroleum products. This would eliminate the 5-year phase-in now required by the Tax Reduction Act of 1975. These proposed changes with respect to the investment credit would be limited to those utilities which "normalize" the increase in the investment credit for ratemaking purposes and which are permitted by their respective state regulatory agencies to include construction work in progress in their rate base for ratemaking purposes.

The normalization requirement refers to the accounting treatment of the proceeds of the investment credit earned in a particular year. Under normalization procedures, the amount of the credit earned with respect to an investment made during the year is pro-rated over the life of the asset for ratemaking purposes. Absent this procedure, the full amount of the credit would be considered to be a reduction in the capital cost of service in the year in which the investment was made rather than a reduction throughout the life of the asset. Normalization, therefore, assures an equitable assignment of cost reduction to all generations of consumers who will benefit from the services of the capital for which a credit was allowed.

The requirement that the cumulative costs of construction work in process be included in the rate base to qualify utility companies for the additional 2 percentage points of investment credit is provided in Title V of the proposed legislation. The aim of this element of the electric utilities' program is to accelerate the restoration of balance between the prices regulated utilities are allowed to charge and the higher costs of the capital they employ. Absent such a re-equilibration of prices and costs, the economic viability of the industry cannot be regained, and the promise of tax incentives would be empty.

We estimate that the revenue cost of Title I--the increased investment credit--will be $70 million the first full year and reach $260 million by 1981. This rise in revenue cost reflects an assumed rate of growth of investment in the utility sector plus a return to profitability and taxability. In terms of the long-run cost of electric service, we estimate that, for coal burning plants, the increase in investment credit alone will make possible a reduction of a little more than 3 percent of total capital costs, or about 1.2 percent of total cost of service. Although we have been unable to make an estimate for nuclear plants, we are confident the implicit cost reduction will be larger.

3. Under present law, section 167 of the Internal Revenue Code allows a deduction for depreciation commencing when a depreciable asset is placed in service. Title III of the proposed legislation would permit electric utilities to begin depreciation of major construction projects during the construction period. The depreciation deduction would be based on the accumulated construction costs which qualify for the investment credit under the construction progress payment system enacted as part of the Tax Reduction Act of 1975. Accelerated methods of depreciation would be permitted, and the depreciation deduction would be based on an assumed useful life which would include the remaining construction period plus the estimated useful life (or asset depreciation range period) attributable to the property as of the time it is placed in service. Depreciation after the property is placed in service would be reduced by depreciation taken during the construction period.

Electric generating facilities fueled by petroleum products would not qualify for this construction period depreciation. Further, construction period depreciation would be conditioned on the utility's normalizing the benefits of the provision for ratemaking purposes and upon the agreement of the relevant state regulatory agency to include construction work in progress in the utility's rate base for ratemaking purposes.

We estimate that the revenue cost of extending depreciation deductions to construction work in progress will be $200 million the first year and rise to $1.2 billion by 1981. For coal burning plants, we estimate that the capital cost reducing effect of this provision, in combination with the increase in investment credit, will be nearly 16 percent of capital costs, or about 6.4 percent of total cost of service. Again, the cost reduction effect for nuclear installations will be substantially larger.

4. Title II of the proposed legislation provides for extending to January 1, 1981 the period during which pollution control equipment installed in a pre-1969 plant or facility will qualify for rapid 5-year straight line amortization in lieu of normal depreciation and qualification for the investment credit. Section 169 of the Internal Revenue Code, which provides for this treatment of pollution control equipment, expired December 31, 1975 and the proposal is to extend the qualification period an additional 5 years.

5. Title II also would provide an election of 5-year amortization in lieu of normal depreciation and the investment credit for the costs of converting an electirc power generating facility fueled by petroleum products into a facility fueled by non-petroleum products, or for the cost of replacing petroleum product fueled facilities.

Both proposals 4 and 5 are aimed toward highly specific investments and it is our present judgment that neither would entail more than a negligible revenue loss. Accordingly, we estimate no long run cost reduction effect will result, although some few companies forced to convert or replace now obsolete facilities will be benefited in the immediate future.

6. Finally, Title IV of the proposed legislation would permit a shareholder of a regulated electric utility to postpone tax on dividends paid by the utility on its common

stock by electing to take additional common stock of the utility in lieu of a cash dividend. The receipt of the stock dividend would not be taxed. The amount of the dividend would be taxed as ordinary income when the shareholder sells the dividend stock, and the amount of capital gain realized on the sale would be decreased (or the amount of capital loss increased) accordingly. Dividend stock would be deemed sold by the shareholder before any other stock of the same utility.

We have had difficulty estimating the probable revenue loss for this provision. The value of income tax deferral on reinvested dividends plainly depends on the income tax bracket of the stockholder and the period of deferral he elects. Computations we have made indicate that for 5-year deferral periods the increase in net yield to an investor in a 30 percent tax bracket would be under 10 percent, i.e., if the stock pays a dividend of 10 percent, 5-year deferral would raise the effective yield to that 30-percent taxpayer to 10.8 percent. For a 70 percent taxpayer, the 10 percent dividend yield would be raised to 11.9 percent by 5-year deferral. If the deferral period is increased to 10 years, the increase in yields to the 30 and 70 percent taxpayers are from 10 percent to 11.7 and 14.4 percent, respectively. The extent to which tax deferral will be elected by utility stockholders is thus highly dependent on the income status of present and prospective stockholders. Our best estimate of the likely revenue loss is thus about $300 million the first year and rising somewhat to $365 million by 1981. In view of the relatively slight impact this provision is likely to have on the yield-to-equity requirements of utilities, we have not attempted to assess the cost reduction implications of this provision.

Altogether, then, the proposed legislation will reduce tax revenues by an estimated $200 million in the transitional quarter of 1976 and $800 million in fiscal 1977. The long run benefits which this purchases are an orderly restructuring of the U.S. electric utility plant to de-emphasize the use of petroleum-based fuels and an accelerated normalization of annual investment to meet future electric power needs of the economy.

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FOR RELEASE ON DELIVERY

STATEMENT OF THE HONORABLE EDWIN H. YEO III
UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS
BEFORE
THE SUBCOMMITTEE ON SECURITIES, SENATE COMMITTEE ON
BANKING, HOUSING AND URBAN AFFAIRS
TUESDAY, FEBRUARY 24, 1976, 10 A.M.

Mr. Chairman and members of this distinguished Subcommittee, I am pleased to appear before you to testify on legislative initiatives to require disclosure by States and municipalities of their fiscal and financial condition. The Treasury supports the concept, and, with qualifications which I will spell out later, supports the Williams-Tower Bill, S. 2969.

The Current State of Municipal Disclosure and Its Shortcomings

Until last June, with one exception, no aspect of the municipal securities field was subject to Federal Securities law. Apart from the reach of the anti-fraud provisions -- Section 17 of the 1933 Act and Section 10(b) of the 1934 Act -- there were no uniform national standards to govern and guide dealings in municipal securities.

Under the leadership of the Chairman, Congress moved last year to fill part of that void. The Securities Act Amendments of 1975 established a comprehensive mechanism to regulate transactions in municipal securities and the

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intermediaries which facilitate the process. Today we begin the infinitely more difficult and delicate -- but equally important -- task of recognizing the critical need for current, accurate and comparable information about the fiscal and financial condition of State and local governments.

Forty three years ago, when municipal securities were exempted from the Securities laws, Congress could not have foreseen the importance of the municipal market of today. Approximately $30 billion of tax-exempt bonds were issued in 1975. Another $30 billion was borrowed short term. Perhaps a more significant change than growth in the size of the market was the revelation that municipal securities were not riskless. Investors learned in 1975 that theoretical access to the ad valorem taxing power was not an absolute guarantee of timely repayment.

Clearly the times have changed for States and municipalities as well as for other economic sectors. States and municipalities now perform far more diverse services than four decades ago, or even ten years ago. They employ a much more diverse set of taxes. Their financings are far more complicated. All of these changes accentuate the need of investors and underwriters and dealers for reliable, current and comparable information on the fiscal and financial condition of State and local governments.

A major defect in the flow of information now available is that the data are not easily, if at all, comparable. The growth of State and municipal activities, the diversity of taxes and the complexity of financing have spawned a variety of methods of reporting. Accounting procedures differ widely. As a result, verification and interpretation of State and local fiscal and financial data is extremely difficult.

The importance of providing reliable information is enhanced by the fact that the nature of investors in the municipal market has changed. Historically, investors have been sophisticated institutions -- banks and fire and casualty companies -- which had both the resources and the expertise to develop and evaluate information on their own. Today, however, individuals are playing an increasingly important role in the municipal market.

Safeguards Currently Available

Under existing practices, there are in effect three mechanisms which tend to safeguard an investor's investment in municipal securities.

First, there is the fact that many States, either by statute or by constitutional provision, prohibit conduct which would undermine a political subdivision's ability to meet financial obligations. Such limitations generally include the requirement of a balanced budget and limitations on such items as outstanding long term debt, short term debt outstanding at the end of the fiscal year, tax rates and expenditures, among others.

Legal limitations provide poor financial standards because they are arbitrarily applied to all municipalities in the jurisdiction and often do not allow for judgment in financial planning. Also, such limitations often are legally established in Constitutions, charters and statute books. As time passes, they often become obsolete and are very hard to amend. Finally, as we learned in the case of New York City, legal prohibitions are not necessarily enforced strictly.

A second source of potential protection is the anti-fraud provisions of the Federal Securities Laws. But these safeguards alone are deficient in two respects. First, they are retrospective only. They cannot help investors to <u>prevent</u> unwise investments, but can only provide a basis for recouping losses after (and if) fraud is proved. Moreover, they do not provide a basis for helping investors choose among competing investments; they only prohibit certain extreme unlawful conduct.

A third possibility is the rating process. But, since the rating services must rely on the insufficient and non-comparable data provided to them, they can at best only make general estimates of creditworthiness. There is a fundamental fallacy in trying to base ratings on less than full disclosure. There is no substitute for reliable, up-to-date, comparable information.

In short, there is no mechanism to insure that investment decisions in municipal securities are made with clarity and confidence. Prudent decisions cannot be made when investors are forced to compare apples and oranges, and often old ones at that. An efficient market requires access to comparable, verified, and reasonably current information.

The Desired Nature and Scope of Disclosure Legislation

The fundamental goal of disclosure legislation must be to assure that the maximum amount of relevant information is readily available, with a minimum amount of Federal intervention and a minimum of cost. Disclosure rules and regulations should enhance the market, not interfere with the market mechanism for municipal issues. Most important, in order to ensure that municipal investors are able to make a concise comparative analysis of the finances of different issuers, disclosure legislation must standardize the presentation of the information being disclosed.

It is the importance of standardization which requires that a disclosure program be administered at the Federal level. We have examined carefully the voluntary disclosure approach. As the Committee knows, it has been argued that since investors and underwriters are demanding more information, if the free market were left to its own devices, the information would be provided by those issuers which needed market access. We concluded, however, that precisely to assure that the free market mechanism will function smoothly with respect to municipal issues, it is necessary to insist upon mandatory disclosure of financial information by issuers entering the market. It is only by mandatory disclosure that adequate, uniform, usable information can be assured, and that its flow to the investing public can be guaranteed.

In designing a disclosure system, we must keep in mind that the policy trade offs here may differ from those employed in the corporate area. It is not an overstatement to say that, under existing law and procedures, the governing principle in the corporate area is spare no expense to give the investor every last ounce of protection. In the municipal area, where such expenses must be directly paid by taxpayers, I do not think we can or should make a similar choice.

Scope

There are many municipalities which do not enter the capital markets frequently or to a heavy degree, and thus present lesser concerns to the investing public or to the proper functioning of our nation's capital markets. There are many municipal issues which have a relatively limited market. So that mandatory disclosure does not result in overkill, we favor the setting of threshold limits below which disclosure would not be required.

Once the issuers which should disclose have been identified, the information required of them should be carefully specified and relatively comprehensive. Some flexibility, of course, is required, but State and local governments, we believe, are entitled to have Congress decide the kind of information it is required to disclosure.

Comments on Pending Disclosure Bills

Based on the above principles, we oppose S. 2574 and H.R. 11044. By eliminating the 1933 and 1934 Act exemptions for municipal securities, these bills would require that municipal securities undergo the same disclosure, filing and clearance and registration procedures as corporate securities. Such an approach would impose burdens and costs which outweigh the benefits derived.

We are in general agreement with S. 2969, cosponsored by the Chairman and Senator Tower. S. 2969 is not a regulatory bill; it would not require filing, registration or presale clearance of issues. Instead, it is strictly designed to insure that information -- reports and distribution statements -- be prepared and made readily available to the public.

Let me stress this fundamental difference between the Solarz and Eagleton bills, and S. 2969, even at the risk of belaboring the point. The Solarz and Eagleton bills are regulatory measures. They would intimately involve the SEC in the issuance process, as it is in the corporate area. The Williams-Tower bill does not contemplate such involvement, providing only that informational reports and statements be prepared and made readily available.

Responsibility, in the final analysis, is more a matter of accountability than motive. And, in turn, accountability requires good information. If comparable, reliable, up-to-date

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information were made available through disclosure guidelines, in depth scrutiny by investors and the electorate would be facilitated.

The mechanism for public scrutiny of municipal issues already exists. It lies in the market place and the election process. What is required is only to put it to work, and this, in turn, requires only assuring the flow of information. Reliable, comparable current data would pre-empt the need for presale registration and clearance.

I concur with the essential substance of S. 2969. The bill provides for the preparation of annual reports including audited financial statements by issuers of municipal securities with more than $50 million outstanding. It provides also that distribution statements be prepared prior to public offer or sale of $5 million or more of securities. And it requires that such reports and statements be reliable and comparable, as well as readily available to underwriters, dealers and investors. Finally, it encourages State oversight by providing for exemptions from the distribution statement requirement where a State authority has approved the offer or sale of the issue.

The advantages of the Williams-Tower bill's approach are numerous. The '34 Act's reporting requirements are less burdensome than those under the '33 Act and will result in less burden to reporting entities. Ongoing information about the basic financial health of a city affords an excellent means of evaluating its creditworthiness and its potential for meeting debt service on bond issues into the future. To the extent new issue information is needed, the distribution statement which the Williams-Tower bill would require will provide all the relevant data. Thus, the Williams-Tower bill strikes an appropriate balance: requiring disclosure of as much information as is necessary to allow the market to function properly, without burdening our States and cities with requirements that impose unnecessary costs.

In my view, the bill as currently drafted requires improvement in two areas. First, I am concerned about the authority conferred upon the Commission by subsection (d) of Section 13A. To the extent this provision reflects the authors' belief that, in light of inflation, it may be appropriate at some future date to allow the Commission to adjust upward the minimum filing requirements, such intent could be more clearly expressed by substituting the word "increase" for the word "change" on line 5.

If, on the other hand, the provision contemplates a possible downward adjustment of the minimum limits, I believe the provision constitutes an inappropriate delegation of authority to the Commission. It is important to keep in mind that this legislation contemplates a degree of Federal involvement in the affairs of sovereign political units. Accordingly, it is our strong belief that any change which materially increases the scope of the legislation, or the burden on entities initially subject to the legislation, must receive the review and approval of the Congress in the form of new legislation.

This leads directly to our second area of concern. While we recognize the necessity for a slight degree of rule-making authority in the Commission to implement the statutory directives, we think the legislation, as currently drafted, goes much too far. As I indicated earlier, while the protection of investors is, and must be, a consideration, it is not in my view a consideration of such paramount importance as might be the case on the corporate side. The grant of discretion to the Commission to expand the type of information required must be carefully circumscribed and should recognize expressly the different competing considerations which exist in the municipal securities area.

After all of us have had the benefit of the hearing process, we expect to work closely with the Commission and the staff of this Subcommittee to develop language to deal with the concerns set forth above. At the same time we will also present additional minor technical amendments which we feel will improve the legislation.

All in all, S. 2969 presents a desirable framework for satisfying the important objectives of more and more useful information about municipal credits. We believe such legislation is urgently needed and we will cooperate with the Committee and the Congress in an attempt to achieve its expeditious passage.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR IMMEDIATE RELEASE February 24, 1976

SECRETARY SIMON LEADS DELEGATION TO THE MIDDLE EAST AND EUROPE

Treasury Secretary William E. Simon will lead a high-level delegation to the Middle East and Europe to hold economic discussions with senior government officials in Saudi Arabia, Israel, Syria, the United Arab Emirates, Egypt, Italy, and Germany. The delegation departs Washington February 26, and will return March 11.

Secretary Simon plans to meet with King Khalid while in Saudi Arabia, Prime Minister Rabin in Israel, President Asad in Syria, President Zayid in the United Arab Emirates, and President Sadat while in Egypt.

In addition, Secretary Simon will co-chair a meeting of the U.S.-Saudi Arabian Joint Commission on Economic Cooperation with Finance Minister Aba al-Khail. In Israel, Secretary Simon will co-chair a meeting of the U.S.-Israeli Joint Committee for Trade and Investment with Finance Minister Rabinowitz.

"This mission will seek to strengthen economic ties between the United States and the countries of the Middle East. We believe that the United States can assist these countries in their development efforts and such cooperation will further our goal of achieving a lasting peace in the Middle East," Simon said.

On his return from the Middle East, the Secretary will visit Rome and Frankfurt, where he will give an address at the University of Mainz.

The Secretary will be accompanied by Assistant to the President, L. William Seidman; Assistant Treasury Secretary, Gerald L. Parsky; and senior officials from the Departments of State, Treasury, Commerce, and other U.S. agencies.

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FOR IMMEDIATE RELEASE February 24, 1976

POSTAL SERVICE NOTIFIED OF CHAIN-LETTER, SAVINGS BOND SCHEME

Postal authorities today were notified of the reappearance of chain-letter schemes involving the use of United States Savings Bonds in several areas of the country.

H. J. Hintgen, Commissioner of Treasury Department's Bureau of the Public Debt, said information received indicates that some promoters of the letters are motivating participation in their schemes by falsely claiming Treasury's endorsement, and by cloaking their appeals in bicentennial and other patriotic labels.

"Many years of experience with chain-letter operations indicates that most participants lose their entire investment," Mr. Hintgen said. "This outcome is inevitable because the supply of interested persons is soon exhausted."

Mr. Hintgen pointed out that use of the mails to facilitate participation and transactions in chain letters is considered in violation of postal lottery and fraud laws. There is also the possibility, he said, that such schemes violate local anti-lottery laws, even if the mails are not used in any way.

Chain-letter schemes hurt, rather than help the Savings Bond Program. "Rather than encouraging persons to make genuine investments, they create the illusion that participants are both aiding their government and themselves. Even in the rare case where an individual receives some return, it is likely that he would quickly redeem the bonds, thereby placing a further burden on the Treasury," according to Commissioner Hintgen.

Banks and other issuing agencies are authorized by Treasury to refuse applications where there is reason to believe the bonds will be used in a chain-letter scheme. Information on reappearance of chain-letter activity involving Savings Bonds have been reported from several areas of Florida, Massachusetts, and in parts of Richmond, Baltimore, and the Mid-West.

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FOR RELEASE AT 4:00 P.M. February 24, 1976

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $6,600,000,000 , or thereabouts, to be issued March 4, 1976, as follows:

91-day bills (to maturity date) in the amount of $2,900,000,000, or thereabouts, representing an additional amount of bills dated December 4, 1975, and to mature June 3, 1976 (CUSIP No. 912793 ZK 5), originally issued in the amount of $3,400,700,000, the additional and original bills to be freely interchangeable.

182-day bills, for $3,700,000,000, or thereabouts, to be dated March 4, 1976, and to mature September 2, 1976 (CUSIP No. 912793 A7 1).

The bills will be issued for cash and in exchange for Treasury bills maturing March 4, 1976, outstanding in the amount of $6,406,080,000, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,198,830,000. 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 non-competitive 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 Standard time, Monday, March 1, 1976. 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

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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 March 4, 1976, in cash or other immediately available funds or in a like face amount of Treasury bills maturing March 4, 1976. 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.

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The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR IMMEDIATE RELEASE

STATEMENT OF THE HONORABLE DAVID R. MACDONALD
ASSISTANT SECRETARY OF THE TREASURY
(ENFORCEMENT, OPERATIONS, AND TARIFF AFFAIRS)
BEFORE THE
SENATE SUBCOMMITTEE ON APPROPRIATIONS
TUESDAY, FEBRUARY 24, 1976, 2:00 PM EST

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before you today to discuss the U.S. National Central Bureau of the International Criminal Police Organization -- INTERPOL. With me today are James J. Featherstone, Deputy Assistant Secretary (Enforcement); Louis B. Sims, Chief, United States National Central Bureau of INTERPOL; and, in accordance with your request, Mr. Kenneth S. Giannoules, the previous Chief, United States National Central Bureau of INTERPOL. Since Mr. Giannoules has not appeared before this committee before, I am offering his biographical sketch for the record.

U.S. Membership and Funding

By statute (22 U.S.C. 263a), the Office of the Attorney General, U.S. Department of Justice, is the "Office of Responsibility" for INTERPOL in the United States. In 1958, by P.L. 85-768, the U.S. Congress authorized the Attorney General to designate the Department of the Treasury the official liaison with INTERPOL.

The U.S. Government currently has twelve full-time positions assigned to INTERPOL. One of these positions is located at the Headquarters of INTERPOL in France, the remaining eleven in the Main Treasury Building in Washington, DC. These positions are funded as follows: Three (3) by the Department of Justice; two (2) by the Office of the Secretary, U.S. Treasury Department; two (2) by the U.S. Secret Service; three (3) by the U.S. Customs Service; and two (2) by the Bureau of Alcohol, Tobacco and Firearms.

The Fiscal Year 1976 Department of the Treasury Salaries and Expenses Appropriation for the Office of the Secretary, in addition to the two (2) permanent positions, contains resources for travel and communication costs and for the INTERPOL annual dues.

Public Law 93-468, approved October 24, 1974, increased the limit on INTERPOL dues from $80,000 to $120,000. Because of unforeseeable fluctuations in the Swiss franc exchange rate, we have proposed legislation, which has recently been transmitted to the Congress, to remove this limit.

INTERPOL annual dues were last increased in September of 1974 from 4830 Swiss francs per budget unit to 5900 Swiss francs per budget unit. The United States, Germany, Italy, United Kingdom and France pay 60 budget units each or the equivalent of 354,000 Swiss francs. Other member countries pay correspondingly less, depending on their development and utilization of INTERPOL. In addition to the increased budget unit, currency fluctuations have increased the dollar equivalent of the budget unit as expressed in Swiss francs. For this reason, annual dues have ranged in value from $117,000 in October 1974 to $147,000 in February of 1975, and are now valued at approximately $138,000. The current U.S. dues represent 6.2 percent of the overall INTERPOL dues of 5,693,000 Swiss francs.

In Fiscal year 1977 we are requesting $155,000 for INTERPOL dues. The request for an additional $75,000 is to cover the 1974 increase in dues, which had not previously been budgeted for, and also to provide for the increase resulting from the change in the exchange rate between the U.S. dollar and the Swiss franc. No other increases are requested in the FY 77 budget.

INTERPOL was organized in 1923 and presently consists of 122 member countries with the General Secretariat located in Saint Cloud, France, outside of Paris. The Secretary General is a French citizen named Jean Nepote. The current President of INTERPOL is Mr. William L. Higgitt, recently retired Commissioner of the Royal Canadian Mounted Police, and presently head of the Canadian Safety Council. President Higgitt was elected in 1972 by the General Assembly.

Mr. Nepote was elected by the General Assembly in 1963, and was re-elected in 1968 and 1973. Mr. Nepote is a "Commissaire Divisionnaire" of the French Surete Nationale, a "Chevalier" in the French Legion of Honour, and has been decorated by a number of other countries.

INTERPOL is an intergovernmental organization composed of member countries represented by their law enforcement officials. This normally is the head of the National Police. In the United States, the designated representative is the Assistant Secretary of the Treasury who is responsible for law enforcement. The National Central Bureau of each country maintains its sovereignty by operating within its country's laws. In the United States, the National Central Bureau operates by statute, and answers to the Assistant Secretary of the Treasury and to the Congress.

Functions of INTERPOL

INTERPOL's function is to provide the coordination and communications mechanism for law enforcement agencies (local, state or Federal) having a foreign investigative requirement and to transmit that requirement to other appropriate foreign law enforcement agencies. INTERPOL has no investigative force of its own and carries on no investigations. It has no control over its constituent

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countries' police forces. Its function is that of transmitting information or requests for action by one country's police to another country's police. Compliance with these requests is at the discretion of the recipient country, depending on their laws, type of crime, etc.

The requests for information or action which are handled by INTERPOL range from a simple criminal record check to a full investigation. Sometimes INTERPOL's valuable service may be merely to locate a person wanted either by the United States or one of the other 121 member countries. These services frequently result in the apprehension, extradition and prosecution of an international criminal who would otherwise continue to elude the authorities of several countries.

During FY 1976, the U.S. took an active role in the 44th INTERPOL General Assembly, the INTERPOL American Regional Conference, Crimes in Seaports and Airports Symposium, the European Drug Conference, and the European Regional Conference.

Member countries of INTERPOL, United States law enforcement agencies or any other organization, person, etc. with whom the United States may come into contact in the course of carrying out its responsibilities, have <u>no</u> direct access to criminal records in the United States. Requests from law enforcement agencies for information from the United States are evaluated individually by Federal agents assigned to the United States NCB and arrest or other information is provided as approved (1) by the agency from which the information is obtained and (2) by the responsible agent in the United States NCB. This is known as the "Third Agency Rule," and applies to all exchanges of information between enforcement agencies.

The procedure within INTERPOL requires the requesting country to state the nature of its investigative request, which includes identifying its investigation and the reason for the request. If this is not stated along with the request, the receiving country will make a request for that information prior to transmitting the request. The request must be in accord with the laws of the country receiving the request. Furthermore, the request must not be in conflict with Article III of the INTERPOL Constitution which reads, "It is strictly forbidden for the Organization to undertake any intervention or activities of a political, military, religious or racial character." This Article does not prohibit INTERPOL from assisting in a criminal inquiry concerning a political activist, religious sect, or other entity which engages in generally recognized criminal activity, such as bank robbery, murder, or fraud.

Litigation

A group known as the Church of Scientology is presently in litigation with various branches of the United States Government, including INTERPOL. INTERPOL has no objection to litigating the matters which are the subject of the suit before the Federal Courts and is confident of the outcome of this litigation. The Church of Scientology has, however, for reasons best known to itself, decided to "try its case" in the newspapers, attacking INTERPOL with calumnies to which, to this point, we have responded only in our testimony before you, Mr. Chairman, of May 6, 1975. The most scurrilous attack of this group is the allegation that INTERPOL somehow is, or was in the recent past, under Nazi influence. Probably the shortest refutation of this argument is the simple fact that Israel has been a fully participating member of INTERPOL since 1949.

It has also been argued that INTERPOL is a kind of private club not authorized by or responsible to the Congress. We would like to introduce for the record Title 22, Section 263a, authorizing the U.S. participation in INTERPOL, and the legislative history behind Public

Law 85-768, pursuant to which the Treasury Department's participation in INTERPOL was reported to and authorized by the Congress.

Conclusion

I have attached and submit for the record various operating statistics for our Washington National Central Bureau.

If INTERPOL did not exist, the same international inquiries and investigative request would be made by both U.S. and foreign enforcement agencies in a much more haphazard and costly fashion. The same information would be given out by the receiving agencies in a unilateral basis and without the additional filtering protection provided by the Constitution and long-standing practices of INTERPOL. The protection of rights in connection with this process is and must be the responsibility of the law enforcement agencies who approve the transmission of information. INTERPOL is a necessary, effective and efficient coordination and communications tool used by national enforcement agencies.

This concludes my statement. My associates and I will be pleased to answer any questions that the Committee may have.

Thank you.

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federal financing bank NEWS
WASHINGTON, D.C. 20220
Press inquiries: 202-964-2615

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FOR IMMEDIATE RELEASE

SUMMARY OF LENDING ACTIVITY

February 1 - February 15, 1976

Federal Financing Bank lending activity for the period February 1 through February 15, 1976 was announced as follows by Roland H. Cook, Secretary:

The Federal Financing Bank made the following loans to utility companies guaranteed by the Rural Electrification Administration:

Date	Borrower	Amount	Maturity	Interest Rate
2/2	St. Joseph Telephone Co.	$ 400,000	2/2/78	6.532%
2/10	Tri-State Generation % Transmission Association	2,972,000	12/31/10	8.221
2/11	Florida Central Telephone Co.	461,000	12/31/10	8.243
2/11	Colorado-Ute Electric Association	4,200,000	12/31/10	8.243
2/11	Cooperative Power Association	3,500,000	12/31/10	8.243
2/13	Allied Telephone Co.	296,000	12/31/10	8.214

Interest payments are made quarterly on the above loans.

The US Railway Association made the following drawings against Note No. 3, a $296 million renewable line of credit with the Bank:

Date	Amount	Maturity	Interest Rate
2/2	$29,000,000	2/23/76	4.969%
2/4	5,500,000	2/23/76	5.117

USRA borrowings from the FFB are guaranteed by the Department of Transportation.

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On February 4, the General Services Administration borrowed $502,059.00 under the Series M $190 million commitment with tha Bank. The interest rate is 8.299%. The loan matures June 15, 2005.

On February 13, GSA borrowed $875,019.23 under the Series L $107 million commitment with the Bank. The interest rate is 8.329%. The loan matures November 15, 2004.

On February 5, the Bank advanced $3,704,751.80 under a November 25, 1975 credit agreement with the National Railroad Passenger Corporation (Amtrak) and others to finance 26 GE Electric Locomotives. The agreement provides for serial repayments with a final maturity date of July 15, 1989. The interest rate, set at the time of the advance, is 8.125%.

On February 9, Amtrak borrowed $15 million against Note No. 6, a $130 million renewable line of credit with the Bank. The note matures March 30, 1976. The interest rate is 5.093%. Amtrak borrowings from the FFB are guaranteed by the Department of Transportation.

The Bank advanced $59,225.86 to the Government of China under Note No. 3 on February 10. The loan, which matures on December 31, 1982 and bears interest at a rate of 7.502%, is guaranteed by the Department of Defense under the Foreign Military Sales Act.

On February 11, the Federal Financing Bank paid $250,770,135.42 to the Secretary of Treasury for New York City Note #4. The face amount of the Note is $250 million and bears interest at a rate of 6.29%. The note matures June 20, 1976. The effective rate of return to the FFB is 5.415%. The Secretary of Treasury made the loan to New York City under the New York City Seasonal Financing Act of 1975.

On February 13, the Tennessee Valley Authority borrowed $25 million at an interest rate of 5.147%. The note matures on May 28, 1976.

Federal Financing Bank loans outstanding on February 15, 1976 totalled $19.7 billion.

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR RELEASE ON DELIVERY

STATEMENT BY EDWARD P. SNYDER
DIRECTOR, OFFICE OF DEBT ANALYSIS
U.S. TREASURY DEPARTMENT
BEFORE THE TASK FORCE ON TAX EXPENDITURES OF THE
HOUSE BUDGET COMMITTEE
FEBRUARY 25, 1976, 10:00 A.M.

Mr. Chairman and Members of the Task Force:

I am pleased to be here today to present the views of Treasury Department on the proposed mortgage interest tax credit. We have already responded, for the record, to the detailed and comprehensive list of questions provided by your staff concerning the credit. Thus, it may be most useful if I concentrate on an overview of the place of the MITC in the Administration's program for financial reform, as embodied in the Financial Institutions Act.

The MITC, as I am sure you know, was first proposed as housing and mortgage market recommendation 10 of the Hunt Commission Report; subsequently it became part of Title VII of the Financial Institutions Act of 1973, which was introduced in the 93rd Congress.

The mortgage interest tax credit was aimed at a number of objectives. In particular, it was intended to attract new mortgage lenders, so as to avoid any adverse effects on the mortgage market of the changes in financial institution asset and liability powers in the other six titles of the Act. The MITC was also expected to promote greater cyclical stability in mortgage lending and, therefore, in housing activity, and it was also intended to establish tax neutrality among financial institutions by providing a single, consistent tax treatment of mortgage interest.

The MITC is, of course, a tax credit based on interest income from residential mortgages. As originally proposed, individuals and partnerships could deduct from their tax bill 1 - 1/2 percent of any residential mortgage interest income they received from first liens on property or pass-throughs. Corporations, whose holdings of total assets in residential mortgages would have amounted to less than 10 percent would not be eligible for the credit; with a minimum investment of 10 percent of assets in eligible mortgages, however, corporations would be entitled to a 1 -]/2 percent credit, and the rate of credit would, thereafter, increase by 1/30th of a percentage point for each 1 percent increase in the ratio of qualified residential mortgages to total assets. Thus, for example, while a firm with only 10 percent of its assets in residential mortgages would receive a credit of 1 - 1/2 percent of mortgage interest income, a firm with 55 percent of its assets in residential mortgages would receive a credit of 3 percent of residential mortgage interest income, and a firm with 70 percent of assets in residential mortgages would receive a maximum credit of 3.5 percent of residential mortgage interest income as a credit against its tax bill.

Title VII of the FIA was amended in 1975 to permit S&L's and savings banks the option of continuing their special bad debt loss deduction up to December 1979, in lieu of an earlier mandatory conversion to the MITC, but the tax credit itself was unchanged. The Senate Banking Committee, however, subsequently expanded the tax credit to cover up to 80 percent of assets in residential mortgages. The maximum credit was also increased to 3.833 percent.

The mortgage interest tax credit can be a significant inducement for investors to acquire residential mortgages, because it may substantially increase the effective after-tax yield on such mortgages. The effect depends upon the tax rate of the investor, the contract rate of interest, and the rate of credit. For example, assuming a 48 percent tax rate, an investor who has invested 25 percent of total assets in residential mortgages would find that a mortgage with a before-tax yield of 9 percent could compete directly with other investments yielding up to 9.35 percent before taxes, a difference of 35 basis points. Similarly, an institution

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with 80 percent of its assets in residential mortgages would find that that same 9 percent mortgage would compete with an alternative investment yielding a 9.66 percent return, a difference of 66 basis points. Table 1 presents similar calculations for the entire range of portfolio shares from 10 to 80 percent, and for nominal or contract mortgage rates of interest varying between 5 and 12 percent.

There is, also, an additional, powerful incentive in the MITC which results from the progressive structure of the credit. The increase in the rate of credit from an increase in mortgages applies not only to new investments but to the existing portfolio. As a consequence, taking into account the increase in after-tax yield on the mortgages already held, the effective marginal yield on additional mortgage investment or disinvestment can be very high.

Table 2 shows the effective marginal yields, including the "portfolio effect". Thus, if an institution increases its holdings of 9 percent mortgages from 24 to 25 percent of total assets, the effective marginal before-tax yield is not merely 9.35 percent, but is instead 9.48 percent. For an institution increasing its portfolio share of residential mortgages from 79 to 80 percent of total assets, the effective marginal before-tax yield is raised to 10.12 percent, a difference of 112 basis points over the contract rate.

As I have indicated, a purpose of the tax credit is not only to induce S&L's and savings banks to maintain a basic commitment to mortgage lending, but also to attract new sources of mortgage financing, primarily commercial banks.

At the end of 1974 the commercial banking system held less than 9 percent of total assets in the form of residential mortgages. We have estimated that the incentive provided by the tax credit will induce most commercial banks to increase their holdings of residential mortgages to a minimum of 10 percent of assets. Subsequently, their mortgage holdings should grow at about the same rate as total assets, which since 1966 have grown at a rate of 9.8 percent per year. The MITC should induce commercial banks to increase their holdings of residential mortgages by some $10-15 billion initially, and then by about another $10 billion over the next 5 years, in addition to the mortgage lending they would have undertaken otherwise.

Table 1

Effective Before-Tax Yield on Residential Mortgages Due to the Mortgage Interest Tax Credit

Nominal Yield on Mortgages

PROPORTION	12	11	10	9	8	7	6	5
80	12.884	11.81	10.74	9.66	8.59	7.52	6.44	5.37
79	12.876	11.80	10.73	9.66	8.58	7.51	6.44	5.37
78	12.868	11.80	10.72	9.65	8.58	7.51	6.43	5.36
77	12.861	11.79	10.72	9.65	8.57	7.50	6.43	5.36
76	12.853	11.78	10.71	9.64	8.57	7.50	6.43	5.35
75	12.845	11.77	10.70	9.63	8.56	7.49	6.42	5.35
74	12.838	11.77	10.70	9.63	8.56	7.49	6.42	5.35
73	12.830	11.76	10.69	9.62	8.55	7.48	6.41	5.35
72	12.822	11.75	10.69	9.62	8.55	7.48	6.41	5.34
71	12.815	11.75	10.68	9.61	8.54	7.48	6.41	5.34
70	12.807	11.74	10.67	9.61	8.54	7.47	6.40	5.34
69	12.799	11.73	10.67	9.60	8.53	7.47	6.40	5.33
68	12.792	11.73	10.66	9.59	8.53	7.46	6.40	5.33
67	12.784	11.72	10.65	9.59	8.52	7.46	6.39	5.33
66	12.776	11.71	10.65	9.58	8.52	7.45	6.39	5.32
65	12.768	11.70	10.64	9.58	8.51	7.45	6.38	5.32
64	12.761	11.70	10.63	9.57	8.51	7.44	6.38	5.32
63	12.753	11.69	10.63	9.56	8.50	7.44	6.38	5.31
62	12.745	11.68	10.62	9.56	8.50	7.43	6.37	5.31
61	12.738	11.68	10.61	9.55	8.49	7.43	6.37	5.31
60	12.730	11.67	10.61	9.55	8.49	7.43	6.36	5.30
59	12.722	11.66	10.60	9.54	8.48	7.42	6.36	5.30
58	12.715	11.66	10.60	9.54	8.48	7.42	6.36	5.30
57	12.707	11.65	10.59	9.53	8.47	7.41	6.35	5.29
56	12.699	11.64	10.58	9.52	8.47	7.41	6.35	5.29
55	12.692	11.63	10.58	9.52	8.46	7.40	6.35	5.29
54	12.684	11.63	10.57	9.51	8.46	7.40	6.34	5.28
53	12.676	11.62	10.56	9.51	8.45	7.39	6.34	5.28
52	12.668	11.61	10.56	9.50	8.45	7.39	6.33	5.28
51	12.661	11.61	10.55	9.50	8.44	7.39	6.33	5.28
50	12.653	11.60	10.54	9.49	8.44	7.38	6.33	5.27
49	12.645	11.59	10.54	9.48	8.43	7.38	6.32	5.27
48	12.638	11.58	10.53	9.48	8.43	7.37	6.32	5.27
47	12.630	11.58	10.52	9.47	8.42	7.37	6.31	5.26
46	12.622	11.57	10.52	9.47	8.41	7.36	6.31	5.26
45	12.615	11.56	10.51	9.46	8.41	7.36	6.31	5.26
44	12.607	11.56	10.51	9.46	8.40	7.35	6.30	5.25
43	12.599	11.55	10.50	9.45	8.40	7.35	6.30	5.25
42	12.592	11.54	10.49	9.44	8.39	7.35	6.30	5.25
41	12.584	11.54	10.49	9.44	8.39	7.34	6.29	5.24
40	12.576	11.53	10.48	9.43	8.38	7.34	6.29	5.24
39	12.568	11.52	10.47	9.43	8.38	7.33	6.28	5.24
38	12.561	11.51	10.47	9.42	8.37	7.33	6.28	5.23
37	12.553	11.51	10.46	9.41	8.37	7.32	6.28	5.23
36	12.545	11.50	10.45	9.41	8.36	7.32	6.27	5.23
35	12.538	11.49	10.45	9.40	8.36	7.31	6.27	5.22
34	12.530	11.49	10.44	9.40	8.35	7.31	6.26	5.22
33	12.522	11.48	10.44	9.39	8.35	7.30	6.26	5.22
32	12.515	11.47	10.43	9.39	8.34	7.30	6.26	5.21
31	12.507	11.46	10.42	9.38	8.34	7.30	6.25	5.21
30	12.499	11.46	10.42	9.37	8.33	7.29	6.25	5.21
29	12.492	11.45	10.41	9.37	8.33	7.29	6.25	5.20
28	12.484	11.44	10.40	9.36	8.32	7.28	6.24	5.20
27	12.476	11.44	10.40	9.36	8.32	7.28	6.24	5.20
26	12.468	11.43	10.39	9.35	8.31	7.27	6.23	5.20
25	12.461	11.42	10.38	9.35	8.31	7.27	6.23	5.19
24	12.453	11.42	10.38	9.34	8.30	7.26	6.23	5.19
23	12.445	11.41	10.37	9.33	8.30	7.26	6.22	5.19
22	12.438	11.40	10.36	9.33	8.29	7.26	6.22	5.18
21	12.430	11.39	10.36	9.32	8.29	7.25	6.21	5.18
20	12.422	11.39	10.35	9.32	8.28	7.25	6.21	5.18
19	12.415	11.38	10.35	9.31	8.28	7.24	6.21	5.17
18	12.407	11.37	10.34	9.31	8.27	7.24	6.20	5.17
17	12.399	11.37	10.33	9.30	8.27	7.23	6.20	5.17
16	12.392	11.36	10.33	9.29	8.26	7.23	6.20	5.16
15	12.384	11.35	10.32	9.29	8.26	7.22	6.19	5.16
14	12.376	11.34	10.31	9.28	8.25	7.22	6.19	5.16
13	12.368	11.34	10.31	9.28	8.25	7.21	6.18	5.15
12	12.361	11.33	10.30	9.27	8.24	7.21	6.18	5.15
11	12.353	11.32	10.29	9.26	8.24	7.21	6.18	5.15
10	12.345	11.32	10.29	9.26	8.23	7.20	6.17	5.14

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Table 2

Effective Before-Tax Yield on Residential Mortgages with a MITC and Allowing for the Portfolio Impact

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Nominal Yield on Mortgages

PROPORTION	12	11	10	9	8	7	6	5
80	13.49	12.37	11.24	10.12	8.99	7.87	6.75	5.62
79	13.48	12.35	11.23	10.11	8.98	7.86	6.74	5.62
78	13.46	12.34	11.22	10.10	8.97	7.85	6.73	5.61
77	13.45	12.32	11.20	10.08	8.96	7.84	6.72	5.61
76	13.43	12.31	11.19	10.07	8.95	7.83	6.71	5.60
75	13.41	12.30	11.18	10.06	8.94	7.83	6.71	5.59
74	13.40	12.28	11.17	10.05	8.93	7.82	6.70	5.58
73	13.38	12.27	11.15	10.04	8.92	7.81	6.69	5.58
72	13.37	12.25	11.14	10.03	8.91	7.80	6.68	5.57
71	13.35	12.24	11.13	10.01	8.90	7.79	6.66	5.56
70	13.34	12.23	11.11	10.00	8.89	7.78	6.67	5.56
69	13.32	12.21	11.10	9.99	8.88	7.77	6.66	5.55
68	13.31	12.20	11.09	9.98	8.87	7.76	6.65	5.54
67	13.29	12.18	11.08	9.97	8.86	7.75	6.65	5.54
66	13.28	12.17	11.06	9.96	8.85	7.74	6.64	5.53
65	13.26	12.16	11.05	9.95	8.84	7.74	6.63	5.53
64	13.25	12.14	11.04	9.93	8.83	7.73	6.62	5.52
63	13.23	12.13	11.02	9.92	8.82	7.72	6.62	5.51
62	13.21	12.11	11.01	9.91	8.81	7.71	6.61	5.51
61	13.20	12.10	11.00	9.90	8.80	7.70	6.60	5.50
60	13.18	12.09	10.99	9.69	8.79	7.69	6.59	5.49
59	13.17	12.07	10.97	9.88	8.78	7.68	6.58	5.49
58	13.15	12.06	10.96	9.86	8.77	7.67	6.58	5.48
57	13.14	12.04	10.95	9.85	8.76	7.66	6.57	5.47
56	13.12	12.03	10.94	9.84	8.75	7.65	6.56	5.47
55	13.11	12.01	10.92	9.63	8.74	7.65	6.55	5.46
54	13.09	12.00	10.91	9.82	8.73	7.64	6.55	5.45
53	13.08	11.99	10.90	9.81	8.72	7.63	6.54	5.45
52	13.06	11.97	10.88	9.80	8.71	7.62	6.53	5.44
51	13.05	11.96	10.67	9.78	8.70	7.61	6.52	5.44
50	13.03	11.94	10.86	9.77	8.69	7.60	6.51	5.43
49	13.01	11.93	10.65	9.76	8.68	7.59	6.51	5.42
48	13.00	11.92	10.83	9.75	8.67	7.58	6.50	5.42
47	12.98	11.90	10.82	9.74	8.66	7.57	6.49	5.41
46	12.97	11.89	10.81	9.73	8.65	7.56	6.48	5.41
45	12.95	11.87	10.79	9.71	8.64	7.56	6.48	5.40
44	12.94	11.86	10.78	9.70	8.63	7.55	6.47	5.39
43	12.92	11.85	10.77	9.69	8.61	7.54	6.46	5.38
42	12.91	11.53	10.76	9.66	8.60	7.53	6.45	5.38
41	12.69	11.82	10.74	9.67	8.59	7.52	6.45	5.37
40	12.68	11.80	10.73	9.66	8.58	7.51	6.44	5.37
39	12.86	11.79	10.72	9.65	8.57	7.50	6.43	5.36
38	12.85	11.77	10.70	9.63	8.56	7.49	6.42	5.35
37	12.83	11.76	10.69	9.62	8.55	7.48	6.42	5.35
36	12.81	11.75	10.68	9.61	8.54	7.48	6.41	5.34
35	12.80	11.73	10.67	9.60	8.53	7.47	6.40	5.33
34	12.78	11.72	10.65	9.59	8.52	7.46	6.39	5.33
33	12.77	11.70	10.64	9.58	8.51	7.45	6.38	5.32
32	12.75	11.69	10.63	9.56	8.50	7.44	6.38	5.31
31	12.74	11.68	10.61	9.55	8.49	7.43	6.37	5.31
30	12.72	11.66	10.60	9.54	8.48	7.42	6.36	5.30
29	12.71	11.65	10.59	9.53	8.47	7.41	6.35	5.29
28	12.69	11.63	10.58	9.52	8.46	7.40	6.35	5.29
27	12.68	11.62	10.56	9.51	8.45	7.39	6.34	5.28
[illegible]	12.66	11.61	10.55	9.50	8.44	7.39	6.33	5.28
[illegible]	12.65	11.59	10.54	9.48	8.43	7.38	6.32	5.27
[illegible]	12.63	11.58	10.52	9.47	8.42	7.37	6.31	5.26
[illegible]	12.61	11.56	10.51	9.46	8.41	7.36	6.31	5.26
[illegible]	12.60	11.55	10.50	9.45	8.40	7.35	6.30	5.25
[illegible]	12.58	11.54	10.49	9.44	8.39	7.34	6.29	5.24
[illegible]	12.57	11.52	10.47	9.43	8.38	7.33	6.28	5.24
[illegible]	12.55	11.51	10.46	9.41	8.37	7.32	6.28	5.23
[illegible]	12.54	11.49	10.45	9.40	8.36	7.31	6.27	5.22
[illegible]	12.52	11.48	10.44	9.39	8.35	7.30	6.26	5.22
[illegible]	12.51	11.46	10.42	9.38	8.34	7.30	6.25	5.21
[illegible]	12.49	11.45	10.41	9.37	8.33	7.29	6.25	5.21
[illegible]	12.48	11.44	10.40	9.36	8.32	7.28	6.24	5.20
[illegible]	12.46	11.42	10.38	9.35	8.31	7.27	6.23	5.19
[illegible]	12.45	11.41	10.37	9.33	8.30	7.26	6.22	5.19
[illegible]	12.43	11.39	10.36	9.32	8.29	7.25	6.22	5.18
[illegible]	15.45	14.17	12.88	11.59	10.30	9.01	7.73	6.[illegible]

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We also believe that the mortgage interest tax credit will act as an automatic stabilizer for mortgage credit over the interest rate cycle. The present bad debt reserve provisions for mortgage-oriented thrift institutions provide the greatest return when profits are high, and the least when profits are low, thus accentuating the volatility of mortgage lending. On the other hand, the mortgage interest tax credit changes with gross mortgage interest income; therefore, it provides mortgage lenders with an increase in effective after-tax yield when interest rates are highest, and competition for funds is greatest, and it reduces this stimulus when interest rates are low and funds are plentiful for all purposes.

The Treasury Department has been seriously concerned about the stability of the supply of mortgage credit. I do not have to recite the familiar litany. We are all familiar with the housing cycle, and with the unemployment at one end and excessive inflation at the other. Instability in housing has involved costs for the consumer, the construction worker, and the supplier of construction materials. The mortgage interest tax credit, by bringing about greater stability in the flows of mortgage credit, could have a signficant impact on the health of the whole housing industry and all those associated with it.

Tax neutrality between competing depository financial institutions is a desirable objective. We can move a long way toward achieving this end, within the context of overall financial reform, by substituting the tax credit for the special tax preferences presently enjoyed by S&L's and savings banks, in such a way as to compensate them for their foregone special treatment while providing a statutorily equal treatment for all investors. This can be accomplished by the stepped rate of credit, which assures that mortgage-specializing institutions will receive a greater reward for their efforts. In this regard, then, the MITC

(1) will induce S&L's and savings banks to maintain their commitment to residential mortgage lending as well as attract other mortgage lenders, such as commercial banks, by enhancing the attraction of mortgage instruments; and

(2) will compensate S&L's and savings banks for their foregone special tax preferences.

The attached Table 3 shows our most recent estimates of the cost of the mortgage interest tax credit, by type of mortgage lender. The estimates allow for offsets from the elimination of the present tax preferences, and because we have assumed continuing portfolio growth with no change in portfolio composition, which is our standard procedure for revenue estimation, the estimates are probably conservative in the sense of being outside estimates. If growth should be lower than the assumed annual rates of 11 percent and the portfolio composition of investors changes, the actual costs would be somewhat below the present set of estimates.

In summary, Mr. Chairman, the mortgage interest tax credit from the beginning has been viewed as necessary for the balance and comprehensiveness of the reforms contained in the Financial Institutions Act.

The FIA seeks to modernize our financial structure and to correct its inability to function without excessive Federal intervention during periods of high interest rates. Because mortgage-oriented thrift institutions are unable to offer depositors services or rates of return on deposits which would enable them to compete with commercial banks and with non-depository institutions during periods of high interest rates, they have increasingly been paralyzed by savings outflows, and the residential mortgage market has been able to keep functioning only through the intervention of Federal agencies during these times. But even this, as a measure, has been self-defeating, because to finance home mortgages, Federal agencies have had to borrow in the capital markets creating further upward interest rate pressures which have contributed to the problems of the institutions.

The FIA is intended to remedy this situation by enabling mortgage-oriented thrift institutions to compete more effectively, allowing them to offer increased deposit and lending services, and by improving their ability to pay more competitive rates of interest on their deposits. While S&L's, and to a lesser extent mutual savings banks, are expected to remain primarily mortgage lenders, these broad objectives require that they be allowed more portfolio diversification.

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Table 3

Revenue Effects of Financial Institutions Act
(Tax Provisions Only) as Amended by Senate Banking Committee

	1976	1977	1978	1979	1980
Savings and loans:					
1. Repeal section 593	+388	+417	+450	+485	+538
2. Mortgage credit	-642	-713	-791	-877	-974
3. Cost of option 1/..............	-12	-10	-7	-4	0
4. Net revenue change	-266	-306	-348	-396	-436
Mutual savings banks:					
1. Repeal section 593	+57	+60	+65	+68	+77
2. Mortgage credit	-167	-185	-206	-229	-254
3. Net revenue change	-110	-125	-141	-161	-177
All others - mortgage credit:					
1. Life insurance companies	-42	-47	-52	-57	-64
2. Banks, etc.	-81	-90	-102	-114	-126
3. Individuals	-45	-50	-56	-62	-69
Total revenue change	-544	-618	-699	-790	-872

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1/ This is the additional revenue cost of allowing institutions to retain Section 593, in lieu of the credit, in 1976-1979. It is assumed that only 20 percent of SL's, and no MSB's, will exercise this option.

I should also like to point out that the beneficiaries of the mortgage interest tax credit will ultimately be the savers and the mortgage borrowers. Competition will achieve that result. Both savers and mortgage borrowers are interest-sensitive. Paying savers slightly higher interest rates will attract savings flows, while reducing mortgage rates by fairly small amounts will stimulate mortgage demand. By allowing the institution to respond in a flexible manner, consumers, whether in the guise of savers or borrowers, will reap the benefit. Thus, the mortgage interest tax credit is not simply a stimulus to housing, but an important element of financial reform, which takes into account the interest of the depositor as well as that of the borrower, and thus assumes that residential housing will not be adversely affected by the other elements of financial reform.

Throughout the introduction and debate on the financial institutions bill in the Senate and in the House, the Treasury Department and other witnesses have testified to the desirability of a balanced and comprehensive reform program. Viewed as a part of the overall program of financial reform, the mortgage interest tax credit is a necessary complement to the expanded range of services to be offered to consumers, savers, and home buyers.

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Responses to Questions

1. What would be the annual gross revenue loss from the proposed mortgage interest tax credit for the period 1977-81? How much of this loss would be offset by revenue gains from repeal of excess bad debt loss reserve provisions? Upon what assumptions are these revenue estimates based? How reliable are these assumptions?

A. Our most recent estimates are appended, as are the assumptions on which the calculations were based. Perhaps most important of the latter is the assumption that relative mortgage holdings and the supply and demand for mortgage credit are unchanged by the credit. While this is a standard procedure when projecting revenue estimates it may overstate the cost.

Although we do not have firm estimates, we do have reason to believe that the mortgage demand of S&L's will be reduced under the FIA, relative to the demand for other assets. This would reduce the gross tax credit, as well as the repeal of 593 offset. If the ratios of these factors projected in the chart are used as a guide there might well be a modest reduction in cost. In addition, the estimates do not allow for secondary impacts, such as later recovery of the credit after distribution to depositors, or a reduction due to a probable decline in mortgage rates below what they otherwise would have been.

On balance, the attached figures are most likely outside estimates of the cost.

Revenue Effects of Financial Institutions Act
(Tax Provisions Only) as Amended by Senate Banking Committee

	1976	1977	1978	1979	1980
Savings and loans:					
1. Repeal section 593	+388	+417	+450	+485	+538
2. Mortgage credit	-642	-713	-791	-877	-974
3. Cost of option 1/..............	-12	-10	-7	-4	0
4. Net revenue change	-266	-306	-348	-396	-436
Mutual savings banks:					
1. Repeal section 593	+57	+60	+65	+68	+77
2. Mortgage credit	-167	-185	-206	-229	-254
3. Net revenue change	-110	-125	-141	-161	-177
All others - mortgage credit:					
1. Life insurance companies	-42	-47	-52	-57	-64
2. Banks, etc.	-81	-90	-102	-114	-126
3. Individuals	-45	-50	-56	-62	-69
Total revenue change	-544	-618	-699	-790	-872

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December 22, 1975

1/ This is the additional revenue cost of allowing institutions to retain Section 593, in lieu of the credit, in 1976-1979. It is assumed that only 20 percent of SL's, and no MSB's, will exercise this option.

Technical Notes on Estimates
of Revenue Effects of Financial Institutions Act

1. Growth rate. Residential mortgages held by private financial institutions were $277.1 billion at the end of 1970, and $409.1 billion at the end of September, 1974. (FRB, Dec., '74, p. A-44.) This represents an annual growth rate of 10.95 percent, which was rounded to 11 percent and used whenever extrapolation was necessary in the entire project.

2. Effect of option. Estimates have been made independently for repeal of Section 593 and for the mortgage tax credit on the assumption that both would take effect in 1976 for all taxpayers. But under the proposal, each taxpayer is to have a choice of which of the five years 1976-1980 it is to come under the new plan. The option is irrevocable and becomes a requirement in 1980. Since taxpayers will switch to the new plan only when they consider it favorable to them, the option increases the revenue loss under the Act.

For mutual savings banks, the credit is (in the aggregate) three times as favorable as Section 593, and it is assumed that all will change to the new plan at the first opportunity. For savings and loan associations, the old plan is relatively more attractive, and it is assumed that 20 percent of these will postpone their election, in equal proportions, to 1977, 1978, 1979, or 1980. Further, the nonelecting companies are assumed to save 10 percent more from Section 593 than they would have saved from the credit.

These assumptions are arbitrary but they are apparently not very sensitive, since the additional revenue loss caused by the option works out to only $12 million in 1976.

3. All of these estimates refer to calendar year liabilities.

4. It is assumed that FNMA and other Federal and related agencies are ineligible for the credit.

5. Inconsistency with prior estimates. The effect of Section 593 has been estimated before, both by OTA and by the Joint Committe on Internal Revenue Taxation. The present estimates are lower, for two reasons:

(a) The tax data from the 1971 Sourcebook were not available when the earlier estimates were made, so the "assumed base" could not be calculated. Instead, various published "net income" series were used, with or without various adjustments; and these proved to be too high.

(b) The "minimum tax" was not considered in the earlier estimates. These estimates are therefore refinements of the earlier ones and should be used in place of them.

6. Section 585 as alternative. Under the proposal, thirft institutions disqualified from using Section 593 will become eligible for Section 585, which now provides a tax preference for commercial banks. However, the thrift institutions will derive no tax preference from Section 585, since, for the remainder of this century, their reserves will exceed the limits set by that section. Thus, the thrift institutions will deduct only their actual bad debt losses.

7. Other assumptions were needed to make the Treasury estimates consistent with those of the Senate Banking Committee Staff and the National Savings and Loan Study. These include (1) a 3.75 percent rate of credit for S&L's corresponding to a 77.5 percent of assets in qualifying mortgages and (2) the eligibility of 60 percent of mortgage income received by commercial banks and other financial institutions for the credit.

2. How much of the net tax reduction from the credit would go to different types of financial institutions (savings and loan associations, mutual savings banks, commercial banks and others), and how would it be distributed by size of institution?

A. The first part of the question was dealt with in the answer to question No. 1. Although we have not dealt explicitly with the size distribution of the credit, a National Savings and Loan League study, conducted by Kenneth Biederman, of Georgetown University and formerly of the Treasury Department and John Tuccillo of HUD, has estimated the size distributional impact. Tables II-5 and II-6 from the summary report, "The Taxation of Financial Intermediaries" (1975), attached, suggest that the tax savings are relatively independent of size. All categories receive an equal effective tax rate under the assumptions of below average growth in assets with both low and high rates of before tax income, and a 3.5 percent rate of credit.

Table II-5

A Comparison of Average Tax Bills and Tax Rates for Savings and Loan Associations
Under the Bad Debt Allowance (Full Phase-In) and the Proposed Mortgage
Tax Credit, by Asset Size of Association, 1979 Levels
(Average Return on Portfolio = 7 Percent)[a]

(Below Average Growth in Assets--High Rate of Net Return)

Asset Size Class ($ millions)	Average Tax Bill-- Bad Debt Allowance (BDA) ($000)	Average Tax Bill-- Mortgage Tax Credit (3-1/2%) ($000)	Tax Rate-- Bad Debt Allowance (BDA) (percent)	Tax Rate-- Mortgage Tax Credit (3-1/2 (percent)
Less than 10	19.5	16.4	29.2%	24.7%
10-25	54.1	45.8	29.1	24.7
25-50	117.0	98.3	29.4	24.7
50-100	223.7	189.8	29.1	24.7
100-250	485.2	408.9	29.3	24.7
More than 250	1592.0	1363.5	28.8	24.7

[a]Source: Sample of 1000 Associations, 1973 Data Base.

Notes:

1. These are projections based on the assumption of continued activities similar to current portfolio structure.
2. No allowances made for first $25,000 exemption from 26% corporate surcharge; therefore, all rates on small associations marginally overstated.
3. Figures do not show minimum tax. Add about 10% to <u>Tax Bill</u> under BDA and 10-12% to <u>Tax Rates</u> unde BDA to reflect effect of minimum tax.

Table II-6

A Comparison of Average Tax Bills and Tax Rates for Savings and Loan Associations Under the Bad Debt Allowance (Full Phase-In) and the Proposed Mortgage Tax Credit, by Asset Size of Association, 1979 Levels[a]

(Below Average Growth in Assets--Low Rate of Net Return)

Asset Size Class ($ millions)	Average Tax Bill-- Bad Debt Allowance (BDA) ($000)	Average Tax Bill-- Mortgage Tax Credit (3-1/2%) ($000)	Tax Rate-- Bad Debt Allowance (BDA) (percent)	Tax Rate-- Mortgage Tax Credit (3-1/2% (percent)
Less than 10	12.5	5.8	29.0%	13.0%
10-25	35.6	16.1	28.8	13.0
25-50	76.5	34.5	28.8	13.0
50-100	147.7	66.7	28.8	13.0
100-250	318.3	143.7	28.8	13.0
More than 250	1061.3	479.0	28.8	13.0

[a]Source: Sample of 1000 Associations, 1973 Data Base.

Notes:

1. These are projections based on assumption of continued activities similar to current portfolio structure.
2. No allowances made for first $25,000 exemption from 26% corporate surcharge; therefore, all rates on small associations marginally overstated.
3. Figures do not show minimum tax. Add about 10% to <u>Tax Bill</u> under BDA and 10-12% to <u>Tax Rates</u> under BDA to reflect effect of minimum tax.

3. How have the effective tax rates on economic income (as defined in the 1968 Treasury Tax Reform Studies and Proposals, pp. 458-75) for commercial banks, savings and loan associations, and mutual savings banks changed from 1967-76? How would these rates be affected during the period from 1977-81 by the proposed mortgage interest tax credit and the phase out of excess bad debt reserves?

A. Tables A-C based on the most recent consistent set of financial statement definitions show effective Federal income tax rates on insured commercial banks, insured savings and loan associations and insured mutual savings banks.

Over the period covered in the tables, savings and loan associations averaged the highest "effective" income tax rate, about 24 percent. Commercial banks averaged the lowest "effective" tax rate of about 18 percent. Mutual savings banks averaged an "effective" tax rate in between.

But it is important to keep these measures of "effective" tax rate in perspective. The corporation income tax to which all banks are subject is a tax <u>only</u> on the income attributable to bank equity. That portion of the gross income of banks--and of all corporations--which is paid out to employees and to cover other operating expenses becomes income taxable to these contributing factors of production; and the income paid out to depositors and other creditors of the banks becomes taxable income to these individuals and firms. Only the residual is taxable income of the banks, and the taxability of this portion only varies with the tax rules for income measurement.

Due to the fact that banks characteristically finance their asset holdings largely with funds supplied by depositors, the corporation income tax wedge in the gross income of banks--a cost which must be covered in the rates and service charges levied by banks--is exceedingly small. For savings and loan associations this wedge, <u>i.e.</u>, the tax burden on the totality of the banks' activities, is running at only 2.5 percent, for mutual savings banks 1.3 percent, and for commercial banks about 2.5 percent. Mutual savings banks reflect the smallest tax burden because these banks operate with substantially smaller equity ratios, characteristically allocating a larger share of gross income to depositors.

Corresponding to the estimates of increased revenue loss resulting from the replacement of artificial bad debt deductions by the MITC, it is to be expected that the tax wedge, "effective" tax rates, on banks will shrink. Part of this shrinkage will be absorbed in lower nominal rates on mortgage loans, part in higher interest payments to depositors and other creditors of banks. There is no reason to believe that after-tax rates of return on equity to banking institutions will be increased by the tax subsidy to mortgage lending.

Table A

Income, Income Shares, and Income Taxes:
Insured Commercial Banks, 1969-74

	1969	1970	1971	1972	1973	1974
Gross Income: (millions)	$30,299	$34,456	$36,710	$40,439	$52,994	$68,018
Percentage distribution:						
Administrative and operating expenses	43.4%	45.2%	45.1%	44.2%	38.9%	36.0%
Interest paid depositors & creditors	37.7	35.8	36.6	38.1	45.7	51.2
Income attributable to equity	18.9	19.0	18.3	17.7	15.4	12.8
Federal income tax	4.3	4.7	3.7	3.2	2.5	2.0
Net income after tax	14.6	14.3	14.6	14.5	12.9	10.8
Federal income tax as percent of income attributable to equity	22.5	24.7	20.3	18.0	16.4	15.5
Rate of return on equity (percent)	11.6	12.0	12.0	11.8	12.4	12.1
Return on total assets* (percent)	3.3	3.5	3.3	3.3	4.2	5.0
Provisions for loan losses as a percent of gross income	1.7	2.0	2.4	2.4	2.4	2.4

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Source: Annual Report of the Federal Deposit Insurance Corporation.

*Gross Income less operating and administrative expense divided by total assets.

Table B

Income, Income Shares, and Income Taxes:
Insured Mutual Savings Banks, 1969-74

	1969	1970	1971	1972	1973	1974
Gross Income: (millions)	$ 3,523	$ 3,754	$ 4,471	$ 5,280	$ 5,973	$ 6,335
Percentage distribution:						
Administrative and operating expenses	13.7%	14.8%	14.2%	14.1%	14.6%	15.1%
Interest paid depositors & creditors	80.0	80.1	76.6	74.8	75.5	78.7
Income attributable to equity	6.3	5.1	9.2	11.1	9.9	6.2
Federal income tax	0.4	0.7	1.4	2.1	1.9	1.3
Net income after tax	5.9	4.4	7.7	9.1	8.0	5.0
Federal income tax as percent of income attributable to equity	6.3	13.0	15.7	18.5	19.4	20.3
Rate of return on equity (percent)	4.4	3.4	6.6	8.4	7.6	4.8
Return on total assets* (percent)	4.8	4.8	5.2	5.5	5.6	5.7
Net loan losses as a percent of gross income	<0.1	<0.1	0.1	0.1	0.2	0.2

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Source: Annual Report of the Federal Deposit Insurance Corporation.

*Gross Income less operating and administrative expense divided by total assets.

Table C

Income, Income Shares, and Income Taxes:
Insured Savings and Loan Associations, 1971-74

	1971	1972	1973	1974
Gross Income: (millions)	$12,833	$15,323	$18,392	$21,102
Percentage distribution:				
Administrative and operating expenses	17.8%	17.4%	17.8%	17.9%
Interest paid depositors & creditors	69.2	68.2	68.5	72.6
Income attributable to equity	13.0	14.4	13.7	9.5
Federal income tax	2.8	3.4	3.4	2.5
Net income after tax	10.2	11.0	10.3	7.0
Federal income tax as percent of income attributable to equity	21.5	23.5	24.7	26.4
Rate of return on equity (percent)	10.1	11.5	11,5	8.3
Return on total assets* (percent)	5.3	5.4	5.7	6.0
Net loan on losses as a percent of gross income	N.A.	0.2	0.3	0.4

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*Gross Income less operating and administrative expense divided by total assets.

Date prior to 1971 not available on a comparable basis.

Source: FSLIC - Insured savings and loan associations, combined financial statements; net loan losses unpublished data.

4. What would be the impact of the Financial Institutions Act regulatory reforms on mortgage lending, housing, housing production, costs to home buyers, and cyclical fluctuations in the housing industry? How would this impact be modified by the proposed mortgage interest tax credit (and the phaseout of excess bad debt reserves)? Would there be a difference between the impact in the short run (2-3 years) and the long run (5-10 years)?

A. The regulatory reforms (expanded asset and liability powers) are intended to break mortgage-oriented thrifts free from the boom and bust instability in their savings flows occasioned by shifts in monetary policy and the economy. As a result:

(1) the impact on mortgage credit would be to reduce its volatility and increase its general availability as sharp swings in savings flows are reduced;

(2) the impact on housing fluctuations would be to moderate them through a more constant availability of mortgage credit at moderate rates; and

(3) the impact on housing production and costs to homebuyers would be to stabilize production and reduce those costs resulting from the unemployment of resources and the elimination of firms during housing recessions and the consequent shortages of men and materials during construction booms.

The increased deposit stability would be achieved through a greater portfolio diversification on the part of mortgage-oriented thrift institutions. Although we do not anticipate a reduction in the overall supply of mortgage credit as a consequence, it remains a possibility. The MITC would nullify this likelihood by broadening the base of mortgage supply and increasing the effective yields on mortgages to investors. This would enable S&L's and savings banks to maintain their mortgage commitment more advantageously, and would encourage a greater degree of mortgage investment from commercial banks, other financial institutions and individuals.

The phasing out of the bad debt reserve tax preference would restore tax neutrality between competing financial

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institutions. The rate of tax credit has been calculated to compensate S&L's and MSB's for the reduced incentive to invest in residential mortgages resulting from the elimination of this measure.

Our best estimates of the long run impact as compared to the short run are derived from the simulations performed by Patric Hendershott for HUD. He found that both short run and long run impacts would be stimulative, especially the former. His simulations dealt explicitly only with the long run impacts -- the post transition period.

5. Would the proposed mortgage interest tax credit be more or less effective in encouraging mortgage lending than the present excess bad debt loss provisions?

A. There are several reasons to believe the MITC to be superior to the present set of tax preferences. First, the mortgage interest tax credit would lead to a greater stability in the flow of mortgage credit than the present bad debt loss provision. The latter provides an incentive for S&L's to increase their mortgage lending when profits are high. Since periods of high profitability typically occur when short-term yields are low relative to long-term yields, this incentive comes when it is least needed, and can add to the instability of mortgage flows. The mortgage interest tax credit, on the other hand, since it is a percentage of the gross interest income received from mortgage lending, increases in value to S&L's as interest rates rise and decreases in value as interest rates fall.

For example, an S&L with a portfolio containing 80 percent residential mortgages would find that under the mortgage interest tax credit a mortgage with a contract rate of 7 percent would actually have an effective before-tax rate of 7.52 percent, a gain of 52 basis points. If interest rates were to rise so that the same S&L were to receive a contract rate of 10 percent on its mortgage loan, the effective before-tax yield on that mortgage would be 10.74 percent, a gain of 74 basis points, and an increase of 22 basis points over the 7 percent loan. In short, the tax credit makes residential mortgages a relatively more attractive investment when interest rates are high, thus tending to stabilize the flow of mortgage lending.

Ralated to this point is the fact that the MITC raises the effective after-tax yields of mortgages., making them more competitive with other types of investment. The incentive varies with the tax rate, the contract rate of interest, and the share of total assets of the investor devoted to qualified residential mortgages. Table 1 shows the before-tax yields on alternative investments that would be necessary before they would be competitive with mortgages of comparable risk and maturity and of given nominal yields (contract rates) for the range of possible portfolio shares.

The mortgage interest tax credit presents a strong additional incentive for S&L's to maintain their traditional mortgage lending roles. For each percentage of total assets that residential mortgage loans fall below 80 percent, the rate of credit decreases by 1/30th of 1 percent, and it decreases to zero if qualified mortgage loans drop below 10 percent of total assets. This is a powerful incentive to stay in mortgage lending, since each 1/30th of a percent reduction applies not only to the interest earned on the foregone mortgage loans, but to the interest earned on the mortgages remaining in the portfolio as well. For example, suppose an S&L is at 80 percent qualified residential mortgage loans in its portfolio, and that all such loans bear a contract rate of interest of 9 percent. The effective before-tax yield on each of the loans would be about 9.66 percent, of which 66 basis points can be attributed to the MITC. If there is a reduction in mortgage holdings of 1 percent of total assets, the 9.66 percent on that 1 percent of portfolio is foregone, of course. In addition, .57 basis points is foregone on the remainder of the residential mortgage portfolio, which multiplied by 79 percent of total assets gives about 46 additional basis points which must be added to the value of the foregone mortgages. Thus, instead of foregoing an effective 9.66 percent yield, the S&L is effectively foregoing mortgages with a 10.12 percent yield.

Table 2 summarizes this additional incentive to hold mortgages by share of portfolio and by contract rate or nominal yield, under the simplifying assumption that all mortgages in the portfolio carry the same rate of interest. Not only is it a disincentive for institutions to disinvest, it is also a powerful incentive for financial institutions to acquire residential mortgages.

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Table 1

Effective Before-Tax Yield on Residential Mortgages Due to the Mortgage Interest Tax Credit

	Nominal Yield on Mortgages						
'OPORTION 12	11	10	9	8	7	6	5
12.884	11.81	10.74	9.66	8.59	7.52	6.44	5.37
12.876	11.80	10.73	9.66	8.58	7.51	6.44	5.37
12.868	11.80	10.72	9.65	8.58	7.51	6.43	5.36
12.861	11.79	10.72	9.65	8.57	7.50	6.43	5.36
12.853	11.78	10.71	9.64	8.57	7.50	6.43	5.36
12.845	11.77	10.70	9.63	8.56	7.49	6.42	5.35
12.838	11.77	10.70	9.63	8.56	7.49	6.42	5.35
12.830	11.76	10.69	9.62	8.55	7.48	6.41	5.35
12.822	11.75	10.69	9.62	8.55	7.48	6.41	5.34
12.815	11.75	10.68	9.61	8.54	7.48	6.41	5.34
12.807	11.74	10.67	9.61	8.54	7.47	6.40	5.34
12.799	11.73	10.67	9.60	8.53	7.47	6.40	5.33
12.792	11.73	10.66	9.59	8.53	7.46	6.40	5.33
12.784	11.72	10.65	9.59	8.52	7.46	6.39	5.33
12.776	11.71	10.65	9.58	8.52	7.45	6.39	5.32
12.768	11.70	10.64	9.58	8.51	7.45	6.38	5.32
12.761	11.70	10.63	9.57	8.51	7.44	6.38	5.32
12.753	11.69	10.63	9.56	8.50	7.44	6.38	5.31
12.745	11.68	10.62	9.56	8.50	7.43	6.37	5.31
12.738	11.68	10.61	9.55	8.49	7.43	6.37	5.31
12.730	11.67	10.61	9.55	8.49	7.43	6.36	5.30
12.722	11.66	10.60	9.54	8.48	7.42	6.36	5.30
12.715	11.66	10.60	9.54	8.48	7.42	6.36	5.30
12.707	11.65	10.59	9.53	8.47	7.41	6.35	5.29
12.699	11.64	10.58	9.52	8.47	7.41	6.35	5.29
12.692	11.63	10.58	9.52	8.46	7.40	6.35	5.29
12.684	11.63	10.57	9.51	8.46	7.40	6.34	5.28
12.676	11.62	10.56	9.51	8.45	7.39	6.34	5.28
12.668	11.61	10.56	9.50	8.45	7.39	6.33	5.28
12.661	11.61	10.55	9.50	8.44	7.39	6.33	5.28
12.653	11.60	10.54	9.49	8.44	7.38	6.33	5.27
12.645	11.59	10.54	9.48	8.43	7.38	6.32	5.27
12.638	11.58	10.53	9.48	8.43	7.37	6.32	5.27
12.630	11.58	10.52	9.47	8.42	7.37	6.31	5.26
12.622	11.57	10.52	9.47	8.41	7.36	6.31	5.26
12.615	11.56	10.51	9.46	8.41	7.36	6.31	5.26
12.607	11.56	10.51	9.46	8.40	7.35	6.30	5.25
12.599	11.55	10.50	9.45	8.40	7.35	6.30	5.25
12.592	11.54	10.49	9.44	8.39	7.35	6.30	5.25
12.584	11.54	10.49	9.44	8.39	7.34	6.29	5.24
12.576	11.53	10.48	9.43	8.38	7.34	6.29	5.24
12.568	11.52	10.47	9.43	8.38	7.33	6.28	5.24
12.561	11.51	10.47	9.42	8.37	7.33	6.28	5.23
12.553	11.51	10.46	9.41	8.37	7.32	6.28	5.23
12.545	11.50	10.45	9.41	8.36	7.32	6.27	5.23
12.538	11.49	10.45	9.40	8.36	7.31	6.27	5.22
12.530	11.49	10.44	9.40	8.35	7.31	6.26	5.22
12.522	11.48	10.44	9.39	8.35	7.30	6.26	5.22
12.515	11.47	10.43	9.39	8.34	7.30	6.26	5.21
12.507	11.46	10.42	9.38	8.34	7.30	6.25	5.21
12.499	11.46	10.42	9.37	8.33	7.29	6.25	5.21
12.492	11.45	10.41	9.37	8.33	7.29	6.25	5.20
12.484	11.44	10.40	9.36	8.32	7.28	6.24	5.20
12.476	11.44	10.40	9.36	8.32	7.28	6.24	5.20
12.468	11.43	10.39	9.35	8.31	7.27	6.23	5.20
12.461	11.42	10.38	9.35	8.31	7.27	6.23	5.19
12.453	11.42	10.38	9.34	8.30	7.26	6.23	5.19
12.445	11.41	10.37	9.33	8.30	7.26	6.22	5.19
12.438	11.40	10.36	9.33	8.29	7.26	6.22	5.18
12.430	11.39	10.36	9.32	8.29	7.25	6.21	5.18
12.422	11.39	10.35	9.32	8.28	7.25	6.21	5.18
12.415	11.38	10.35	9.31	8.28	7.24	6.21	5.17
12.407	11.37	10.34	9.31	8.27	7.24	6.20	5.17
12.399	11.37	10.33	9.30	8.27	7.23	6.20	5.17
12.392	11.36	10.33	9.29	8.26	7.23	6.20	5.16
12.384	11.35	10.32	9.29	8.26	7.22	6.19	5.16
12.376	11.34	10.31	9.28	8.25	7.22	6.19	5.16
12.368	11.34	10.31	9.28	8.25	7.21	6.18	5.15
12.361	11.33	10.30	9.27	8.24	7.21	6.18	5.15
12.353	11.32	10.29	9.26	8.24	7.21	6.18	5.15
12.345	11.32	10.29	9.26	8.23	7.20	6.17	5.14

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Table 2

Effective Before-Tax Yield on Residential Mortgages with a MITC and Allowing for the Portfolio Impact

PROPORTION	Nominal Yield on Mortgages 12	11	10	9	8	7	6	5
80	13.49	12.37	11.24	10.12	8.99	7.87	6.75	5.62
79	13.48	12.35	11.23	10.11	8.98	7.86	6.74	5.62
78	13.46	12.34	11.22	10.10	8.97	7.85	6.73	5.6[illegible]
77	13.45	12.32	11.20	10.08	8.96	7.84	6.72	5.6[illegible]
76	13.43	12.31	11.19	10.07	8.95	7.83	6.71	5.6[illegible]
75	13.41	12.30	11.18	10.06	8.94	7.83	6.71	5.5[illegible]
74	13.40	12.28	11.17	10.05	8.93	7.82	6.70	5.5[illegible]
73	13.38	12.27	11.15	10.04	8.92	7.81	6.69	5.5[illegible]
72	13.37	12.25	11.14	10.03	8.91	7.80	6.68	5.57
71	13.35	12.24	11.13	10.01	8.90	7.79	6.66	5.5[illegible]
70	13.34	12.23	11.11	10.00	8.89	7.78	6.67	5.5[illegible]
69	13.32	12.21	11.10	9.99	8.88	7.77	6.66	5.55
68	13.31	12.20	11.09	9.98	8.87	7.76	6.65	5.5[illegible]
67	13.29	12.18	11.08	9.97	8.86	7.75	6.65	5.5[illegible]
66	13.28	12.17	11.06	9.96	8.85	7.74	6.64	5.53
65	13.26	12.16	11.05	9.95	8.84	7.74	6.63	5.53
64	13.25	12.14	11.04	9.93	8.83	7.73	6.62	5.52
63	13.23	12.13	11.02	9.92	8.82	7.72	6.62	5.5[illegible]
62	13.21	12.11	11.01	9.91	8.81	7.71	6.61	5.5[illegible]
61	13.20	12.10	11.00	9.90	8.80	7.70	6.60	5.5[illegible]
60	13.18	12.09	10.99	9.89	8.79	7.69	6.59	5.49
59	13.17	12.07	10.97	9.88	8.78	7.68	6.58	5.4[illegible]
58	13.15	12.06	10.96	9.86	8.77	7.67	6.58	5.4[illegible]
57	13.14	12.04	10.95	9.85	8.76	7.66	6.57	5.[illegible]7
56	13.12	12.03	10.94	9.84	8.75	7.65	6.56	5.47
55	13.11	12.01	10.92	9.83	8.74	7.65	6.55	5.4[illegible]
54	13.09	12.00	10.91	9.82	8.73	7.64	6.55	5.4[illegible]
53	13.08	11.99	10.90	9.81	8.72	7.63	6.54	5.45
52	13.06	11.97	10.88	9.80	8.71	7.62	6.53	5.4[illegible]
51	13.05	11.96	10.87	9.78	8.70	7.61	6.52	5.4[illegible]
50	13.03	11.94	10.86	9.77	8.69	7.60	6.51	5.43
49	13.01	11.93	10.85	9.76	8.68	7.59	6.51	5.42
48	13.00	11.92	10.83	9.75	8.67	7.58	6.50	5.42
47	12.98	11.90	10.82	9.74	8.66	7.57	6.49	5.4[illegible]
46	12.97	11.89	10.81	9.73	8.65	7.56	6.48	5.4[illegible]
45	12.95	11.87	10.79	9.71	8.64	7.56	6.48	5.4[illegible]
44	12.94	11.86	10.78	9.70	8.63	7.55	6.47	5.3[illegible]
43	12.92	11.85	10.77	9.69	8.61	7.54	6.46	5.3[illegible]
42	12.91	11.83	10.76	9.68	8.60	7.53	6.45	5.3[illegible]
41	12.89	11.82	10.74	9.67	8.59	7.52	6.45	5.37
40	12.88	11.80	10.73	9.66	8.58	7.51	6.44	5.37
39	12.86	11.79	10.72	9.65	8.57	7.50	6.43	5.3[illegible]
38	12.85	11.77	10.70	9.63	8.56	7.49	6.42	5.35
37	12.83	11.76	10.69	9.62	8.55	7.48	6.42	5.35
36	12.81	11.75	10.68	9.61	8.54	7.48	6.41	5.3[illegible]
35	12.80	11.73	10.67	9.60	8.53	7.47	6.40	5.33
34	12.78	11.72	10.65	9.59	8.52	7.46	6.39	5.33
33	12.77	11.70	10.64	9.58	8.51	7.45	6.38	5.32
32	12.75	11.69	10.63	9.56	8.50	7.44	6.38	5.3[illegible]
31	12.74	11.68	10.61	9.55	8.49	7.43	6.37	5.3[illegible]
30	12.72	11.66	10.60	9.54	8.48	7.42	6.36	5.3[illegible]
29	12.71	11.65	10.59	9.53	8.47	7.41	6.35	5.2[illegible]
28	12.69	11.63	10.58	9.52	8.46	7.40	6.35	5.29
27	12.68	11.62	10.56	9.51	8.45	7.39	6.34	5.2[illegible]
26	12.66	11.61	10.55	9.50	8.44	7.39	6.33	5.2[illegible]
25	12.65	11.59	10.54	9.48	8.43	7.38	6.32	5.2[illegible]
24	12.63	11.58	10.52	9.47	8.42	7.37	6.31	5.2[illegible]
23	12.61	11.56	10.51	9.46	8.41	7.36	6.31	5.2[illegible]
22	12.60	11.55	10.50	9.45	8.40	7.35	6.30	5.2[illegible]
21	12.58	11.54	10.49	9.44	8.39	7.34	6.29	5.2[illegible]
20	12.57	11.52	10.47	9.43	8.38	7.33	6.28	5.2[illegible]
19	12.55	11.51	10.46	9.41	8.37	7.32	6.28	5.23
18	12.54	11.49	10.45	9.40	8.36	7.31	6.27	5.22
17	12.52	11.48	10.44	9.39	8.35	7.30	6.26	5.22
16	12.51	11.46	10.42	9.38	8.34	7.30	6.25	5.2[illegible]
15	12.49	11.45	10.41	9.37	8.33	7.29	6.25	5.2[illegible]
14	12.48	11.44	10.40	9.36	8.32	7.28	6.24	5.2[illegible]
13	12.46	11.42	10.38	9.35	8.31	7.27	6.23	5.1[illegible]
12	12.45	11.41	10.37	9.33	8.30	7.26	6.22	5.1[illegible]
11	12.43	11.39	10.36	9.32	8.29	7.25	6.22	5.1[illegible]
10	15.45	14.17	12.88	11.59	10.30	9.01	7.73	6.[illegible]

Office of the Secretary of the Treasury
Office of Debt Analysis

6. What would be the impact of the mortgage interest tax credit on the mortgage holdings of savings and loan associations, mutual savings banks, and commercial banks?

A. In the absence of the other measures it would increase them. However, for the S&L's and MSB's, the MITC as proposed would be accompanied by the elimination of the present bad debt loss reserve, which would increase the attraction of tax exempt investment as an alternative for these institutions. Partly as a consequence of this and partly due to the other provisions of the FIA, they would be likely to reduce their relative holdings of residential mortgages. Under these circumstances and allowing for the new investment powers of the FIA, the impact of the MITC would be to prevent their mortgage holdings from declining too rapidly or too far, and would provide them with additional income with which to attract deposits. With sufficient asset growth their mortgage holdings might even increase, although the relative share declined.

The MITC is intended to induce other financial institutions to fill the potential gap by increasing their participation in mortgage lending. We estimate that commercial banks, by simply bringing themselves up to the 10 percent of assets level could increase their mortgage holdings by at least $10-15 billion, after which their mortgage holdings should continue to grow at the same rate as the remainder of their portfolio If we assume that insured commercial banks' total assets of $912.5 billion on December 31, 1974, grow by a rate of 9.8 percent, then between 1976 and 1980 banks would add about $10 billion in new residential mortgage loans which could be directly attributed to the tax credit.

7. How much of the credit would be passed on to home buyers in the form of lower interest rates? How would this benefit to home buyers be distributed among individuals in different income classes? How much of the credit would be retained by financial institutions in the form of higher earnings?

A. Because there is some reason to believe that the demand for mortgages is relatively more interest-elastic than the supply there will be more impact on the volume of mortgage lending than on the rates. We expect rates to fall moderately (on the order of 25 basis points), based on the Hendershott study while the flow of mortgage credit is smoothed out. Since the mortgage rate is set by the last transaction to occur during a period of time, we expect the bulk of the credit to be passed to the institution in the form of higher earnings. From there much of it should flow to depositors in the form of increased services and to mortgage borrowers in the form of extended availability of credit, even when earnings fall.

8. Is a subsidy which goes to mortgage lenders more or less effective in encouraging additional housing production than a subsidy which goes directly to home buyers?

A. This would depend on the relative elasticities of supply and demand for mortgage credit and the elasticity of demand for time deposits at mortgage-oriented thrift institutions. Experience leads us to believe that the demand for time deposits is strongly interest elastic (e.g., the periodic crises of disintermediation) and that the demand for mortgage credit is more interest elastic than the supply, the latter largely determined by the volume of savings flows and future expectations concerning these flows. If such is the case then the institution is the logical recipient of the subsidy, where the competing forces of savings demand and mortgage credit demand will jointly determine savings rates and mortgage rates that are at the respectively highest and lowest levels to maximize mortgage flows.

9. If the credit were made refundable (i.e., payable whether or not the institution had tax liability), how much additional mortgage lending could be expected by pension funds, life insurance compaines, and other investors with little or no tax liability? What would be the additional revenue loss from making the credit refundable for the period 1977-81?

A. Life insurance companies and pension funds have been disinvesting in residential mortgages during the past 10 years, especially in 1-4 family home mortgages. It is not at all clear to us that simply making the tax credit refundable would have any impact at all. The attached table presenting historical data on the share of residential mortgages at these institutions and the corporate bond rate - residential mortgages rate spread illustrates the basis for our concern. A substantially higher subsidy could well be needed before any reversal of the historical trend would be noted.

Nondepository Financial Participation 1/ in the Residential Mortgage Market

Year	Life insurance	Private pension funds 2/	State and local gvt. retirement funds 2/	Mortgage rate - corporate bond rate spread 3/ (basis points)
1965	23.5	4.5	11.3	40
1966	23.5	5.2	12.1	37
1967	22.7	4.6	12.1	11
1968	21.5	4.0	11.6	1
1969	20.7	4.1	11.5	- 25
1970	19.9	3.9	11.7	- 41
1971	18.0	2.8	11.0	- 57
1972	16.0	1.9	9.4	- 39
1973	14.9	2.0	8.2	- 8
1974	14.2	2.3	7.4	- 58

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1/ Residential mortgage holdings as a percent of assets.
2/ Residential mortgage holdings as a percent of financial assets only.
3/ FHA mortgage yields and new "A" utility bonds.

Source: Life Insurance Fact Book, Institute of Life Insurance, Federal Reserve Flow of Funds, Salomon Brothers, An Anatylical Record of Yields and Yield Spreads.

10. Could modifications be made in the mortgage interest tax credit to make it a more effective device to encourage lending? Would a flat rate credit (i.e., a credit which did not have a higher rate for institutions with a higher percentage of their holdings in mortgages) be more or less effective in encouraging mortgage lending than the present sliding rate credit?

A. There are certainly ways in which the MITC could be made more cost effective, although some of them might prove to be difficult to administer. For example a tax credit

1. could be targeted towards different types of institutions with the rates of credit and steps (if any) chosen to elicit the greatest response from each,

2. could be keyed to an index of disintermediation, such as the Treasury 6-month bill rate -- 5 year note rate spread, which would ensure that it would only be available when needed, or

3. could have floating rates that vary not only with the share of residential mortgages in the portfolio, but also with a disintermediation index.

This is by no means an exhaustive list.

A flat rate credit would be an inferior device, because the strong marginal incentive to invest in residential mortgages (or to refrain from disinvesting excessively) would be lost.

Because any increase in effective before-tax yield resulting from the tax credit as a consequence of increasing the residential mortgage portfolio share would also go to income derived from all other residential mortgages, it might add in the neighborhood 30-40 of basis points to the yield on the last investment undertaken. Not only would this marginal incentive be lost under a flat rate system, but those who specialized less heavily would be rewarded as well as those who specialized more so, which might call up questions of equity.

11. Should the credit (or any alternative subsidy for mortgage lending) be limited to mortgages for low and middle income home buyers and/or for low and medium-priced homes?

A. It is not clear to us that limiting the MITC to low and middle income home buyers or for low and medium priced homes would result in a relative increase in the number of such homes. We believe that such a scheme would quickly result in the mortgage rates for other home buyers or homes being raised to competitive levels.

In addition, such a provision would prove to be difficult to enforce. There would be problems in choosing an equitable standard of income or price, and in policing home buyers and builders, who would certainly devise methods of achieving a superficial compliance with whatever regulations were set out, while actually responding to conditions determined by the workings of the housing and mortgage markets.

12. Should the credit (or any alternative subsidy) be limited only to new mortgage lending over and above the level of mortgage lending done previously by an institution, i.e., additional or new incremental lending?

A. While this appears to be desirable on the surface, we believe that it would be difficult to enforce in practice. In particular there would be a rush of "re-financings" which would be difficult to police properly.

An alternative might simply be to phase in a certain percentage of the credit each year until portfolios consisted only of "new mortgages." This however would rob the MITC of its primary appeal -- the impact it would have on a new mortgage investment, and would be likely to induce further complexity by forcing us to phase out the present tax preferences as a consequence.

13. Are there nontax alternatives that would be more effective and/or equitable in encouraging mortgage lending, increasing housing production, reducing costs to home buyers, and smoothing out the cyclical fluctuation in the housing industry?

A. Nontax alternatives do exist. For example a direct subsidy of mortgage credit, either as a one time payment to the originator or as an annual payment to the holder is one possibility. An expanded GNMA tandem program might be another. Subsidies could be scaled much like the MITC. The presumption would be, however, that in the absence of a tax credit thrifts would retain their present tax preferences.

As to whether direct subsidies would be as cost effective as the MITC, we have no evidence proving clear superiority of either approach. We believe the MITC would be a less expensive method because we would be able to eliminate the present tax preferences in the process. But it is possible that they could be eliminated under some sort of stepped subsidy arrangement; then the subsidy would have the additional advantages of periodic review and appropriations.

14. If a goal of tax policy is to provide for equal or uniform tax treatment of financial institutions, is the proposed mortgage interest tax credit an appropriate mechanism for doing so? Would other tax changes be more effective and/or equitable?

A. The mortgage interest tax credit moves in the right direction by making more equal the rules under which financial institutions operate. The structure of the mortgage interest tax credit itself gives a larger tax benefit to institutions holding a greater portion of assets in residential mortgages. Thus, the structure of the credit itself is not entirely neutral among financial institutions.

Treasury has always favored a uniform tax system based on standard income accounting. As noted in the answer to question 3 Federal income taxes are such a small portion of gross income that virtually undetectable changes in interest payments or charges would be required to adjust to a tax change. Thus, a question worthy of consideration by Congress is the degree of exceptional treatment that should be given to financial institutions.

15. Should the present tax treatment of bad debt loss reserves of savings and loan associations and mutual savings banks be continued?

A. One purpose of the bad debt reserve provision granted savings and loan associations and mutual savings banks was to encourage the growth of these institutions specializing in mortgage loans.

One of the intentions of the Financial Institutions Act is to diversify the sources of mortgage loans and other services among financial institutions, encouraging competition in the financial industry and protecting against the disruptions of disintermediation. Phasing out artificial bad debt loss provisions is a means of achieving this objective.

16. If commercial banks currently receive tax advantages not available to savings and loan associations and mutual savings banks, could tax equity be achieved by reducing the tax advantages of commercial banks? What tax changes should be considered?

A. It is not clear that commercial banks do receive significant tax advantages not available to savings and loan associations and mutual savings banks excepting an ability to invest in tax-exempt securities which is not fully available to savings and loan associations. The percentage method of calculating commercial bank bad debt reserves is still less favorable than the bad debt allowances provided the thrift institutions.

17. If the mortgage tax credit were enacted, should commercial banks be permitted to retain their "excess" bad debt allowances through 1987 and also receive the credit, while savings and loan associations and mutual savings banks are required to give up their excess bad debt reserves in exchange for the credit? In light of the recent increase in bad debt losses experienced by commercial banks, will the "percentage method" of calculating commercial bank bad debt reserves (1.2 percent of eligible loans through 1981, then 0.6 percent until 1988) continue to permit bad debt allowances in excess of actual losses calculated under the "experience method"?

A. The mortgage interest tax credit is structured to provide a higher rate of credit to financial institutions as they hold a greater portion of their assets in the form of residential mortgages. This will tend to encourage savings and loan associations and mutual savings banks to continue to hold mortgages, and to the extent they do, their taxability will be less than that of commercial banks. Whether commercial banks should be permitted to retain their "excess" bad debt allowances or otherwise be accorded equalizing tax preferences is a policy question which Congress may wish to consider on its merits.

Recent bad debt losses of commercial banks yield amounts that are still below tax allowances based on the percentage of eligible loans method referred to in the question.

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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NOTE TO CORRESPONDENTS: February 25, 1976

Attached is a preliminary analysis on "Tax Treatment of Income from International Shipping," prepared by the Office of International Taxation, for consideration by the House Ways and Means Committee Task Force on the Taxation of Foreign Income.

The analysis does not represent an Administration position and does not contain recommendations. Recommendations from the Treasury Department are expected to follow at a later date, after consultation with other agencies of the Executive Branch.

The attached preliminary analysis is the first in a series of five or six similar studies being prepared for the Ways and Means Task Force on foreign income taxation. Topics of the studies being prepared include State Taxation of Foreign Source Income, Income of Private Employees earned abroad, Tax-Free Allowances of Federal Employees Abroad, Deferral of U.S. Tax by Foreign Subsidiaries of U.S. Corporations, Limitations on the Use of Excess Foreign Tax Credits, and Expropriation Gains and Losses.

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Tax Treatment of Income from International Shipping

Department of the Treasury
February 1976

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PREFACE

This preliminary analysis was prepared by Marcia Field and Richard Gordon of the Office of International Tax Affairs for consideration by the House Ways and Means Committee Task Force on the Taxation of Foreign Income. The analysis does not represent an Administration position and does not contain recommendations. It is anticipated that the Treasury Department will make recommendations at a later date, after consultation with other agencies of the Executive branch.

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Part B: Tax Deferral

I. INTRODUCTION

The broad issue of what changes, if any, should be made in the taxation of income from international shipping operations has two aspects. The first aspect concerns the statutory exemption from U.S. income tax, on the basis of reciprocity, of foreign flag ships which engage in traffic to and from U.S. ports. This aspect also involves consideration of how U.S. tax is imposed on those foreign flag ships which do not qualify for the exemption.

The second aspect concerns U.S. taxation of foreign shipping corporations which are controlled by U.S. shareholders, whether or not they engage in traffic to and from U.S. ports. This aspect focuses on the deferral of U.S. tax for U.S. shareholders of controlled foreign corporations.

In formulating a coherent policy for the taxation of international shipping income the two aspects should be viewed together. However, since each raises distinct issues, they are considered separately in Parts A and B of this paper.

PART A: RECIPROCAL EXEMPTION

II. ISSUE

The issue is whether the statutory exemption from U.S. income tax of ships registered in foreign countries which provide an "equivalent exemption" to U.S. citizens and corporations should be repealed or amended.[1/]

The exemption is a departure from the general rules of taxing income from international business activities. Under the general rules, the country in which the business operations are conducted is granted the prior right to impose tax and the country of residence is granted the residual right. Since international shipping is likely to involve many countries in the course of a year, reserving the exclusive right to tax to the country of residence clearly has administrative advantages. But it also makes it attractive to establish residence and register ships in a country which does not tax foreign income. Shipping

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1/ See Internal Revenue Code Sections 872 (b) (1), 872 (b) (2), and 883(a). These sections also provide reciprocal exemption for foreign airlines, which is not discussed here. International airlines are generally government owned or subsidized, often operate at a loss, and rarely incorporate in tax haven countries. Thus, they raise different tax issues. The discussion of alternative methods of taxing those shipping companies which are not exempt from U.S. tax is relevant to airlines as well, however.

companies have great latitude in choosing their place of residence, and much of the world merchant fleet is registered in countries which impose no income tax. Since worldwide exemption was not the purpose of the reciprocal exemption of the Internal Revenue Code, the question arises whether those provisions should be amended or repealed.

III. PRESENT LAW

1. Equivalent exemption. Section 883(a)(1), excludes from the gross income of a foreign corporation the earnings derived from the operation of a ship documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States. Section 872(b)(1) contains a parallel provision for non-resident alien individuals. The IRS has taken the position that to qualify for the exemption the foreign country granting the exemption must be the country of registration of the vessel (Rev. Rul. 75-459, I.R.B. 1975-43, 11). This position reverses the "dual test" of an earlier ruling which held that the country granting the exemption must be not only the country of registration of the vessel (the "flag" test), but also the country of residence of the operator of the vessel (Rev. Rul. 73-350, 1973-2 C.B. 251).

The law is not clear on the circumstances under which income from leasing a ship qualifies as income from the operation of a ship. In general, income from time or voyage charters does qualify, but bareboat charter hire (payment for the use of the vessel alone without crew)

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may not be considered as income from the operation of a vessel but rather as rental income for the use of property. This result is implied in Rev. Rul. 74-170 (1974-1 C.B., 175) which held that a foreign corporation's income from leasing its ships under time or voyage charters, and the income of a foreign charterer from the operation of ships under time, voyage, or bareboat charters qualify for exemption as earnings from the operation of ships within the meaning of Section 883, while the income of an owner from leasing a ship under a bareboat charter is not exempt unless the ship owner is regularly engaged in the shipping business and the lease is merely an incidental activity. The question, however, cannot be considered as settled.[1/]

1/ The outcome can have significant tax consequences. If it does not qualify for the reciprocal exemption as income from the operation of a ship, bareboat charter hire is subject to U.S. tax, to the extent derived from U.S. sources, either at 30 percent of the gross rental (except where an income tax treaty provides more favorable treatment) or at the ordinary rates on net income if the income is "effectively connected" with a U.S. trade or business. The latter treatment would in many cases be less burdensome than a 30 percent tax on gross rentals because of the high deductions incurred in operating a ship; but to be "effectively connected" the income would have to meet the tests of Section 864(c)(2) and the regulations thereunder, principally the asset use test or the business activities test. Clearly there are serious administrative problems involved in making such a determination.

2. Treatment of income which does not qualify for reciprocal exemption. In those cases where the foreign country does not grant an equivalent exemption to U.S. citizens and corporations, the U.S. tax liability of the foreign shipper is determined by applying the ordinary U.S. tax rate to taxable income from U.S. sources. In the case of gross income derived from sources partly within and partly without the United States, Section 863(b) provides that taxable income may be computed by deducting expenses apportioned or allocated thereto and a ratable part of any expenses which cannot definitely be allocated to some item or class of gross income. The portion of the taxable income attributable to sources within the United States may be determined by processes or formulas of general apportionment prescribed by the Treasury. This provision is specifically made applicable to transportation income in Section 863(b)(1).

The original allocation published by the Treasury seemed to have provided that all of the income from an outward bound voyage from the United States was U.S. source income (T.D. 3111, 4 C.B. 380 (1921)). In 1922, this rule was abandoned in favor of the present rules (T.D. 3387, I-2 C.B. 153 (1922)).

The present rules (Regulation 1.863-4) involve a complicated formula by which the gross income from U.S. sources is considered to be that fraction of the total gross revenues which equals the fraction of (a) expenses incurred within the United States plus a reasonable rate of return on property used within the United States over (b) total expenses of the business and a reasonable return on the total business property. Expenses not directly attributable to U.S. operations are apportioned on the basis of days spent or miles traveled in U.S. waters to the total time and distance of the voyage. Property must be valued net of the appropriate depreciation measured by U.S. standards. Eight percent is ordinarily taken as a reasonable rate of return.

Under these rules, income from U.S. sources is limited to income allocable to operations within U.S. territorial waters. The United States observes a three mile limit to its territorial waters. All income derived on the high seas is regarded as income from sources outside the United States.

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IV. ANALYSIS

1. Impact on ocean freight rates. As a general matter, the U.S. tax on corporate income is approximately equivalent to a tax on equity capital. Contrary to popular belief, it is not a tax on economic profit. A tax on economic profit would require a deduction for the "normal" rate of return on equity capital in computing the taxable income base. No such deduction is permitted under U.S. tax law.

A tax on equity capital, like any other factor tax, will be reflected in a higher price of goods or services sold. As an approximation, a corporate income tax imposed at rate t on a single sector will raise the price of that sector's goods by tu, where u is the proportion of the sales price accounted for by corporate profit. In addition, there will be a small reduction in the after-tax rate of return to capital, but that effect will be spread over capital throughout the economy.

On the basis of these principles, it is easy to see that the reciprocal exemption of shipping income from corporate tax lowers the price of shipping services. Thus, if the reciprocal exemption were repealed, freight charges on U.S. imports and exports would rise to reflect the tax. Depending on the elasticities of demand and supply for imports and exports, the burden of the tax would be divided between domestic and foreign producers and consumers. Unless the supply and demand picture for exports is very different from the supply and demand picture for imports, it is reasonable to suppose that about one-half the tax would be borne by foreign producers and consumers, and about one-half by U.S. producers and consumers.

If a U.S. initiative on taxing shipping income were followed by other countries, the tax incidence would be similar, with part borne by the U.S. economy and part borne by foreign economies.

The end result of the imposition of corporate taxes on shipping income would be a general increase in freight rates, approximately on the order of 5 percent.[1/] At first sight, this seems undesirable. No one likes higher prices. However, it must be remembered that the present virtual exemption of shipping income from taxation results in a discriminatory advantage for the ultimate consumers of shipping services. The prices they pay are too low relative to the prices paid by consumers of goods produced by taxed sectors. Moreover, the effective exemption of shipping income from taxation results in the inefficient allocation of capital.

1/ This figure assumes a 50 percent tax on net income, or a 5 percent tax on shipping receipts. See the revenue estimates in Section VI.

The impact on labor of repealing the statutory exemption is less clear. On the one hand, the exemption is an incentive to foreign registry and thus also encourages the employment of foreign labor, so its repeal would be expected to have the opposite effect and to benefit U.S. labor. Lower labor costs abroad are themselves an incentive to foreign registry, and taxes may have only a marginal effect, but the tax exemption increases the attractiveness of foreign registry and reduces the relative attractiveness of the tax and subsidy benefits to U.S. registry. On the other hand, repeal of the statutory exemption by the United States alone would subject foreign flag ships carrying U.S. trade to tax only on their U.S. source income, whereas U.S. flag ships would be subject to tax on their worldwide income. This differential taxation might somewhat diminish the attractions of the U.S. flag and thus the employment of U.S. crews. Finally, repeal of the reciprocal exemption by the United States alone could have a negative impact on U.S. registry and thus on the employment of U.S. crew and officers, for those ships which engage in commerce between third countries. If other countries continued to grant exemption on the basis of reciprocity, such ships would find it attractive to move from U.S. registry to registry in a country where reciprocal exemption was still available. In practice, this effect is likely to be very small, since there are few cases of U.S. flag ships engaging exclusively in foreign commerce between third countries.

2. Rationale and effect of the exemption. It is difficult to allocate expenses among the various jurisdictions crossed in an international voyage. If each country taxed the worldwide income of its residents, the situation could be best taken care of by exemption at source, leaving it to the residence country to tally all receipts and expenses and levy the tax on net income. This is the solution aimed at by the provisions in the Internal Revenue Code (Sections 872 and 883) which take international shipping (and aviation) out of the ordinary rules for taxing the income of foreign investors and grant a special exemption from U.S. tax on the basis of reciprocity.

When introduced into the law in 1921, the exemption for foreign ship operators was explained as a method of avoiding double taxation. It now could be more accurately described as a method of providing double exemption. Some 30 percent of the world merchant fleet is registered in Liberia, Greece, and Panama which impose no income tax on their ships (see Table 1). These vessels also enjoy exemption from tax in most ports of call including the United States.

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Table 1

Principal Countries of Registry of Merchant Fleets
as of December 31, 1974

(thousands of tons)

Country of Registry	All Vessels Gross Tons	All Vessels Percent of Total	Tankers Gross Tons	Tankers Percent of Total
Total, all Countries	306,366	100.0%	143,399	100.0%
Liberia	60,006	19.6	37,808	26.4
Japan	35,994	11.7	16,891	11.8
United Kingdom	32,153	10.5	17,403	12.1
Norway	25,095	8.2	13,319	9.3
Greece	22,339	7.3	8,018	5.6
U.S.S.R.	13,533	4.4	3,867	2.7
U.S.A. 1/	12,503	4.1	5,252	3.6
Panama	11,539	3.8	4,990	3.5
All Other	93,204	30.4	35,851	25.0

1/ Includes 3 million tons of government-owned reserve fleet, of which 300,000 tons are tankers.

Source: U.S. Department of Commerce, Maritime Administration, Office of Subsidy Administration, Division of Trade Studies and Statistics.

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The provision of a statutory reciprocal exemption puts foreign ship operators in a preferred position over other foreign persons engaged in business in the United States. Foreign flag ships carry more than 90 percent by volume and more than 80 percent by value of U.S. trade (Table 2). Very little of the income they derive is subject to U.S. taxation. Data for 1973 indicate that gross receipts of foreign flag ships from carrying U.S. trade amounted to roughly $6 billion of which approximately $5.5 billion was derived by ships exempt from U.S. tax (Table 3). The ships of some 50 countries qualify for exemption from U.S. income tax on the basis of reciprocity; 37 of these exemptions are confirmed in U.S. bilateral income tax treaties (Table 4). Thus the equivalent exemption can be criticized as an unintended incentive to ships of foreign registry carrying U.S. goods.[1/]

3. Source rules and administrative aspects. Repeal of the statutory exemption would have little effect unless accompanied by changes in the source rules. Under present source rules only a small portion of the total net income

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1/ Repeal of the equivalent exemption provision would not, however, put the tax treatment of foreign and domestic flag ships on an equal footing because special tax benefits and construction subsidies are available exclusively to U.S. owners of domestic flag ships in foreign commerce.

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Table 2

U.S. FOREIGN TRADE TRANSPORTED UNDER FOREIGN FLAGS, 1974 1/

	Total		Liner		Irregular		Tanker	
	Tons (000)	% of Total	Tons (000)	% of Total	Tons (000)	% of Total	Tons (000)	% of Total
1971	433,058	94.7	34,080	77.1	215,949	97.8	183,029	95.1
1972	489,802	95.4	34,843	78.1	238,769	98.4	216,190	95.5
1973	591,669	93.7	38,028	74.2	277,375	98.4	276,266	92.6
1974	587,720	93.5	37,381	70.6	276,609	98.3	273,730	93.0

	Total		Liner		Irregular		Tanker	
	Dollars (Millions)	% of Total	Dollars (Millions)	% of Total	Dollars (Millions)	% of Total	Dollars (Millions)	% of Total
1971	40,539	80.4	23,196	71.6	12,755	96.9	4,588	94.5
1972	49,410	81.6	27,035	72.3	16,980	97.6	5,395	93.8
1973	68,106	81.1	35,215	70.9	24,578	97.5	8,313	90.9
1974	102,179	82.2	44,213	69.4	33,767	97.7	24,199	93.1

1/ Preliminary Data

Source: U.S. Department of Commerce, Maritime Administration, Statistics Branch, Division of Trade Studies and Statistics.

Table 3

Gross Receipts of Foreign Ships Carrying
U.S. Trade, 1973

(billions of dollars)

Flag of Registry	Exports	Imports	Charter Hire	Passenger Fares	Total
Total foreign flags	2.9	2.5	0.4	0.3	6.1
Exempt by treaty e/	1.7	1.5	0.2	0.2	3.6
Exempt by statute e/	0.9	0.8	0.2	0.1	2.0
Not exempt e/	0.3	0.1	*	*	0.5

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January 14, 1976

e/ estimated

* Less than $50 million

Source: Totals and some flag data on import shipments from U.S. Department of Commerce, Bureau of Economic Analysis. Exempt and non-exempt categories estimated on the basis of treaty and statutory exemptions and relative tonnage of fleets of exempt and non-exempt flags.

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Table 4

Exemption confirmed by income tax treaty	Exemption confirmed by exchange of notes or by a ruling (examples)
Austria	Chile (notes, 1976)
Australia	Jordan (notes, 1974)
Barbados 1/	Brazil (Rev. Rul. 74-309)
Belgium	Taiwan (notes, 1972)
Burundi 1/	Spain (Rev. Rul. 70-464) 3/
Canada	**De facto exemption (examples)**
Denmark	
Finland	Bahamas
France	Bermuda
Gambia 1/	Liberia
Germany	
Greece	**Not exempt (examples)**
Iceland	
Ireland	India
Italy	Indonesia
Jamacia 1/	Malaysia
Japan	Philippines
Luxembourg	Singapore
Malawi 1/	Venezuela
Netherlands	
Netherlands Antilles 1/	
New Zealand	
Nigeria 1/	
Norway	
Pakistan	
Poland 2/	
Romania	
Rwanda 1/	
Sierra Leone 1/	
South Africa	
Sweden	
Switzerland	
Trinidad and Tobago	
United Kingdom	
U.S.S.R.	
Zaire 1/	
Zambia 1/	

1/ By extension of another treaty (U.K., Belgian, or the Netherlands).

2/ Instruments of ratification not yet exchanged.

3/ Certain other countries were found to fulfill the equivalent exemption test in prior years; Lebanon (Rev. Rul. 67-183), and by notes, Mexico (1964), Colombia (1961), Argentina (1950) and Panama (1941).

is treated as of U.S. source, and all income derived from the high seas is foreign source. It has been estimated that U.S. source income under these rules represents only 10 percent, on average, of the total taxable income. On this basis, the revenue effect of eliminating the statutory exemption, but retaining the present source rules, would be negligible, probably less than $5 million.[1/]

A number of countries treat part of the income earned on the high seas as having a domestic source. Most regard the outbound voyage as generating domestic source income and the inbound voyage as generating foreign source income. Australia, the Philippines, Indonesia, Malaysia, and Singapore follow this practice. Venezuela achieves the same effect by treating one-half of a round trip to and from a domestic port as generating domestic source income; this approach might be more easily reconciled with the jurisdiction of other countries having foreign tax credit systems.

The administrative burden of imposing tax on foreign flag shipping could be minimized by giving the operators

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1/ In 1972, the latest year for which such data are available, the U.S. tax collected from foreign corporations engaged in transportation activity (shipping, airlines, trucking, etc.) was only $850,000. It is unlikely that this amount would increase more than five times with repeal of the reciprocal exemption and retention of the present source rules.

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an election to compute their tax on presumed net income, calculated as a flat percentage of gross receipts. Several other countries impose tax on gross receipts, but not all make the gross receipts base elective. Such an election would seem a desirable feature; on the other hand, where exercised it should be binding for future years. Such a presumptive tax should seek to approximate average profitability, taking into account good years and bad. The limited data available (Table 5) indicate that the ratio between net and gross income varies widely from company to company, but suggest that 10 percent may be a reasonable ratio.

If an operator elected to be taxed on a gross receipts basis, charter hire payments to a third party would not be separately taxed. If the tax were computed on net income, the charter hire payments would show up as a deduction, and the operator would be the withholding agent for U.S. tax purposes.

Companies not electing the presumptive income tax would be required to file a return and pay tax on net income, supplying the necessary books and records to calculate profit and loss on individual voyages. Alternatively, they might be permitted to measure net income as a percentage of their worldwide net, equal to the ratio between U.S. gross receipts on shipments to (or from) the

Table 5

Ratio of Net (Taxable) Income to Gross Income from International Shipping Operations for a Sample of U.S.-Controlled Foreign Shipping Corporations, 1972

Ratio of net operating income to gross operating receipts	Number of subsidiaries
Total number of subsidiaries	77
Negative or zero net income	14
Total subsidiaries with net income	63
Net income as percent of gross:	
1 through 9%	8
10 through 19%	21
20 through 29%	11
30 through 39%	9
40 through 49%	8
50 through 59%	1
60 through 69%	1
70 through 79%	2
80 through 89%	2
Aggregate ratio, subsidiaries with net income	11%
Aggregate ratio, all subsidiaries	9%

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Office of Tax Analysis

February 13, 1976

Source: Tax Forms 2952.

United States and worldwide gross receipts.[1] It might be desirable, especially if net income were calculated on the basis of a return, to limit certain deductions, for example to deny accelerated depreciation, in order to avoid artificial losses. It would also be important to prevent avoidance of the U.S. tax by transshipment through Canada or Mexico. One possible approach would be to define the relevant voyage in terms of the ultimate point of origin or destination of the goods.

4. Competitive and treaty implications. A sweeping repeal of the present exemption system undertaken by the United States acting alone could result in taxation by many countries of U.S. ships, since reciprocity would no longer exist. However, ships of other countries would continue to enjoy reciprocal exemption. Thus, U.S. ships engaged in trade between third countries would be placed at a competitive disadvantage.

A sweeping repeal of the present system would also require Treasury to terminate U.S. income tax treaties with 37 countries in order to delete the shipping exemption; reinstituting the other treaty provisions might

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1/ Singapore, for example, permits this apportionment method to be used by companies incorporated in countries for which Singapore is prepared to accept the certification of the national tax authorities as to worldwide gross and net income.

require concessions on unrelated issues. On the other hand, maintaining a policy of exemption by tax treaty could simply transfer tax haven benefits from the traditional tax havens, such as Liberia and Panama, to treaty countries which may also not tax foreign shipping income (see the discussion below and Table 6).

A compromise solution to both these problems would permit selective reciprocal exemptions by treaty but require that existing and future treaties be reviewed. Where the other country constitutes a tax haven for foreign owned shipping companies, future treaties would not grant an exemption, and existing treaties would be renegotiated to remove the exemption. Table 6 and the following text describe some of the features of other countries' taxation of income from international shipping.

Table 6 attempts to summarize the principal features of foreign country tax laws as they apply to income from international shipping. The information summarized in the table must be regarded as both tentative and partial. The detailed information needed for a thorough report is not readily available, and the implementation of the laws is subject to considerable administrative discretion. Moreover, the statutory rates cited ignore such features as accelerated depreciation, investment allowances and investment reserves, which substantially reduce the effec-

Table 6

Taxation of Income from International Shipping in Selected Countries

Country (by gross tonnage of merchant fleet)	Million Gross Tons	Percent of Total	Taxation of domestic companies: Taxable on foreign source income	Taxation of domestic companies: Applicable statutory rate 1/	Taxation of foreign companies: Statutory reciprocal exemption	Taxation of foreign companies: Rate of tax where applicable 1/	Taxation of foreign companies: Tax base limited to profits of a p.e. 2/
Total, all countries	306.4	100.0	--	--	--	--	--
Liberia	60.0	19.6	no	0	yes	0	--
Japan	36.0	11.7	yes	52.61/40.88	yes	52.61	no
United Kingdom	32.2	10.5	yes	52/26.16	?	52	yes
Norway	25.1	8.2	yes	50.8/24.3	yes	50.8	yes
Subtotal	153.3	50.0	--	--	--	--	
Greece	22.3	7.3	no	0	?	38.24	no
U.S.S.R.	13.5	4.4	yes	3/	yes	0	--
U.S.	12.5	4.1	yes	48	yes	48	no
Panama	11.5	3.8	no	0	?	10-50	?
France	9.5	3.1	4/	50/25	yes	50	yes
Italy	9.4	3.1	yes	49.7	no	49.7	no
Germany	8.5	2.8	yes	27.5/15 5/	yes	51	yes
Sweden	6.8	2.2	yes	54.4	yes	54.4	yes
The Netherlands	4.7	1.5	yes 6/	48	yes	48	yes
Spain	4.4	1.4	yes	32.69	yes	37	yes
Denmark	4.2	1.4	yes	37	no	34	yes
India	3.7	1.2	no 7/	57.75	yes	73.5	no
Cyprus	3.6	1.2	no 7/	42.5	no	42.5	?
Singapore	3.3	1.1	--	40	no	40	no
Subtotal	271.2	88.5	--	--	--	--	--
All Others	35.2	11.5	--	--	--	--	--

Office of the Secretary of the Treasury
Office of Tax Analysis

February 10, 1976

Sources: Submission by various countries, Harvard University, World Tax Series, volumes, various issues of the Price Waterhouse Information Guides (for Doing Business in _________), and the United Kingdom Board of Trade, Report of the Committee of Inquiry into Shipping (London, May 1970).

1/ Where two rates are shown divided by a slash (/) the first applies to undistributed profits and the second to distributed. If divided by a hyphen (-) the rates indicate the range of marginal rates in a graduated scale. These are statutory rates; effective rates are lower due to accelerated depreciation, investment allowances, investment reserves and other tax benefits.

2/ I.e., no tax is imposed unless there is a local "permanent establishment" (which usually includes an agent who signs contracts for the home office but not a commission agent) and the tax base is limited to the profits of that establishment. In some cases, e.g., Norway and Sweden, this amounts to exemption in practice, and in most cases the taxable income is comparable to a freight forwarder's commission.

3/ The U.S.S.R. is state owned, so apart from amounts allocated to certain reserves, the net earnings belong to the Government.

4/ In general French companies are not taxed on their foreign source income; but French law (Article 209, C.G.I.) specifically authorizes France to tax in those cases where an income tax treaty reserves to France the right to tax. This is the case in most French income tax treaties with respect to shipping profits; the usual treaty rule reserves the right to tax shipping profits to the country of residence of the company.

5/ One half of the income from shipping (the outbound portion) is presumed to be foreign source income and is taxed at the special rate with no foreign tax credit. The taxpayer elects to be taxed at the ordinary rates on the full amount and claim a foreign tax credit. The portion considered domestic source is taxable at the ordinary rates of 51/15.

6/ Foreign source profits are exempt from Netherlands tax if they are derived through a permanent establishment in another country and have been taxed by that country.

7/ Foreign source profits are taxable if remitted to Cyprus and Singapore.

tive tax rates.

With respect to the taxation of domestic flag ships, Liberia, Greece and Panama, which together account for over 30 percent of the gross tonnage of the world's merchant fleet, do not tax income derived from international commerce by ships flying their respective flags, and each country makes it easy for foreign companies to register ships locally. Cyprus and Singapore tax the foreign income of their shipping companies only when it is remitted to (received in) Cyprus and Singapore, respectively.

In contrast, although France and the Netherlands exempt most foreign source income from taxation, they often tax the income of their domestic shipping companies. For example, the Netherlands exemption of foreign source income is conditioned on the derivation of foreign income through a foreign permanent establishment which has borne some foreign income tax (the amount does not matter); since much of the foreign income of shipping companies is earned on the high seas or in countries which exempt ships of Dutch registry by treaty or statute, that condition will frequently not be met. As a general rule, the foreign source income of a French company is excluded from the French tax base without regard to whether any foreign tax liability is incurred; but French officials report that one consequence of Article 209 of the General Tax Code, which gives France the right to impose tax where a treaty reserves taxing jurisdiction to the other country, is that French shipping companies are subject to tax on their foreign source income from the numerous countries with which France has concluded a treaty providing for reciprocal exemption of ships and aircraft. It is not clear how France determines taxable income in such cases.

Germany presumes that one half of the income of domestic companies from international shipping is of domestic source and is taxed at the ordinary rate. The other half is presumed to be foreign source and is taxed at a reduced rate with no foreign tax credit. Alternatively, the shipping company can elect to be taxed on all income in the ordinary way with a foreign tax credit against the tax on the half deemed to be foreign source. The taxpayer's choice will depend on how much foreign tax was paid.

The United Kingdom has made an effort to compete with the flags of convenience by offering free depreciation and investment grants which greatly reduce, or eliminate, the tax liability of U.K. flag ships. Similarly, the United States has attempted to keep its shippers from fleeing to flags of convenience by giving tax benefits and direct subsidies to domestic flag shippers. The United Kingdom, unlike the United States, permits the use of foreign crews on its ships. The U.K. tax preferences go beyond those of the United States in one respect: as of 1970, shipping companies of other Commonwealth countries could fly the U.K. flag; thus a Bahamas corporation, liable to no domestic income tax, could register its ships in Britain.1/

The other countries listed in Table 6 typically subject their corporations to tax on their worldwide income and provide a credit for foreign taxes paid on foreign source income. However, liberal depreciation allowances, investment grants, and similar measures generally ensure that the net tax burden is small.

Traditionally, countries have exempted foreign flag ships from income tax on the basis of reciprocity, without the need for any special bilateral agreement between the countries. But three countries listed in Table 6 (India, Cyprus, and Singapore) are exceptions to this rule. They

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1/ (The U.K. Board of Trade, Report of the Committee of Inquiry into Shipping, London, 1970, reports that Bahamas and Bermuda companies represented only about 1.5 million gross tons of the U.K. flag fleet in 1970).

do not exempt foreign flag ships on the basis of de facto reciprocal exemption, and are unwilling to grant exemption by tax treaty, although they may be willing to reduce the tax in a treaty. There are a number of other countries not listed on the table which also unilaterally impose tax on foreign flag ships in the absence of a formal tax treaty (e.g., Australia, Singapore, Indonesia, Malaysia, the Philippines, Venezuela); the reluctance to grant exemption even by treaty appears to be growing, as evidenced by several recent treaty negotiations.

The countries which do not grant reciprocal exemption tend to tax on presumptive net income, usually a flat percentage of gross receipts from outbound traffic. Singapore is an example of this approach. Singapore imposes tax equal to 2 percent of the gross receipts (calculated as the corporate tax rate of 40 percent times presumed net income equal to 5 percent of gross receipts) of any voyage outbound from Singapore to the point of destination or transshipment. The company may elect to be taxed instead at 40 percent of that portion of its worldwide net income which gross receipts from Singapore bear to worldwide gross receipts. This pattern varies somewhat among other taxing countries, as to the gross receipts figure used, the net election, and the transshipment rule.

The countries which have traditionally granted reciprocal exemption usually rely on the general statutory rules for taxing foreign business activities in their jurisdictions to determine the taxable income of foreign shippers. In most cases this means that tax is imposed only on the profits derived by a local office authorized to contract for the company; thus the tax base is roughly the commission income of a freight forwarding agent. In some cases even this element is ignored, for example, where the law specifically limits the taxation of foreign companies to income derived <u>in</u> the taxing country. Sweden has interpreted such language narrowly and has rarely, if ever, imposed tax on a foreign shipping company. Denmark has followed a similar interpretation, and Panama's law would support exemption on the same interpretation. Norway has not exercised its authority to tax. Japan, Italy and Greece have broader source rules. Japan considers income from outbound traffic to be of domestic source, but it is not clear whether net income is determined as a percentage of worldwide net or computed separately on the basis of books and records. Italy may use an imputation of profit per ton where net income cannot be determined. When a foreign shipping company maintains a local office in Greece, Greece may tax not only the income attributable to Greek sources but also a portion of the foreign source income. In no case is the method of determining taxable income clear. The U.S. rules are also imprecise.

V. OPTIONS

1. Retain present law. It can be argued that a change in the present reciprocal exemption would raise the cost of ocean freight and disturb our tax relations with treaty countries. Further, any change in the reciprocal exemption system might result in selectively heavier foreign taxation of U.S. flag vessels, which would place those vessels at a competitive disadvantage. On the other hand, the present system allows international shipping to be free of most (or all) taxes.

2. Change the flag test to a residence test. Residents of any country which grants an equivalent exemption to U.S. ships operated by U.S. residents would be exempt from U.S. tax on income from the international operation of ships (and aircraft), without regard to where the ships were registered. This approach would have the advantage of not depriving a U.S. or treaty country operator of exemption solely because it uses foreign flag feeder vessels. But it does not address the basic criticism that international shipping frequently pays tax to no country.

3. Require a dual test. Under a dual test, the foreign country must be both the country of registry of the ship and the country of residence of the operator. This was the

position taken in Revenue Ruling 73-350 (subsequently reversed by Rev. Rul. 75-459). It makes the conditions for reciprocal exemption parallel for both countries, since foreign countries are now only required to exempt U.S. citizens and residents operating U.S. flag vessels. But it has the presumably unintended effect that while Liberian and Panamanian ships would be exempt from U.S. tax when operated by residents of Liberia and Panama, respectively, the exemption would no longer apply if either operator were to lease the ship of the other.

4. Repeal the statutory exemption. Repealing the statutory exemption would make the tax treatment of foreign flag shipping comparable to that of other foreign business activity in the United States, cut back on the tax-free status of international shipping, and thereby reduce the appeal of tax havens. U.S. action in this direction might encourage other countries to take similar steps. These are desirable policy objectives. But simple repeal of the U.S. statutory exemption while maintaining the present source rules would accomplish little toward these goals, and would have the disadvantages of multiplying the administrative burden of taxpayers and tax collectors and (at least initially) making U.S. flag ships subject to foreign taxes

while ships of other countries continue to enjoy reciprocal exemption. These disadvantages could be largely overcome by additional changes along the lines indicated below:

(a) The source rules would be changed to define as U.S. source income one half of the gross income from any voyage to or from a U.S. port. This change should be considered for international aviation as well as shipping.

(b) The tax would be levied at ordinary rates on net income realized in or apportioned to U.S. sources, provided the taxpayer furnishes adequate accounts. However, the taxpayer could elect to be taxed on presumptive net income. The election would be revocable only with the consent of the Commissioner. As an example, this alternative tax might be set at 5 percent of gross receipts from U.S. sources (roughly 48 percent of net income presumed at 10 percent of gross receipts).

(c) In certain cases, the operator would be required to post a bond in an amount equal to the tax on gross income, unless sufficient business contacts with the United States were regularly maintained so that the Internal Revenue Service could be reasonably sure of collecting the tax.

(d) Reciprocal exemptions could be granted in income tax treaties with countries that are not tax havens for shipping, with instructions to the Treasury that existing agreements with countries that constitute tax havens for international shipping be renegotiated to terminate the exemption. Guidelines for identifying tax havens could be provided by regulation. For example, a shipping tax haven might be defined in terms of the following characteristics: little or no tax on shipping income, a large fleet in relation to the volume of exports and imports, ease of registry of foreign owned vessels, and foreign ownership of a substantial portion of the fleet. Some of the characteristics might be found in a number of countries, but a tax haven would generally meet all of them.

(e) Subpart F would be changed to ensure the current taxation of the U.S. controlled foreign flag fleet, as discussed in Part B.

Repeal of the reciprocal exemption, together with these collateral changes, would place the tax treatment of foreign flag shipping on the same basis as other foreign activity in the United States at a minimum of administrative cost and would produce additional revenue of about $100 million. Some U.S. flag ships would still be subject to a competitive disadvantage through the loss of foreign tax exemption, but this effect would be relatively minor in view of the possibility of treaty exemptions. Moreover, in light of the low volume of U.S. trade carried on U.S. flag vessels, this effect should not be overestimated.

VI. REVENUE ESTIMATES

Option (1), retaining present law, would involve no revenue change. Option (2), eliminating the flag test, would involve a negligible revenue loss. Option (3), requiring the dual test would involve a negligible revenue gain. Option (4) would impose a net income tax on half of the gross receipts on all traffic to and from U.S. ports, but the taxpayer could elect a presumed income tax of 5 percent of gross receipts. Selected exemptions would be permitted by treaty. This option would yield an estimated revenue gain of $100 million.

The revenue estimate for option (4) is derived from Table 7. Figures were based on 1973 data, projected forward to 1975 on the assumption that gross receipts of foreign flag ships from carrying U.S. trade increased proportionately with the value of waterborne U.S. trade. The estimate assumes no change in the treaty exemptions already agreed to, but no new treaty exemptions.

Table 7

Estimated Revenue Effect of Taxing Presumed
Net Income of Foreign Flag Ships
($ millions)

	Gross receipts 1/			U.S. gross receipts (50% of total)	Tax base (10% of U.S. gross)	Tax (5% of U.S. gross)
	inbound	outbound	total			
1973						
All Foreign Flags	2,700	3,100	5,800	2,900	290	145
exempt by statute	950	1,000	1,950	950	95	47
Liberia, Panama	750	450	1,200	600	60	30
exempt by treaty	1,600	1,800	3,400	1,700	170	85
taxable	150	300	450	225	20	10
Est. 1975						
All Foreign Flags			9,300	4,650	465	235
exempt by statute			3,100	1,550	155	80
exempt by treaty			5,500	2,750	275	140
taxable			700	350	35	20
Estimated revenue gain						
on flags exempt by statute						100
on flags taxable under present rules 2/						80
						20

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January 28, 1976

1/ Inbound figures rounded to nearest $50 m., outbound available only to nearest $100 m.

2/ Tax now collected estimated at 48% of 10% of the presumed tax base, due to treatment as foreign source of all income earned outside U.S. territorial waters; i.e. tax now collected would be only about $2 m.

PART B: TAX DEFERRAL

VII. ISSUE

The issue is whether U.S. shareholders of controlled foreign shipping corporations should be taxed currently on their share of the profits of such corporations. This would be accomplished by amending the Internal Revenue Code so that shipping profits are fully included in subpart F, without the current exception for profits reinvested in shipping operations.

Foreign registry is attractive to U.S. shipowners for a number of reasons. Lower operating costs are most frequently cited, but tax savings are also important. The possibility of deferring tax on foreign flag shipping runs counter to other legislation designed to encourage U.S. flag shipping. Moreover, given the prevalence of tax haven countries as the chosen place of registry of many U.S. owned foreign flag ships and the fact that their services are largely performed outside the country of registry, foreign shipping services exemplify the type of activity to which subpart F applies. The issue then, is whether the partial inclusion of shipping income within subpart F under the Tax Reduction Act is adequate, or whether shipping should be included under subpart F on the same basis as other

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services. A related question is whether the general exception to subpart F for corporations not formed or availed of to avoid tax should also be revised.

VIII. PRESENT LAW

Under subpart F of the Code, certain categories of earnings and profits of a controlled foreign corporation (CFC) are includable in the gross income of the U.S. shareholder. The most important of these categories is foreign base company income. As originally enacted, subpart F provided an exclusion from foreign base company income for income derived from, or in connection with, the use (or hiring or leasing for use) of any aircraft or vessel in foreign commerce, or the performance of services directly related to the use of any such aircraft or vessel (section 954(b)(2)).

This outright exclusion for shipping income was repealed, effective for taxable years beginning after December 31, 1975, by the Tax Reduction Act of 1975. Under that Act, foreign base company income will include foreign base company shipping income except to the extent reinvested in foreign base company shipping operations. Foreign base company shipping income, as defined in Section 954(f), includes income derived from the use (or hiring or leasing for use) of any aircraft or vessel in foreign commerce, the performance of services directly related to the use of an aircraft or vessel, or the sale or exchange of the aircraft or vessel. It also includes dividends and interest from certain foreign subsidiaries and gain from the sale of securities of those corporations to the extent attributable to foreign base company shipping income.

IX. ANALYSIS

1. Reasons for foreign incorporation. U.S. owners of ships, by incorporating in a country which imposes no income tax, can avoid tax on most or all of their worldwide income since many countries, like the United States, provide statutory exemptions on the basis of reciprocity. According to the Maritime Administration, as of June 30, 1974, there were 678 U.S. owned foreign flag ships, totalling 14 million gross tons. More than 80 percent of these ships, by gross tonnage, were registered in Liberia, the United Kingdom, and Panama (Table 8). Liberia and Panama impose no income tax; the United Kingdom imposes tax but provides generous writeoffs for shipping investments, and permits ships owned by residents of tax haven colonies, like Bermuda, to fly the U.K. flag.

Tax savings are not the only factor influencing the choice of foreign over U.S. registry. Costs of operation, particularly wages for the crew,[1/] are often very much less abroad. And ships which engage exclusively in commerce between third countries are not eligible for U.S. subsidies. But tax exemption provides an added attraction, particularly for integrated companies which may be able to shelter some

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1/ In order to qualify for U.S. registry, all the officers and 75 percent of the crew must be U.S. citizens. If the ship receives operating subsidies, then all the crew must be U.S. citizens.

Table 8

FOREIGN FLAG SHIPS OWNED BY UNITED STATES COMPANIES OR FOREIGN AFFILIATES OF UNITED STATES COMPANIES INCORPORATED UNDER THE LAWS OF THE UNITED STATES

As of June 30, 1974

S U M M A R Y

	Total			Tankers			Freighters			Bulk & Ore Carriers		
	No.	Gross Tons	Dead-weight Tons	No.	Gross Tons	Dead-weight Tons	No.	Gross Tons	Dead-weight Tons	No.	Gross Tons	Dead-weight Tons
Total	678	25,264,165	47,925,033	485	21,793,448	41,739,038	84	396,921	392,797	109	3,073,796	5,793,198
Liberia	321	14,491,604	28,651,732	224	11,753,858	23,418,121	9	58,267	67,508	88	2,679,479	5,166,103
United Kingdom	122	4,415,586	8,155,906	74	4,098,941	7,748,047	39	146,892	151,748	9	169,753	256,111
Panama	102	2,103,487	3,627,452	85	1,979,438	3,463,665	12	54,590	48,280	5	69,459	115,507
France	12	1,022,107	1,978,118	12	1,022,107	1,978,118	-	-	-	-	-	-
Netherlands	25	716,097	1,251,523	13	643,844	1,179,852	12	72,253	71,671	-	-	-
Germany (West)	11	525,577	971,720	11	525,577	971,720	-	-	-	-	-	-
Spain	5	489,149	931,367	5	489,149	931,367	-	-	-	-	-	-
Italy	10	333,880	494,091	10	333,880	494,091	-	-	-	-	-	-
Norway	10	254,916	453,895	10	254,916	453,895	-	-	-	-	-	-
Belgium	9	163,159	259,393	9	163,159	259,393	-	-	-	-	-	-
Argentina	11	169,791	258,183	6	96,037	141,921	-	-	-	5	73,754	116,262
Denmark	6	109,455	181,649	6	109,455	181,649	-	-	-	-	-	-
Venezuela	6	116,113	172,569	6	116,113	172,569	-	-	-	-	-	-
Australia	3	98,241	165,857	1	16,890	26,642	-	-	-	2	81,351	139,215
British Colonies	1	59,267	110,187	1	59,267	110,187	-	-	-	-	-	-
Canada	6	58,517	88,737	6	58,517	88,737	-	-	-	-	-	-
Uruguay	2	50,766	85,830	2	50,766	85,830	-	-	-	-	-	-
Honduras	9	46,921	43,618	-	-	-	9	46,921	43,618	-	-	-
South Africa	1	14,560	23,421	1	14,560	23,421	-	-	-	-	-	-
Greece	3	17,998	9,972	-	-	-	3	17,998	9,972	-	-	-
Finland	3	6,974	9,813	3	6,974	9,813	-	-	-	-	-	-

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profits from other activities in their tax haven shipping subsidiaries, and which may have excess foreign tax credits which can be used to repatriate the tax sheltered income to the United States free of U.S. tax. More than 85 percent of the U.S. owned foreign flag ships, by gross tonnage, were oil tankers, most of which were owned by the large oil producing companies (Table 8). While the Tax Reduction Act of 1975 placed a special limit on excess foreign tax credits from oil production and restricted their use to other "oil related income", that term was defined to include shipping income arising from the transport of petroleum products. Thus, some integrated companies continue to have ample excess foreign tax credits which can be used to shield shipping income from U.S. taxation.

2. Modifications to subpart F in 1975. Under the Tax Reduction Act of 1975, shipping profits are not subject to subpart F except to the extent they are reinvested in shipping operations. In one sense shipping is now treated more harshly than other subpart F activities, since profits characterized as foreign base company shipping income are "tainted" even if derived from unrelated companies. But shipping also continues to enjoy a preferred status in qualifying for partial exclusion by virtue of the reinvestment condition.

It is too early to tell what effect the reinvestment condition will have. In fact, the rules are so complex that even the affected taxpayers will find it very difficult to assess their impact.[1/] However, while the reinvestment condition might not benefit foreign shipping companies when the industry is experiencing a prolonged recession, it could easily be satisfied in a growing economy for those companies that are renewing or expanding their fleets.[2/] For example, assume that $10 million is borrowed to finance a ship which will yield gross receipts of 25 percent, or $2.5 million, and a pre-tax profit, after payment of interest and other expenses, of $500,000, per year. The profit could be used to retire the mortgage over 20 years, and during this time there would be no U.S. tax liability under subpart F. To continue qualifying after 20 years, the shipping company would have to replace the one ship or expand its fleet. So long as the reinvestment condition is met, shipping profits will continue to enjoy exclusion from subpart F; and when it is not met, shipping profits will be subject to subpart F but with special and extraordinarily

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1/ The regulations have not yet been issued in proposed form, but a preliminary draft is approximately 130 pages.

2/ Of course in a prolonged shipping recession, the profits of foreign shipping companies might be modest or non-existent, so that current U.S. taxation under subpart F would result in little additional burden.

complex rules (even by comparison with other subpart F rules).

3. Effect of including shipping income within subpart F. The nature of international shipping services, especially the frequency of incorporation in tax havens with most of the services performed outside the country of incorporation, is analogous to the general concept of base company service income, which suggests including shipping income under subpart F on the same basis. However, the idea of including shipping within subpart F on the same basis as foreign base company service income raises three further issues. One is the shippers' contention that the result would be a sale of U.S. controlled foreign flag ships to foreign owners with adverse effects for U.S. national security. The second is a quite different concern, that to be effective the proposal should amend the general exception to subpart F for corporations not formed or availed of to reduce tax. And finally, some provision should be made to cancel any overlap between U.S. tax imposed as a consequence of repealing the statutory reciprocal exemption and U.S. tax imposed under subpart F.

It has been argued that taxing the undistributed profits of foreign shipping companies could cause their sale to foreign interests and their consequent loss to the

United States in time of national emergency. But both the Maritime Administration and the Defense Department have expressed doubts about the usefulness of the "Effective U.S. Control Fleet". In recent emergencies, such as the closing of the Suez Canal and in Vietnam, both practical and legal problems have arisen with respect to commandeering foreign registered ships manned by foreign crews. This is especially difficult when the ships engage primarily or exclusively in third country commerce so that they have virtually no contact with the United States. This is believed to be true of many U.S. controlled foreign flag ships. The Maritime Administration estimated in 1974 that only about 20 percent of the U.S. owned foreign flag tankers carried U.S. trade. (As of April 1975, 330 of the 461 ships on the Effective U.S. Control List were oil tankers.) Other Commerce Department data indirectly support this general view by indicating that on average under 10 percent of the sales of foreign affiliates of U.S. international transport corporations are to U.S. purchasers. Thus, it is unlikely that the sale of U.S. controlled foreign flag ships would have a serious adverse affect on the national security of the United States.

To the extent U.S. controlled foreign flag ships were sold, presumably they would escape taxation, and there would be little or no impact on freight charges. However, to the extent these ships remained under U.S. control, and paid U.S. taxes, there would be some increase in freight rates, mainly between third countries. In any event, there would be no discernable effect on the employment of U.S. seamen, since U.S. crews are seldom used on foreign flag vessels, whether or not controlled by U.S. corporations.

The second issue concerns the exception from subpart F for controlled foreign corporations not availed of for the substantial reduction of taxes. In the case of service income, the CFC will not be considered to have been availed of to reduce taxes if the effective foreign tax paid is at least 90 percent of the effective rate that would have been paid where the services are rendered, or is not more than 5 percentage points below that rate. The "substantial reduction" test, as it is called, involves the enormous confusion of computing potential effective tax rates in many countries. Moreover, a shipping CFC might well pass the substantial reduction test. Under the test, no tax will be attributed to income earned on the high seas, and the income generated within any given country will qualify for the special benefits which many countries, like the

United States, grant to shipping. The problems with the test could be resolved by changing the standard from the effective foreign rate to the statutory U.S. rate (48 percent for corporations).

If the deferral of U.S. tax were to be eliminated for foreign shipping subsidiaries along with eliminating the exemption provided under Section 883, some taxpayers would be taxable under both concepts. In those cases any tax paid or withheld on U.S. source shipping income should be credited against the tax on their worldwide net income under subpart F.

X. OPTIONS

1. Retain present law. This option could be supported on the grounds that the treatment of shipping income under subpart F was changed just last year and any further changes should be delayed long enough to see the results of the earlier legislation. But the 1975 change is not satisfactory. The Tax Reduction Act puts shipping services neither in nor out of the foreign base company services category, but in a special in-between category, sometimes favored and sometimes penalized compared to other covered services. Moreover, applying the new provision promises to be extremely complicated.

2. Remove shipping income from subpart F. This option would return to the pre-1976 situation, which condoned the use of tax haven companies by U.S. ship owners, in contradiction both to the general tax policy of denying deferral benefits to tax haven companies and to the policy of granting special tax benefits and direct subsidies to U.S. flag ships.

3. Include foreign shipping income under subpart F as foreign base company service income. The purpose of the subpart F provisions with respect to foreign base company service income is: "... to deny tax deferral where a service

subsidiary is separated from manufacturing or similar activities of a related corporation and organized in another country ordinarily to obtain a lower rate of tax for the service income." (S. Rep. No. 1881 37th Cong., 2d Sess., C.B. 1962-3, 703, at 709). The use of tax haven corporations to furnish international shipping services answers this description.

If shipping income were to be treated like foreign base company service income under subpart F, the substantial reduction test would have to be strengthened. Using as the standard the foreign effective rates where the services are performed is extremely complex and leaves too much to the discretion of the taxpayer. In the case of shipping, all of the income earned on the high seas and much of that earned in individual countries pays an effective rate of zero. The test could be strengthened by making the U.S. corporate rate the standard.

Any substantial change in the reciprocal exemption (discussed in Part A) should be accompanied by the inclusion of shipping income under subpart F. Otherwise, to the extent that other countries continue to grant exemption on the basis of reciprocity, owners of U.S. flag vessels would have an additional incentive to transfer those vessels to a controlled foreign corporation and register them outside the United States.

XI. REVENUE ESTIMATES

Option (1), retaining present law, would involve no revenue change. Option (2) would return to pre-1976 rules which specifically exclude shipping from subpart F. This would involve some revenue loss, but a small one; in general the exception for shipping profits reinvested in shipping operations is tantamount to an exclusion.

Option (3) would define foreign base company service income to include shipping profits without exception and would strengthen the substantial reduction test. The estimated revenue gain from this option viewed in isolation is $100 million. However, an estimated $30 million of this amount would represent double counting if the statutory exemption under section 883 were also eliminated. In other words, if both proposals were enacted, the additional revenue gain from the subpart F proposals is estimated at $70 million.

The estimation of the revenue gain under Option (3) may be briefly explained. A sample representing about two-thirds of the gross tonnage of U.S. owned foreign flag ships showed pre-tax earnings and profits of $690 million in 1973, an effective foreign tax rate of 3 percent and dividends paid of $260 million, or 40 percent of earnings and profits (Table 9). Based on that sample, the estimated revenue gain

Table 9

Earnings & Profits, Foreign Taxes and Dividends Paid, Selected CFCs engaged in shipping, 1973
($ millions)

	Pre-tax Earnings & profits	Foreign tax paid: $ million	Foreign tax paid: % of pretax E+P	Earnings & profits	Dividends $ million	Paid % of E&P
Sample of U.S. owned foreign flag ships 1/	687.2	23.0	3.3	664.3	256.8	38.7
Owned by oil companies	636.4	22.8	3.6	613.6	232.7	37.9
Owned by others	50.8	0.2	0.4	50.6	24.2	47.8

1/ Representing two-thirds of the total gross tonnage of U.S. owned foreign flag ships. Includes some CFCs which also engage in other activities.

Source: 1973 tax return data for selected parent companies and their shipping CFCs.

of eliminating deferral for shipping CFCs would be about $100 million after foreign tax credits and usable excess credits. This assumes no exceptions from the subpart F 1975 Tax Reduction Act amendments (Table 10). While the 1974 figure would have been higher than for 1973, the current depressed market for tankers suggests a drop from 1974 levels for 1975 and 1976. The estimate assumes that the 1975 figure would be roughly the same as for 1973.

It is estimated by the Maritime Administration that only about 20 percent of U.S. owned foreign flag oil tankers carry U.S. trade, the rest engaging exclusively in foreign commerce. Assuming that 50 percent of the nontankers carry U.S. trade and that the ships which carry U.S. trade derive two-thirds of their pre-tax income from U.S. sources, the tax imposed on their U.S. income by eliminating the statutory exemption would have amounted to perhaps $30 million. Thus, crediting that tax would reduce the net revenue gain of eliminating deferral to $70 million (Table 10).

Table 10

Estimated Revenue Effect of Eliminating Deferral on the Income of Shipping CFCs in 1973
($ millions)

	Gross tonnage of ships (thousand tons)	Undistributed pre-tax earnings and profits 2/	Tentative U.S. tax	Foreign tax credit	Applied/ excess credits of parent 4/	Net rev gai
Sample for which tax returns available	17,771	427	205	18	135	52
oil companies	15,755	399	192	18	135	39
others	1,936	28	13	*	*	13
Estimated others	4,857	100 3/	48	3	--	45
Estimated total	22,549 1/	527	253	21	135	9[illegible]
Less credit for tax on U.S. source income						3[illegible]
Net revenue gain						7[illegible]

Office of the Secretary for the Treasury
Office of Tax Analysis
July 17, 1975

1/ As reported in U.S. Department of Commerce, Maritime Administration, Foreign Flag Merchant Ships Owned by U.S. Parent Companies, March 1975. Excludes ships owned by Mr. D.K. Ludwig, an individual, who would presumably not be subject to subpart F but to such other provisior as the tax on accumulated earnings.

2/ Assumes that gross-up required on all distributions, including those from LDC corporations and that all companies were on the overall limitation.

3/ Estimated on an average of $33 thousand per gross ton. E & P based on the tonnage of tanke cf. freighters and the E & P/ton figures of the tax return group.

4/ Computed on the basis of foreign taxes paid and deemed paid in 1973 (or in some cases, 1972 reduced by the limitations on taxes paid on extraction income once the 1975 Tax Reduction A is fully in effect. Since extraction income was not identified on the tax returns it was estimated on the basis of countries and was probably overstated; this would have the effect of overstating the excess credits available, but only for those companies which clearly ha more than enough credits.

5/ Gross of any revenue gain from the 1975 Reduction Act changes with respect to shipping, her assumed to be zero.

6/ Based on Maritime estimate that only 20% of U.S. owned foreign flag tankers carry U.S. trad Assumes further that (a) 50% of nontankers carry U.S. trade, (b) that U.S. owned foreign fl ships carry U.S. trade derive 2/3 of their total taxable income from that traffic, and (c) that under section 1 the tax on presumed net income of such vessel is equal to a tax on the actual net income. Pre-tax E & P estimated at $192 million of which 2/3 or $128 million assumed from U.S. trade. The tax on U.S. source income is estimated at 48% of one half of the $128 (which includes traffic in both directions).

7/ This is a maximum estimate in that it does not make any allowance for the various escape mechanisms of subpart F.

Source: 1973 tax return data for shipping CFCs and estimates explained above.

the Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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Contact: L.F. Potts
Extension 2951
February 26,1976

FOR IMMEDIATE RELEASE

WITHHOLDING OF APPRAISEMENT ON SKI BINDINGS AND PARTS THEREOF FROM WEST GERMANY, AUSTRIA, AND SWITZERLAND

The Treasury Department announced today a six-month withholding of appraisement on the subject merchandise from West Germany, Austria, and Switzerland, pending determination as to whether the subject merchandise is being sold at less than fair value within the meaning of the Antidumping Act, 1921, as amended.

This decision will appear in the Federal Register of February 27, 1976.

Under the Antidumping Act, the Secretary of the Treasury is required to withhold appraisement whenever he has reasonable cause to believe or suspect that sales at less than fair value may be taking place.

A final decision in this case will be made on or before May 27, 1976. Appraisement will be withheld for a period not to exceed six months from the date of publication of the "Withholding of Appraisement Notice" in the Federal Register.

Under the Antidumping Act, a determination of sales in the United States at less than fair value requires that the case be referred to the U.S. International Trade Commission, which would consider whether an American industry was being injured. Both sales at less than fair value and injury must be shown to justify a finding of dumping under the law. Upon a finding of dumping, a special duty is assessed.

Imports of the subject merchandise from Austria for calendar year 1974 were valued at approximately $860,000; from West Germany for the period June 1974-July 1975, roughly $1,560,000; and, from Switzerland for the period January through August 1975, roughly $115,000.

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he Department of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 964-2041

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Contact: D. Cameron
Extension 2951
February 25, 1976

FOR IMMEDIATE RELEASE

TREASURY ISSUES
ANTIDUMPING PROCEEDING NOTICE WITH
RESPECT TO AUTOMOBILE BODY DIES FROM JAPAN

Assistant Secretary of the Treasury David R. Macdonald announced today that he was issuing an antidumping proceeding notice with respect to Automobile Body Dies from Japan. Notice of this action will be published in the FEDERAL REGISTER of February 26, 1976.

The Treasury Department's announcement followed a summary investigation conducted by the U.S. Customs Service after receipt of a petition alleging that sales at less than fair value are occurring in the United States. The petition also provided sufficient indication of injury to the domestic industry to warrant an investigation.

The estimated volume of prospective imports is between $1,660,000 and $1,992,600.

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e Department of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR RELEASE AT 4:00 P.M. February 26, 1976

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for $3,100 million, or thereabouts, of 364-day Treasury bills to be dated March 9, 1976, and to mature March 8, 1977 (CUSIP No. 912793 D2 9). The bills will be issued for cash and in exchange for Treasury bills maturing March 9, 1976.

This issue will provide $1.0 billion of new money for the Treasury as the maturing issue is outstanding in the amount of $2,102 million, of which $761 million is held by the public and $1,341 million is held by Government accounts and the Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities. Additional amounts of the bills may be issued to Federal Reserve Banks as agents of foreign and international monetary authorities. Tenders from Government accounts and the Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities will be accepted at the average price 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 Standard time, Wednesday, March 3, 1976. 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

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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 $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. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank or Branch on March 9, 1976, in cash or other immediately available funds or in a like face amount of Treasury bills maturing March 9, 1976. 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.

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Department of the TREASURY NEWS
NGTON, D.C. 20220 TELEPHONE 964-2041

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FOR RELEASE ON DELIVERY

STATEMENT OF THE HONORABLE DAVID R. MACDONALD
ASSISTANT SECRETARY OF THE TREASURY
(ENFORCEMENT, OPERATIONS, AND TARIFF AFFAIRS)
BEFORE THE SENATE COMMITTEE
ON BANKING, HOUSING AND URBAN AFFAIRS
ON S. 1339 AND H.R. 5620
FRIDAY, FEBRUARY 27, 1976

Mr. Chairman, I am pleased to be here today to testify in support of legislation which would enable the Department to replace the present Denver Mint with a new and modern facility. The bills you are considering today would amend the 1963 Mint construction statute by increasing the amount of authorized funds and by extending the period during which these funds would be available for use in building the facility. In effect, the proposals would authorize the funding of up to $65 million for a new coinage facility to replace the existing Mint at Denver. The funds so authorized would be subject to annual appropriations and would be available through fiscal year 1983.

Passage of the legislation, in our view, is essential to assure production of coins in the quantities required in the years ahead. Virtually all coinage production takes place in the U.S. Mints at Philadelphia and Denver. At the time the present Denver Mint began operations in 1906, it produced about 13 million coins. Today, after several expansions that have strained the facility, it produces 5 billion coins in a multi-story, outdated building which any private manufacturing concern would have abandoned years ago.

In the meantime, the total coinage demand of the nation, which has nearly doubled since 1970, is expected to rise to approximately 18 billion coins per year by 1980 from the current annual demand of about 13 billion coins. The demand is expected to increase further to 30 billion pieces by 1985. Even if the present rate of increase does not itself increase in the future, the present production capacity of the Bureau of the Mint would probably be insufficient to meet coinage demand by the end of this decade. Action should, therefore, be taken now to prevent the recurrence of a coinage shortage similar to the one we experienced about a decade ago, which would seriously inconvenience our citizens and hinder retail transactions throughout the nation.

To be able to satisfy the anticipated increase in coinage demand, we project that a new Denver Mint facility must be in operation by 1980. Once completed, the new Mint will have an initial production capacity of 10.5 billion coins per year -- in contrast to the present production of about 5 billion coins -- which could ultimately be expanded to 25 billion coins annually. Together with the other Mint facilities which have the combined capacity of producing 11 billion coins per year, the new Denver Mint would represent an assurance that our nation's coinage needs would be fully supplied for many years.

The bills before you, Mr. Chairman, (S. 1339 and H.R. 5620) are essentially the same as the measure proposed by the Administration in early 1973, which the Senate, after unanimous approval by the Banking Committee, passed in June 1973. While that measure was similarly approved by the House Public Works Committee, it failed to gain the votes necessary for passage under suspension of rules in the House in the closing days of the 93rd Congress. Before the Administration could reintroduce the proposals in this Congress, the Colorado delegation both in the House and Senate introduced the bills now pending before you. After hearings before the House Public Works Committee, held in the spring of 1975, the House overwhelmingly approved the proposal in September of last year.

While the authorization proposal was being considered by the 93rd Congress, the Department and GSA undertook a thorough evaluation of the available sites in the Denver area for a new Mint facility. After an intensive examination of available alternatives, and after completion of clearance in accordance with the National Environmental Policy Act of 1969, the Department selected a site for the facility in July 1974, which is known as the "Park Hill" site. This site is located on a golf course in the northeast part of Denver and consists of some 34 acres. Under an agreement with the City of Denver, title to that property was conveyed to the Federal Government by the City for $1.5 million in September 1975.

Although the Department continues to consider the site we have so acquired as an excellent and entirely feasible location for a new Denver facility, we feel obligated to bring to your attention, Mr. Chairman, an alternative site which our people and GSA have concluded will result in considerable savings for the Government. Approximately three months ago, a real estate firm brought to our attention the availability of an industrial facility (known as the Littleton facility) located just outside Denver. This vacant industrial building (containing 425,000 square feet of finished space and 50,000 square feet of unfinished space on one unobstructed floor), together with some 58 acres of land, is available for $8.5 million. The Department could not ignore the potential savings which might result from the acquisition and modification of this alternative site, we ordered, with the General Services Administration, a thorough evaluation of this facility. According to the findings of the study, the acquisition and renovation of this facility would result in estimated savings of $25 million for the Federal Government over the cost of acquiring the site and constructing a new Mint on the Park Hill site. In addition, by acquiring the existing facility, it appears to us that the Department could save about two years in placing the new coinage facility into operation.

If we were called on to make a purely business judgment as a private company could, we would have to conclude that the acquisition of the existing Littleton facility is preferable to constructing an entirely new Mint at the Park Hill site. We do, at the same time, fully realize that, as a Department of the Federal Government, there are numerous legal complications that could effectively delay the completion of the adaptation of the Littleton facility for use as a Mint for years, particularly litigation over the adequacy of any environmental impact statement that we might file. While we believe that any environmental impact -- social, economic or otherwise -- of relocating the Mint from downtown Denver to outside the city limits is far outweighed

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by the cost savings, we realize that Congress, in which the ultimate selection responsibility rests, may feel differently. While we are recommending the Littleton facility, our real need is a new Denver Mint, and we cannot afford to be tied up in litigation for years and years defending this choice. We therefore propose the approval of S. 1339 and H.R. 5620, Mr. Chairman, but with the addition of an amendment, which would enable the Mint to acquire the Littleton facility.

If the Congress believes, as we do, that the potential savings in both time and money warrant the selection of the Littleton site, then I draw your attention to section 2 of H.R. 5620, as passed by the House. This provision, since it contemplates new construction, would be inconsistent with the acquisition of an existing facility. Thus, if the Littleton site is to be acquired, then perhaps H.R. 5620 should be further amended by adding a new section 3 along the following lines:

> Notwithstanding any other provision of this Act, if negotiation to that end can be concluded, the Secretary of the Treasury is directed to acquire an existing plant and associated real property in the Denver, Colorado area and the appropriations authorized by the first section of this Act shall be available for such acquisition and the subsequent conversion and equipping of such plant for use as a coinage facility.

Such language would recognize that the Government may not necessarily be successful in negotiating the purchase of the Littleton plant and site because it may no longer be on the market when appropriations become available, or because the owners may not be agreeable to a sale to the Government. However, if the site can be acquired, the Congressional direction will assure that the acquisition can proceed without further delay.

The Committee may also wish to address itself in its report to the need for further consideration of environmental concerns. The previous environmental impact statements fully dealt with the matter. While the most recent statement primarily related to the Park Hill site, most of the discussion is applicable to a Mint anywhere in the Denver area. In addition, we have made a preliminary examination of the environmental factors associated with the possible use of the Littleton facility and concluded that there would be no significant adverse environmental effects under this proposal. Thus, the Committee may wish to affirmatively state its satisfaction with the analysis as its basis for directing that the Littleton site be acquired.

Such modification in H.R. 5620, in the Department's view, is necessary so that we may acquire the Littleton site without delay. Nevertheless, Mr. Chairman, if the Committee feels it is not prepared to amend the House-passed bill, we, alternatively, recommend that it vote favorably on H.R. 5620 as it now reads. Passage of H.R. 5620 in its present form would, at least, enable us to proceed with the construction of a new facility at the Park Hill site.

Before I joined the Treasury Department, when I was practicing law, it was a commonplace occurrence for my clients to be forced to change their capital plans at the last minute. Having come to Washington two years ago, I find that we have to be just as flexible in planning Government capital expenditures. The only thing that surprises me is the criticism that appeared in the Denver press and elsewhere regarding the motives of those Mint and Treasury officials who, when presented with the Littleton facility, proceeded to analyze its advantages and disadvantages. Let me assure you, Mr. Chairman, that no matter what decision is ultimately made, our recommendation to the Committee reflects simply the best efforts of dedicated Treasury personnel to spend the taxpayers' money at though it were our own.

This, Mr. Chairman, concludes my prepared statement. I appreciate your patience and the patience of the Committee, and I will be happy to answer and questions you may have.

# # #

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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For information on submitting tenders in the Washington, D. C. area: PHONE WO4-2604

FOR RELEASE AT 4:00 P.M. February 27, 1976

TREASURY TO AUCTION $2.0 BILLION OF NOTES

The Department of the Treasury will auction $2.0 billion of 4-year notes to raise new cash. Additional amounts of the notes may be issued to Federal Reserve Banks as agents of foreign and international monetary authorities.

The notes now being offered will be Treasury Notes of Series C-1980 dated March 17, 1976, due March 31, 1980 (CUSIP No. 912827 FK 3), with interest payable on September 30, 1976, and thereafter on March 31 and September 30. They will be issued in registered and bearer form in denominations of $1,000, $5,000, $10,000, $100,000, and $1,000,000, and they will be available for issue in book-entry form.

Payment for the notes must be made on March 17, 1976. Payment may not be made through tax and loan accounts.

Tenders will be received up to 1:30 p.m., Eastern Standard time, Friday, March 5, 1976, at any Federal Reserve Bank or Branch and at the Bureau of the Public Debt, Washington, D. C. 20226; provided, however, that noncompetitive tenders will be considered timely received if they are mailed to any such agency under a postmark no later than Thursday, March 4. Each tender must be in the amount of $1,000 or a multiple thereof, and all tenders must state the yield desired, if a competitive tender, or the term "noncompetitive", if a noncompetitive tender. Fractions may not be used in tenders. The notation "TENDER FOR TREASURY NOTES" should be printed at the bottom of envelopes in which tenders are submitted.

Competitive tenders must be expressed in terms of annual yield in two decimal places, e.g., 7.11, and not in terms of a price. Tenders at the lowest yields, and noncompetitive tenders, will be accepted to the extent required to attain the amount offered. After a determination is made as to which tenders are accepted, a coupon yield will be determined to the nearest 1/8 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 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. Tenders at a yield that will produce a price less than 99.001 will not be accepted.

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 $500,000 or less will be accepted in full at the average price of accepted competitive tenders, which price will be 100.000 or less.

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(OVER)

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 the 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 commercial and other banks 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, Federal Reserve Banks, and Government accounts. Tenders from others must be accompanied by payment of 5 percent of the face amount of notes applied for. However, bidders who submit checks in payment on tenders submitted directly to a Federal Reserve Bank or the Treasury may find it necessary to submit full payment for the notes with their tenders in order to meet the time limits pertaining to checks as hereinafter set forth. Allotment notices will not be sent to bidders who submit noncompetitive tenders.

Payment for accepted tenders must be completed on or before Wednesday, March 17, 1976, at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt in cash, in other funds immediately available to the Treasury by March 17, 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) Thursday, March 11, 1976, 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) Tuesday, March 9, 1976, 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. Where full payment is not completed on time, the allotment will be canceled and the deposit with the tender up to 5 percent of the amount of notes allotted will be subject to forfeiture to the United States.

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Department of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 964-2041

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The Treasury will sell $2 billion notes due March 31, 1980. The issue will be auctioned on March 5 and will be settled on March 17.

February 27, 1976

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Department of the TREASURY NEWS
[WASH]INGTON, D.C. 20220 TELEPHONE 964-2041

FOR RELEASE ON DELIVERY

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STATEMENT BY THE HONORABLE CHARLES M. WALKER
ASSISTANT SECRETARY OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL FINANCE AND RESOURCES
SENATE FINANCE COMMITTEE
MONDAY, MARCH 1, 1976, 10:30 A.M.

Elimination of U.S. Withholding on Dividends and Interest Paid to Foreign Investors

Mr. Chairman and Members of the Subcommittee:

I want to thank you for this opportunity to present to this Subcommittee our views on the elimination of withholding taxes on dividends and interest paid to foreign investors.

At the outset, let me state that the Treasury Department and the Administration believe that the existing withholding taxes on dividends and interest payments by United States persons to non-resident aliens and foreign corporations should be eliminated. We strongly support elimination of these taxes because of the defects inherent in the present tax withholding system and the benefits to be derived through its elimination.

Under present law, and subject to numerous exceptions, a 30 percent withholding tax is imposed on the gross amount of dividends and interest paid to foreign investors.

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In our view, this present tax withholding system:

-- Handicaps U.S. companies seeking to raise funds in the international capital market:

-- Favors short term debt investment at the expense of longer term investment; and

-- Has resulted in an unwarranted degree of complexity in our tax law which is now replete with exceptions for the tax-wise foreign investor and traps for the unwary.

The present tax withholding system handicaps U.S. companies seeking foreign capital in a number of ways.

First, the present system narrows and inhibits the market in which potential foreign investors operate. It places a great premium on complexity and discourages from investing at all, those who are unable or unwilling to deal with these complexities, such as avoiding double taxation or finding the optimum route for tax treaty reductions. Certainly the development of our own national capital market would have been severely retarded if each state had imposed withholding taxes at varying rates on dividends and interest paid by local corporations to investors residing in other states.

Second, the present system inhibits an effective international secondary market in U.S. securities and securities which are not freely marketable throughout the world are not competitively attractive investments. Foreigners investing in U.S. securities today are generally those able to blunt the impact of U.S. withholding taxes through use of our network of bilateral income tax treaties which eliminate or substantially reduce these withholding taxes. However, these treaty exemptions and reductions are unsatisfactory in making U.S. securities attractive in international markets because they depend on the identity of the holder of the security. That is, they exempt only residents of treaty countries. This fact greatly restricts the negotiability of securities in international capital markets and greatly narrows the opportunities open to U.S. issuers abroad.

Third, U.S. borrowers seeking long-term funds are at a competitive disadvantage with borrowers of other major countries which do not impose withholding taxes on investments by nonresidents. Indeed, other countries recently have been taking legislative action to eliminate their withholding on interest obligations in order to give their borrowers greater access to international capital markets. For example, Australia in 1973, Japan in 1975 and Canada in 1975 enacted laws to exempt interest on long term international bonds.

They have joined other countries that already provide for exemption on international issues. (See Annex A).

Finally, U.S. withholding taxes increase the capital costs of American companies. Foreign borrowing is either deterred or it is the American company, not the foreign investors, who bear the burden of U.S. withholding tax, For example, an American borrower who would otherwise borrow at 9 percent may be required to pay a nonresident as much as 13 percent to secure the same loan.

In addition, the present tax withholding system favors short term debt investment rather than desirable long term debt or equity investment. This bias arises as a result of the present exemptions from withholding for interest on bank deposits and other short term obligations.

Finally, the present tax withholding system has resulted in a patchwork of statutory and treaty provisions, which in sum, are not simple, are not neutral with respect to investment decisions, and do not raise significant revenue. Indeed, there have been so many ways around the United States withholding tax that the 30 percent tax on gross income either acts as a deterrent to investment or is noted more for its

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avoidance than its collection. These conclusions are perhaps best illustrated through a description of the exceptions available under the present tax withholding system.

Domestic legislation has singled out certain categories of income recipients to be free of withholding taxes.

Interest on United States bank deposits held by foreigners has traditionally been free from United States withholding tax and the Congress has extended such exemption on several occasions. The tax reform act passed by the House and now before the Finance Committee makes this exemption permanent. The present exemption undoubtedly contributes to the present flow of foreign funds into bank deposits rather than longer term securities.

The Internal Revenue Code exempts from withholding tax, investments in stocks and debt obligations by foreign governments. There are major administrative problems in determining the scope of this exempiton and its application to specific cases, particularly where the investment is made through an entity separate in form from the foreign government. A broad exemption would avoid the difficult administrative problem of making such determinations on a case-by-case basis through private rulings.

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In some cases, withholding has been eliminated because it is not practical, as an administrative matter, to collect a tax. For example, there are very difficult problems in applying withholding where securities are issued at discount, and the economic benefit is realized subsequently through sale to third parties. Accordingly, short term discount was removed from withholding in 1971. Similarly, capital gains taxes on U.S. investment assets held by foreigners were eliminated through amendments to the Code in 1966.

Other exemptions have been established on conceptual grounds. Thus, U.S. companies having more than 80 percent of their gross income from foreign sources are not subject to withholding tax on dividends and interest paid to foreign investors. This rule, coupled with favorable Internal Revenue Service ruling practices, was the basis of a major financing device during the period when direct investment regulations required that U.S. companies who wanted to borrow for foreign investment had to do that borrowing abroad.

Statutory amendments tied to the Interest Equalization Tax permitted the direct issuance by United States companies of debt obligations free from United States withholding and estate taxes. These possibilities for raising capital abroad are foreclosed today following expiration of the investment control programs and changes in ruling policy. This leaves United States companies largely unable to issue new securities in the international securities markets that trade free of withholding and estate taxes.

Major exceptions to the tax lie in our series of bilateral tax treaties. For many years, United States policy has been to seek treaties which eliminate withholding on interest payments. We have treaties with 12 countries which eliminate withholding and treaties with others which reduce the withholding rate. Similarly, we have a number of treaties which reduce dividend rates to 15 percent in the case of portfolio investment and 5 percent in the case of direct investment by a corporate investor. These rates follow the treaty model of the Organization for Economic Cooperation and Development (OECD), which has been widely adopted by member countries to reduce withholding taxes. These bilateral conventions in effect create a series of individual income tax codes under which income flows incur less tax when passed through a circuitous route of interlocking tax treaties. Inordinate time and effort is spent by tax planners in routing transactions and investments to obtain the most favorable arrangements. In some cases, this leads to the use of nominees and concealed ownership.

The treaty network already serves to reduce or eliminate withholding in the case of the bulk of investments which are actually in place today. In 1973 more than 90 percent of non-bank interest and dividend income flowed to residents of treaty countries.

The important lesson of treaty experience, however, is that elimination of withholding taxes on dividends and interest paid to foreign investors is not only a practical result but has long been recognized as sound tax policy.

The question of dividend and interest income was considered more than 50 years ago by a commission of tax experts extablished by the League of Nations. They concluded, back in 1923, that the right to tax investment income properly belongs to the state of the taxpayer's residence. This principle has been reaffirmed in the commentaries to the OECD Model Convention, while recognizing that some states may wish to maintain some minimal withholding tax solely on revenue grounds.

With respect to those investments in the United States that have not been deterred by withholding taxes, the net effect of the various statutory and treaty exemptions has been to substantially lower the average rate of withholding tax. For 1973, the total withholding taxes collected on dividends, and interest other than bank interest, were less than 10 percent of the gross payments despite a basic statutory rate of 30 percent. Further, the amount of tax actually collected is very small. In 1973, only \$210 million of withholding tax was collected of which less than \$20 million is clearly identifiable as withholding on interest.

Thus, the revenue aspects of withholding are not major. In sum, we are persuaded that our present tax withholding system is counter-productive in hampering our economy, denying access to foreign capital markets, favoring short term foreign debt investment, and needlessly complicating our tax law in order to raise so little revenue. Rather, we recommend the elimination of withholding taxes on dividends and interest paid to foreign investors.

In our view, elimination of withholding tax on investment income is desirable because:

1. Removal of the tax will make investing more attractive and less difficult for investors. It will make it easier for U.S. companies to seek funds in international capital markets and will enhance market efficiency for investment in the United States. At a time when projections show a

need for increased capital sources, we should be concerned over the efficiency of our tax system when applied to foreigners otherwise willing to place their funds in the United States. By elimination of the withholding we reduce the tax burden on capital formation.

2. It should improve the relative attractiveness of long term securities and reduce the present bias. favoring short term obligations and bank deposits.

3. It may help restore the United States financial community to the center of international capital markets.

4. It is consistent with principles of tax equity and other rules relative to source of income.

5. It will eliminate what has become a complex patchwork of legislative and treaty provisions and simplify one area of tax law.

The basic point is that the many benefits of eliminating withholding outweigh the revenue loss and thus, on balance, we believe it is the best approach to take.

We urge elimination of withholding not only with respect to interest income, where a 30 percent tax on gross payments of interest is a clear impediment, but also for dividend payments. There is no reason to perpetuate favorable tax treatment for debt investment over equity investment.

Many foreign investors are interested not only in capital appreciation, which we do not tax in the case of a foreign investor, but in yield. The 30 percent tax on portfolio dividends is clearly a deterrent to those relying on the investment yield. This deprives many of our businesses of access to a form of capital they urgently require.

Before concluding, however, let me treaty briefly with some of the reasons offered for retaining the present withholding system.

Cost. It has been suggested that elimination of tax withholding is costly and would merely give foreign investors a "free ride" at the expense of the U.S. Treasury.

As noted earlier, because of the large number of exemptions and rate reductions under the present system these taxes deter additional investment and raise very little of our total revenue. Indeed for 1976 it is estimated that withholding tax collections will account for less than 1/10th of 1 percent of total revenue. Moreover, it should be noted that to the extent the elimination of withholding results in increased foreign investment in the U.S., additional U.S. tax revenue will be generated from the increased economic activity created by such investment. Finally, to the extent foreign investors qualify for exemption under the present system or the present withholding taxes are borne by the U.S. borrower through an increased interest cost, foreign investors already get this so-called free ride.

Treaty Negotiations. There is some concern over the effect of our unilateral removal of withholding taxes on our bargaining position in tax treaty negotiations. The development of a system of bilateral treaties for avoidance of double taxation led in the past to the adoption of reciprocal reductions in withholding tax rates. However, the new realities are relatively clear. Developing countries with limited amounts of investment in the U.S. generally do not seek to have the United States reduce its withholding tax and the United States has generally not sought in its discussions with developing countries to persuade them to forego revenues by reducing their withholding tax rates.

Moreover, we now have tax conventions with the majority of developed countries, virtually all of which already provide for reduced withholding rates. Finally, in cases where we renegotiate these treaties, developed countries generally do not have the reduction of our withholding taxes as a major treaty objective. Thus, today United States withholding rates are of limited significance in treaty bargaining.

Tax Avoidance. Some European country Treasury officials have expressed concern in recent years over tax avoidance by their residents investing in the Eurobond market in which

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the securities are issued in a manner which makes them free of withholding at the source. They have suggested the desirability of imposing uniform withholding taxes on securities issues, with some form of verification and refund system. On the other hand, some European capital importing countries, which do not have withholding tax on interest today, have opposed this suggestion and have pointed out that the imposition of a withholding tax at the source at a 20 or 30 percent rate may make tax avoidance somewhat more expensive, but will not deter avoidance for persons in higher marginal income brackets.

We are mindful of the problems raised by tax avoidance, but do not believe that it is necessary to structure our internal tax system to make up for the inadequacies of individual countries with respect to the taxation of their own citizens. Thus, we believe it desirable to avoid cumbersome withholding and refund systems, but we do support the concept of expanding information reporting and the exchange of information to permit countries to have access to data they may require for tax enforcement.

The Treasury Department has suggested that legislation eliminating withholding should also permit the imposition of a withholding tax in the case of a country that refused to cooperate in identifying recipients of dividend and interest payments where there is believed to be a substantial

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problem of tax evasion. This discriminatory stick should be more effective than our existing rules in dealing with foreign tax havens.

Conclusion

In conclusion let me again emphasize that it is time we reform the tax withholding system. We believe the investments the present tax withholding system discourages and the complexity it creates are much more significant than the amounts of revenue it produces. Revenues gained from increased investment and economic activities in the United States will offset revenues lost. It is in our national interest, on both economic and tax policy grounds, to eliminate withholding on dividend and interest income. We should do so, and do so promptly.

ANNEX A

International Practice on Withholding Taxes on Interest

The following is a recent survey of foreign countries exempting withholding on interest on obligations (other than bank accounts) paid by domestic issuers to foreigners:

Austria. Interest paid to nonresident lenders is exempt.

Australia. Interest payments by a resident to a nonresident are exempt from payment of the 10% withholding tax if the interest liability is incurred in carrying on a business in a country outside Australia through a permanent establishment in that other country. Furthermore, the income tax law amended in 1971 to exempt any interest payments: (i) made in a foreign currency on public issues or widely offered private placements of bearer bonds, if the bonds were issued in a foreign currency outside Australia by Australian companies for use in their Australian businesses; or (ii) made on bearer bonds in a foreign currency, if the bonds were issued in a foreign currency outside Australia by Australian companies for use in a business which is wholly or substantially Australian owned and controlled.

Belgium. With respect to loan agreements entered into between March 1, 1968 and December 31, 1971, Belgium granted an exemption from withholding for interest paid by Belgian industrial, commercial or agricultural enterprises to nonresidents who had no permanent establishment in Belgium in cases in which the loans served the purpose of financing operations of general economic interest and contributed directly to the establishment, expansion, conversion or modernization of the borrower. (Artc. 89, § 2, 6°, C of Royal Decree of March 4, 1965; Royal Decree of January 5, 1971, 1971 Moniteur Belge 763 (January 21, 1971)). This exemption was applicable to private and public borrowings and no requirements as to maturities were imposed. The only exemptions from withholding presently available in Belgium cover interest paid to nonresidents on (1) loans to and deposits in banks established in Belgium made by foreign banks, and (2) registered obligations of, and deposits in, Belgian banks and certain other financial institutions.

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Canada. The Canadian Income Tax Act was amended in 1975 to exempt from Canadian tax interest which Canadian companies pay to unrelated nonresidents on obligations issued after June 23, 1975 if, under the terms of such obligations, the company may not be obliged to pay more than 25 percent of the principal amount thereof within five years of the date of issue.

Denmark. Interest paid to nonresident lenders is exempt.

France. Under Article 131 ter 1 of the Code Generale des Impots, the Minister of Economy and Finance is authorized to exempt from French withholding tax payments of principal and interest made outside France on special issues of bonds floated abroad by French companies or enterprises. Under this provision, the Minister has authorized exemptions for private placements with a small number of lenders as well as for public issues. No limitations on the maximum period to maturity have been imposed. By Degree of January 7, 1966, codified as Article 41 Duodecies C of Annexe III of the Code Generale des Impots of France, exemption from withholding is also given to interest on deposits of foreign currency with French banks and to income on certain short-term transactions between French banks on the one hand and foreign banks, international organizations and foreign financial institutions on the other. Moreover, in the 1975 Finance Law, passed on December 30, 1975, France has further expended its tax exemption for interest payments to nonresidents.

Finland. Under the "Act on Taxation of Income and Property", Article 7, Section 2, Finland exempts from income tax all bond interest paid to foreign lenders. This provision was first enacted in 1966 as an interim measure to be effective for one year. This law has been renewed from year-to-year, most recently on December 29, 1972, for the year 1973. In 1973, the provision was amended so as to exempt from Finnish income tax all interest paid to foreign lenders on foreign loans, including foreign private placements.

Italy. Italian law provides an exemption from withholding for interest paid to nonresidents on certain loans contracted and bonds issued outside Italy. This exemption, which has been available since April 28, 1970, was to expire on January 7, 1974 unless extended.

Japan. Under special legislation in Japan, interest payable on foreign currency debt securities issued by Japanese companies during the period from April 1, 1968 to March 31, 1972 and having maturities of not less than five years are exempt from withholding if paid to nonresidents of foreign corporations not having permanent establishments in Japan to which the interest is attributable. It is understood that similar relief was extended in 1974.

Netherlands. Interest paid by a Dutch financing company is ordinarily exempt from withholding.

Norway. Interest paid to nonresident lenders is exempt.

Sweden. Interest paid to nonresident lenders is exempt.

United Kingdom. If a borrowing by a resident borrower from a foreign lender is governed by foreign law, the interest is exempt from withholding at the source. In order for the interest to be deductible by the borrower, the borrowing must comply with additional restrictions on the place where, and the currency in which interest is paid and on the purpose of the borrowing. (Income and Corporation Taxes Act 1970, §§ 248(4)(b), 249(1)).

ANNEX B

Projected Revenue Effects of the Elimination of Withholding Taxes on Dividends and Interest Paid to Foreign Investors
($ millions)

Elimination of tax on:	1976	1977	1978	1979	1980
1. interest from portfolio investment	15	20	25	30	35
2. dividends from portfolio investment	150	160	170	180	190
3. interest from direct investment	2	2	2	3	3
4. dividends from direct investment	38	42	46	50	54

* * * * * * *

Totals	1976	1977	1978	1979	1980
portfolio interest and dividends	165	180	195	210	225
direct interest and dividends	40	44	48	53	57
all interest and dividends	205	224	243	263	282

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR IMMEDIATE RELEASE

Contact: R.B. Self
Extension 8256
March 1, 1976

TREASURY ISSUES FINAL COUNTERVAILING DUTY DECISION ON IMPORTED GLAZED CERAMIC WALL TILE FROM THE PHILIPPINES

Assistant Secretary of the Treasury David R. Macdonald announced today a final negative determination under the Countervailing Duty Law with respect to imports of glazed ceramic wall tile from the Philippines. A notice to this effect will be published in the Federal Register of March 3, 1976.

Treasury's investigation revealed that "bounties or grants" were being paid to the ceramic wall tile exporters in the form of various tax incentives provided under the Philippine Investment Incentives Act and the Export Incentives Act. A preliminary determination that bounties are being paid was published in the Federal Register of August 26, 1976. The Treasury has now received assurances from the Government of the Philippines that the Philippine firms receiving benefits under the incentive programs are no longer exporting to the United States, and are not expecting to do so in the future. Should this situation change in any way, the Philippine Government would so inform the United States. On the strength of these assurances, the Treasury concluded that there are no bounties or grants paid or bestowed on imported glazed ceramic wall tile from the Philippines.

During 1974 imports of the glazed ceramic wall tile from the Philippines were approximately $1.6 million.

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WS-684

Department of the TREASURY
OFFICE OF REVENUE SHARING
WASHINGTON, D.C. 20226
NEWS
TELEPHONE 634-5248

665

FOR IMMEDIATE RELEASE
MONDAY, MARCH 1, 1976
CONTACT: PRISCILLA R. CRANE (202) 634-5248

The Third Annual Report of the U. S. Treasury Department's Office of Revenue Sharing was released today.

Revenue sharing law requires the Secretary of the Treasury to report to the Congress by March 1 of each year on the status of the general revenue sharing trust fund. The Annual Report issued today also includes such information as a discussion of the highlights of the work of the office during the previous year, a chronology of major events, a full description of allocation and payment procedures, and a summary of the Administration's proposal for renewal of the program.

Individual copies of the report are available from the Office of Revenue Sharing, 2401 E Street, N.W., Washington, D. C., 20226.

The general revenue sharing program is authorized by Title I of the State and Local Fiscal Assistance Act of 1972 (P.L. 92-512). The law presently authorizes the distribution of $30.2 billion to all units of general-purpose state and local government over a five-year period, from 1972 through December 31, 1976. President Ford has requested the Congress to extend general revenue sharing for an additional five and three-quarter year period.

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WS-675

Department of the TREASURY NEWS
INGTON, D.C. 20220 TELEPHONE 964-2041

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Contact: D.Cameron
Extension 2951
March 1, 1976

FOR IMMEDIATE RELEASE

TREASURY DEPARTMENT ANNOUNCES PRELIMINARY COUNTERVAILING DUTY DETERMINATION ON GLASS BEADS FROM CANADA

Assistant Secretary of the Treasury David R. Macdonald announced today the issuance of a preliminary determination that bounties or grants are being paid or bestowed on imports of glass beads from Canada within the meaning of the United States Countervailing Duty Law (19 U.S.C. 1303). A notice to this effect will be published in the Federal Register of March 2, 1976.

Interested parties will be given an opportunity to submit written views before the Commissioner of Customs in time to be received no later than 30 days from the date of publication of this notice. As required under the Countervailing Duty Law, a final determination will be issued in the Federal Register by no later than August 25, 1976.

The Treasury's preliminary determination concluded that regional assistance provided by the Canadian Government and preferential freight rates may constitute bounties or grants on glass beads exported to the United States. If a final affirmative determination is made, the Countervailing Duty Law requires the Secretary of the Treasury to assess an additional duty on merchandise benefitting from such bounties or grants.

During 1974, imports of glass beads from Canada were approximately $420,000.

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Department of the TREASURY
OFFICE OF REVENUE SHARING
WASHINGTON, D.C. 20226
NEWS
TELEPHONE 634-5248
THE DEPARTMENT OF THE TREASURY 1789

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FOR IMMEDIATE RELEASE
TUESDAY, MARCH 2, 1976
CONTACT: PRISCILLA CRANE (202) 634-5248

The City of Miami, Florida will be required to change its employment and promotion practices according to the provisions of a consent decree approved by the U. S. District Court for the Southern District of Florida on Wednesday, February 18, as a result of Office of Revenue Sharing initiatives.

The U. S. Treasury Department's Office of Revenue Sharing had found evidence of discrimination in employment in the City shortly after the general revenue sharing program was authorized. It was noted, for example, that although 45% of the population were Spanish-speaking persons, they held only 5.5% of the City's jobs.

The Office of Revenue Sharing coordinated its efforts to achieve compliance with the U. S. Department of Justice which was seeking to establish the rights of minorities and women under other programs, as well.

The City of Miami has been allocated $8.8 million in general revenue sharing funds for the current fiscal year. Since the revenue sharing program began in 1972, the City has received more than $31.8 million.

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The consent decree approved recently requires the City to maintain an active program of recruitment for Blacks, Latinos and women and to assist them to prepare for examinations for positions in certain City departments.

Employment tests are required to be developed in conformity with guidelines established by the Equal Employment Opportunity Commission. Examinations will be given in Spanish for positions which do not require proficiency in the English language.

Although the consent decree gives special emphasis to employment procedures for the City's Police and Fire departments, the decree also specifically forbids the City to discriminate in any department on the basis of race, color, sex or national origin.

In order to eliminate the effects of past discrimination, the decree requires the city to seek to employ Blacks, Latinos and women in proportion to their availability in the City labor force. Goals and timetables are set forth for achievement of proper representation in City departments.

The decree also requires the submission of detailed reports by the City to the Office of Revenue Sharing and Department of Justice within ninety (90) days and on each June 30th and December 30th thereafter while the decree is in force. The court will keep jurisdiction of the case for at least five years to insure substantial compliance with the decree and achievement of its basic objectives.

Moreover the decree requires the City to establish a fund of $500,000 to provide back pay for persons discriminated against in promotions or upon discharge from employment.

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REPORT ON DEVELOPING COUNTRIES
EXTERNAL DEBT AND DEBT RELIEF
PROVIDED BY THE UNITED STATES.

January 1976

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THE SECRETARY OF THE TREASURY
WASHINGTON

JAN 30 1976

Dear Mr. Chairman:

I am pleased to submit, as required by Section 634(g) of the Foreign Assistance Act of 1961, as amended, the second annual report on the debt situation in the developing countries and the debt relief provided by the United States.

The report provides an historical perspective of the LDC debt situation as of December 1973, the latest date for which complete data are available. Additionally, the report reviews the balance of payments trends of the non-oil LDC's for the period 1973-1976, and the implications of these trends for LDC debt. The report also contains information on the two major debt reschedulings in which the U.S. participated in fiscal year 1975.

I hope this information will be of use to you and other members of the Foreign Relations Committee.

Sincerely,

William E. Simon

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The Honorable
John J. Sparkman, Chairman
Senate Foreign Relations Committee
United States Senate
Washington, D.C. 20510

Enclosure

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THE SECRETARY OF THE TREASURY
WASHINGTON 20220

JAN 30 1976

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I hope this information will be of use to you and other members of the House. Because of his interest in this subject, I am also sending a copy of the report to Congressman Thomas Morgan, Chairman, International Relations Committee.

Sincerely,

William E. Simon

The Honorable
Carl Albert
Speaker of the House of Representatives
Washington, D.C. 20515

Enclosure

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The Honorable
Thomas E. Morgan, Chairman
Committee on International Relations
House of Representatives
Washington, D.C. 20515

Enclosure

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I. SUMMARY AND CONCLUSIONS

External public debts outstanding of the less developed countries (LDC's) totalled $119 billion at the end of calendar year 1973, the latest year for which complete information is available. While outstanding debt increased about 20 percent in 1973, the ability of the LDC's to service their debt generally improved in 1973.

Export earnings of the LDC's were high in 1973, and increased capital flows contributed to their better overall positions, including a substantial accumulation of reserves. In fact, according to several analytical measures, the external debt positions of the LDC's improved in 1973. For example, the ratio of debt service payments to exports, a ratio which is used frequently to assess external debt burdens, decreased significantly for low income countries between 1972 and 1973.

The economic prospects for most of the non-oil exporting LDC's were significantly impaired by the events of late 1973 and early 1974. The sharp jump in oil prices placed an immediate and extreme burden on the balance of payments of the non-oil LDC's, costing them more than an additional $10 billion in direct oil import payments. Higher food and fertilizer prices in 1974 and the worldwide recession of 1974/1975 also had a serious impact on the balance of payments of many LDC's, although food and fertilizer prices did fall in the second half of 1975.

Precise figures on the current account balances of the non-oil LDC's for 1975 are not yet available, thus the following data are only estimates and projections of the order of magnitude of these deficits for 1975 and 1976. The combined current account deficit of 88 non-oil LDC's rose some $19 billion from 1973 to about $28 billion in 1974, and rose again to approximately $37 billion in 1975. Thus, most non-oil LDC's borrowed substantially more in calendar years 1974 and 1975 than they had in the past to finance these current account deficits. For 1976 the combined current account deficit is estimated to fall by at least $3 billion to about $34 billion.

It is normal for LDC's to be net importers of capital. This capital comes from a variety of sources consisting primarily of bilateral loans and grants, aid from multilateral institutions, private direct investment, private credits, and official trade credits. Some of these normal flows, such as aid grants and most direct investment will not result in increased debt service. A substantial portion of the remaining normal flows consists of long-term concessional credits. These credits often have grace periods and will increase debt service only slightly in the next few years. In 1975 these normal capital flows were estimated at $25 billion, leaving some $12 billion to be financed by a drawdown of reserves and borrowing above normal long-term trends.

For calendar 1976, the financing problem of the non-oil LDC's as a group will be smaller than in 1975. Current account deficits, while still high, will be at least $3 billion smaller and normal capital flows will be about $1 billion higher. Thus the requirement for reserve drawdowns or borrowing beyond long-term trend will be about $8 billion, or about one-third less than that of 1975.

In response to their external financing problems, many LDC's have taken domestic policy measures that will reduce their current account deficits over the next few years, but with some reduction in their growth rates. However, these domestic measures will become effective only after a time lag. Although economic activity in the developing countries is expected to expand substantially in 1976, there will be lags in the effect of this growth on LDC export earnings. As the economic situation in the non-oil LDC's is expected to improve, it would appear that they will be able to arrange for the necessary financing.

In calendar year 1975 some countries initiated proposals in the United Nations Committee on Trade and Development (UNCTAD) for a multilateral debt moratorium or generalized debt rescheduling for the poorest LDC's. The United States opposed this initiative as did virtually all other creditor countries. The U.S. does not consider a generalized debt rescheduling or a debt moratorium to be appropriate instruments for alleviating the current financial difficulties of the LDC's. Nor does it deem such actions to be appropriate instruments for providing official assistance to the LDC's.

In fiscal 1975, the U.S. particpated in a multilateral debt rescheduling for India which related to developments the previous year. The rescheduling was undertaken under the auspices of the World Bank-chaired Aid-to-India Consortium. The U.S. share of this rescheduling was $45 million out of a total of $248 million. At the Aid-to-India Consortium meeting in June 1975, the U.S. stated that it would not grant debt relief to India in its fiscal year 1976 (April 1, 1975--March 30, 1976). Improved short-term prospects should enable India to continue servicing fully its debt to the U.S. in India's fiscal year 1977.

The U.S. also participated in a debt rescheduling for Chile under the auspices of the "Paris Club Creditors." The U.S. share of this rescheduling was $96 million out of a total of $230 million. This rescheduling was undertaken after Chile reached an agreement with the IMF for a stabilization program which included an obligation by Chilean officials to implement a number of economic reform measures recommended by the IMF. The rescheduling was also predicated on a recommendation by the IMF that debt rescheduling was appropriate. The full servicing of external debts was beyond Chile's financial capacity in calendar year 1975.

II. THE DEBT OUTLOOK FOR NON-OIL LDC's

1. Introduction

The international economic and financial events of the last two years, particularly the sharply increased oil prices, radically changed the economic outlook for the non-oil developing countries. Prior to the oil price increases, the external positions and economic prospects of these countries had been rapidly improving. In the early 1970's, their real GNP growth exceeded six percent per annum and their terms of trade had improved substantially. By 1973, improved current account positions and increased capital inflows had contributed significantly to better overall external positions for the non-oil LDC's and resulted in a substantial accumulation of foreign exchange reserves. In general, the economic outlook for the non-oil LDC's at mid-year 1973 appeared encouraging.

The economic and financial prospects for most non-oil exporting developing countries were significantly impaired by events of late 1973 and early 1974. Higher and continually increasing oil prices placed an immediate and extreme burden on the balance of payments of these LDC's. The subsequent worldwide recession during calendar years 1974 and 1975 decreased the demand for many LDC exports and eroded commodity prices, thus inhibiting their ability to earn foreign exchange and intensifying their balance of payments problems. Increases in food and fertilizer prices in 1974 also had a serious impact on the balance of payments in many LDC's, although these prices fell somewhat in 1975. As a result, most non-oil LDC's borrowed substantially more in calendar years 1974 and 1975 than they had in the past to finance their current account deficits.

This chapter evaluates in broad terms the ability of non-oil LDC's to avoid debt servicing difficulties in calendar year 1976. The discussion is divided into two parts. The first part reviews the debt situation of all 88 non-oil LDC's as a group. The framework for this discussion is an analysis of the magnitude of the current account deficits of these 88 LDC's for calendar years 1975 and 1976 and the means by which these deficits are financed.

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In the second part of this chapter, the situation of 23 non-oil LDC's is reviewed in more detail. These 23 LDC's were selected because they account for a substantial portion of the external debt, combined current account deficits, and volume of trade of all non-oil LDC's. They also reflect the broad spectrum of economic conditions in the entire group. For purposes of exposition, the 23 non-oil LDC's are divided into five groups.

2. Definitions, Assumptions, and Forecasting Methodology

Two important definitions used in this chapter must be stated explicitly at the outset. First, LDC's are defined as the less-developed countries in Latin America, Africa, Asia and the Middle East that are not members of OPEC. By definition, all European countries, all Communist countries, and all non-members of the IMF are excluded from this analysis. Israel and some oil-exporting countries that are not members of OPEC are included. Second, the current account deficit is defined as the balance on goods, services, and private transfers (before grant aid). For the purpose of this analysis, grant aid is considered a capital transaction, along with loans, direct investment, etc.

The underlying assumptions for the 1976 forecast of current account deficits are:

(a) the price of oil will not change during the year;

(b) the OECD countries will increase their total GNP by about 4 percent in real terms for the year; and

(c) the terms-of-trade for LDC's will not change.

Two approaches were used to forecast the 1976 current account deficit of the 88 LDC's. First, the balances of 23 LDC's were projected individually, and then combined with an estimated figure for the remaining 65 LDC's. Second, the aggregate current account for OPEC countries, developed countries, and Communist countries was estimated, leaving the LDC deficit as a residual. The two estimates were compared and found to be consistent.

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3. LDC Current Account Deficits and the Pattern of Financing; 1972-1976

(a) 1972-1973

The current account deficit of the 88 non-oil LDC's amounted to about $9 billion both in 1972 and 1973. In the context of historical trends, deficits of this size or even more were normal for these LDC's as they have a shortage of capital relative to the industrial countries and are normally net importers of capital. No particular financing difficulties were encountered. In fact, the LDC's added $15 billion to their foreign exchange reserves in these two years.

"Normal" capital flows to the LDC's consist mainly of bilateral aid, aid from multilateral institutions, and private direct investment. In addition, they include net inflows of private supplier credits and government-sponsored export credits, both of which tend to increase as the volume of trade increases. Finally, they include a certain amount of other credits provided by private capital markets. These private flows are, however, subject to greater annual fluctuations than the other normal flows.

(b) 1974-1975

As a result of the precipitous increase in world oil prices and the recession among the industrial countries, the aggregate deficit increased sharply to about $28 billion in 1974 and reached an estimated $37 billion in 1975. Indications are that the aggregate deficit will fall by at least $3 billion to around $34 billion in 1976.*

The large deficits of 1974 and 1975 were financed without disrupting existing institutional arrangements. However, as in the case of developed countries, LDC growth rates on the whole fell. In some cases, import restrictions were imposed to contain the size of the current account deficits. The financing of these deficits was made possible by normal capital flows and by the use of new or enlarged sources of external capital. Increased flows of private capital were principally in the form of supplier credits and Euro-borrowings.

*This estimate of the 1975 deficit is subject to a margin of error of at least 5 percent, and the forecast for 1976 must be considered even more uncertain. Whatever the actual figures, there is clear evidence of a smaller overall deficit for non-oil LDC's in 1976 than in 1975.

For calendar year 1975, it is estimated that normal capital flows to non-oil LDC's were on the order of $25 billion. This estimate is comprised of the following elements:

Bilateral grants and loans	$ 9 billion
Multilateral grants and loans	$ 3 billion
Grants and loans from centrally-planned economies	$ 1 billion
Official trade credits	$ 1 billion
Direct private investment	$ 4 billion
Private credit	$ 3 billion
OPEC loans and grants	$ 4 billion
TOTAL	$25 billion

Thus, in 1975, $25 billion of the estimated $37 billion combined current account deficit of the non-oil LDC's was financed by these normal flows. The balance, approximately $12 billion, was financed by extraordinary means:

-- $2 billion by IMF credit (including the oil facility)

-- $3 billion by a drawdown of reserves, and about

-- $7 billion from the private sector in excess of normal private capital flows. Most of the private sector capital was in the form of commercial bank loans, including Euro-currency credits.

Most of the private bank credit in 1975 went to a few large borrowers such as Brazil, Mexico, and South Korea. These large borrowers have well-established credit ratings and were generally able to obtain the amounts they needed without difficulty. Even some countries which experienced major problems in 1975, such as Argentina and Chile, were able to obtain significant amounts of additional credit in 1975.

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(c) 1976

For calendar year 1976, the combined current account deficit of the non-oil LDC's is projected to decline by at least $3 billion to approximately $34 billion. A current account deficit of this magnitude probably cannot be sustained indefinitely. Most LDC's have already taken domestic policy measures that will reduce their current account deficits in 1976 and in the following years. The benefits for their balance of payments from these domestic measures and the benefits of increased LDC exports from the recovery of the developed countries should be effective after a short time lag. In many cases, the LDC's have had to reduce their growth rates in order to avoid payments problems which could lead eventually to debt service problems.

Most LDC's are expected to be able to manage the financing of their current account deficits in 1976 for the following reasons. First, the foreign exchange reserve position of the non-oil LDC's as a group is good. At the end of calendar year 1975, these reserves, which were not used as a major source for financing the previous years' deficits, totalled about $27 billion. The 1975 reserves were sufficient to cover an average of 2-1/2 to 3 months of imports. In 1976, reserves could be drawn down by as much as $2-$3 billion and leave the non-oil LDC's with about 2-1/2 months import coverage, an amount which is not inordinately low. Second, the financing problem of the LDC's as a group will be smaller in 1976 than it was in 1975. The detailed country analysis indicates a decline in the non-oil LDC current account deficit of at least $3 billion to $34 billion in 1976. Third, with an expected increase in bilateral grants and long-term loans, the normal capital flows will be at least $1 billion larger than in 1975. After normal capital flows are used, the amount of the current account deficit to be financed by a combination of reserve drawdown, IMF credit, and private bank loans is on the order of $8 billion. This is about $4 billion, or one-third, less than in 1975. The LDC's should be able to maintain their access to private credit markets and, thus, most of this $8 billion net new financing seems to be within the capability of the private capital markets, even though the developed countries are expected to increase their demand for private capital.

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Should sufficient funds not be available for some countries through normal capital flows, private borrowing or reserve reduction, the resources of the International Monetary Fund may be drawn upon by countries experiencing temporary financing problems. The availability of IMF funds has been expanded by recent decisions of the IMF Interim Committee and Executive Board. These expanded resources include a temporary 45 percent increase in each member's access to IMF regular credit, the establishment of a Trust Fund to channel the profits on the sale of 1/6 of the IMF's gold (25 million ounces) to the poorest countries on concessional terms over four years, and the liberalization of the IMF's Compensatory Financing Facility.

IMF financing is not a permanent solution to the problems caused by the oil price increase for the LDC's. IMF programs are designed to provide temporary financing to countries that have short-term financial problems so that the countries can make the necessary internal adjustments. As the oil price increases do not appear to be short-term, the facilities of the IMF are not appropriate to handle the problems associated with these increases, and countries will have to take the necessary adjustment measures.

Expanded IMF access will also enhance the ability of the more developed LDC's to obtain the private credit, which will continue to be their principal source of financing. The availability of IMF financing and the policy conditions attached to use of Fund resources will increase the private sector's confidence in a country's ability to maintain its creditworthiness.

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4. The Situation of 23 Non-oil LDC's

If there are LDC balance of payments and debt problems in calendar year 1976, these problems will be associated with individual countries, rather than the LDC's as a whole. The situation of 23 LDC's was selected for more detailed review. Together these LDC's account for about 75 percent of the trade of all non-oil LDC's that are members of the IMF, and they owe more than 85 percent of the long-term external public debt of all non-oil LDC's. As a group, these countries had a combined current account deficit in 1975 amounting to about $30 billion, compared with about $37 billion for all 88 non-oil LDC's. For 1976, the deficit for these 23 countries is projected to be about $27 billion of the $34 billion estimate for all non-oil LDC's.

The 23 countries can be divided into five groups with distinctive characteristics. Countries in the first four groups should be able to manage their deficits in 1976 without debt servicing problems. However, some countries in the last group may be vulnerable to balance of payments difficulties and debt servicing problems if they fail to take necessary policy measures or if they experience unexpected reverses in weather or other factors outside their control.

The first group of countries consists of LDC's that do not have unusually large balance of payments deficits and they should not incur debt servicing problems. They are: Thailand, Taiwan, Singapore, Malaysia, Colombia, and Morocco. These countries have generally followed sound and flexible policies. Generally, they have been able to attract direct investment on a continuing basis and have reserves to draw upon. They have low debt-service ratios and have been able to borrow in the private capital market. In some cases, these countries have not suffered declines in their terms of trade, and their deficits did not increase greatly in 1974 and 1975, although growth rates may have fallen significantly in some cases. The deficits of this group of countries are calculated to be about $4.1 billion in 1975 and $3.2 billion in 1976.

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The second group consists of only two countries: Egypt and Israel. These two countries face large deficits in 1975 and 1976: $6.2 billion and $5.7 billion respectively. These countries depend on large amounts of bilateral official capital from DAC and OPEC countries to finance their balance of payments deficits.

The third group of countries consists of Ghana, Bangladesh, India, and Pakistan. This is the only group that is expected to have a slightly higher current account deficit in 1976 than in 1975, $3.9 billion compared with $3.7 billion. The growing deficits of these countries are a major source of concern since the debt service ratios of many of these countries are relatively high, around 20 percent. As these countries lack access to private capital markets and cannot afford to borrow on market terms, aid donors are devoting a great deal of attention to their problems. They will be among the primary beneficiaries of the new IMF Trust Fund and are also receiving increased bilateral and multilateral aid.

The economic outlook for India and Pakistan, two countries that have been recipients of substantial debt rescheduling in recent years, is guardedly optimistic for 1976. There are some encouraging signs that Pakistan may be overcoming its economic stagnation of the past two years. Nevertheless, serious economic problems remain. Pakistan's trade deficit is projected to be about $1.2 billion in 1976 and it is expected to rely on external borrowing to finance the deficit. This borrowing will increase its future debt service obligations. Given the four-year (1974-1978) debt relief agreement concluded with the member countries of the Aid to Pakistan Consortium in June 1974, however, Pakistan should be able to avoid debt servicing difficulties in 1976.

India's short-term economic prospects have improved. The best monsoon rains in five years have produced a record grain harvest. Strict monetary controls have reduced inflation dramatically in calendar year 1975, and the large harvest will also help moderate inflationary pressures. Heavy foreign borrowing will, however, still be required to finance a 1976 projected trade deficit of about $1.5 billion. Despite the increased foreign debt, it appears that India should be able to avoid debt service problems in 1976.

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The <u>fourth group</u> of countries includes Brazil, Mexico, and South Korea. This group of countries is distinguished from those in the first group primarily by the size of their deficits and the large extent to which they have already borrowed from the private capital market. Together, they account for more than a third of the aggregate deficit of the 23 LDC's, $11.9 billion in 1975 and $10.9 billion in 1976. While these are sizeable deficits, these countries possess the most productive and diversified economies among the LDC's. Although they have stepped up their borrowing from private sources significantly in 1974 and 1975, and as a result have pushed up their previously high debt service ratios, they continue to be considered creditworthy by private lending institutions. Moreover, the exports of these countries are likely to respond quickly to renewed growth among the industrial countries. They should be able to finance their projected deficits and avoid debt servicing difficulties in 1976. If, however, countries in this group are not able to raise the necessary external finance to cover their current account deficits, they are capable of adjusting their policies to close balance of payments gaps--mainly by lowering growth rates. This group warrants continued attention since they have large private debts and any debt management problems could have an adverse impact on private capital markets.

The <u>fifth group</u> of countries includes: Argentina, Bolivia, Chile, Peru, Uruguay, Zaire, Zambia, and the Philippines. Most countries in this group have high debt service ratios and some have special problems. Some are highly dependent on a single export product like copper, the price of which has dropped precipitously in the past eighteen months to unusually low levels. Some face internal problems that limit their policy options. Others are feeling the effects of unwise economic policy decisions. As a group, the deficits of these countries amounted to $4.3 billion in 1975 and are expected to decline to $3.6 billion in 1976. Nevertheless, with somewhat more favorable external developments and the absence of any internal setbacks, these countries should be able to manage their deficits in 1976, and avoid debt servicing problems. Developments in these countries need to be watched very closely.

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5. Remaining Non-oil LDC's

The combined current account deficit for 1976 of the remaining 65 non-oil LDC's is projected at $6.7 billion, an amount which represents virtually no change from the $6.8 billion estimated for 1975. Thirty five LDC's or approximately one-half of the countries in this group, are classified as MSA's. The magnitude of the projected current account deficits of these MSA's is not great because their economies and volume of international trade are small. Their access to the IMF Trust Fund, combined with some reallocation in aid from donor countries and financial institutions, should enable these countries to manage their economic affairs in calendar year 1976 without incurring serious debt service problems.

The remaining 30 non-oil LDC's would tend to be distributed among the various groups identified above. For example, the Latin American and African coffee exporting countries would fall in group 1 as coffee prices continue to be relatively high.

6. Beyond 1976

Projections beyond 1976 are difficult to make. If for example, countries should be afflicted by sudden droughts, floods or internal strife, or if unexpected bottlenecks develop which would impede these countries' exports, the outlook would be less optimistic. However, two general observations may be made. First, the recent increase in foreign indebtedness will tax countries' export earnings more heavily in future years than has been the case in the past. This is particularly true for those countries which have borrowed heavily on commercial terms. Thus several countries may have to make adjustments to cope with accelerating debt service burdens in the next 3-5 years. The result may be that they will have to accept lower growth rates unless they secure large increases in export earnings and internal savings so as to reduce their reliance on external finance. Secondly, the LDC's have not undertaken massive drawdowns of their international reserves. In fact, very few LDC's have drawn more than their first credit tranche in the IMF. Many LDC's have probably maintained reserve levels--now sufficient to cover at least 2-1/2 months of aggregate imports--to maintain their creditworthiness for private borrowing. The liberalization of access to IMF ordinary credit and to the Compensatory Financing Facility along with the establishment of the Trust Fund should help take pressure off reserves and, thereby, facilitate additional private borrowing by many LDC's.

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III. A SUMMARY OF THE LDC DEBT SITUATION AS OF DECEMBER 31, 1973

1. Introduction

In contrast to Chapter II which focused on the debt outlook for the non-oil LDC's for calendar year 1976, this chapter provides an historical perspective of the LDC external debt situation as of December 31, 1973, the latest date for which complete data are available. The LDC's prospered in 1973. High export earnings and increased capital flows contributed to their better overall external positions and resulted in a substantial accumulation of reserves.

This chapter sets forth the external debt data of LDC's as of December 31, 1973, according to the institutions providing the loans to LDC's and the LDC's receiving these loans. Also, the data are presented for LDC's as divided into income groups and are discussed with regard to three ratios that are used frequently to assess their debt burdens.

A review of LDC debt obligations to the United States government and the government's debt "Early Warning System" is also presented in this chapter.

Several definitions underlie the data in this chapter.

-- External public debts, or "official debts", are debts which are contracted or guaranteed by the public sector of the debtor country and are owed in foreign currency to creditors outside the debtor country. Such debts have an original or extended maturity of over one year. The public sector includes the national government, any of its political subdivisions or agencies, or autonomous public bodies.

-- Debt outstanding includes the principal both on disbursed and undisbursed funds (amounts not yet drawn by the recipient) and is net of past repayments.

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The country debt data are drawn from the Annual Report of the World Bank and the World Bank's World Debt Tables, as reported to the Bank by 86 developing countries. As the data consist only of public sector debts, they may understate a country's total external debt picture because they do not include debts incurred solely by private sector enterprises of the LDC's.

2. Debt Outstanding 1973

At the end of calendar year 1973, the value of the stock of outstanding external debt of 86 developing countries covered in the debt reporting system of the World Bank was $119 billion. Table 1 shows that bilateral official lending was the largest component of this total, followed by private lending and multilateral lending. This pattern of lending did not change significantly in the period 1971-1973.

The $119 billion outstanding debt of LDC's represents an increase of $19 billion, or about 20 percent, compared to the amount outstanding at the end of 1972. This is higher than the 16 percent average increase recorded in the period 1970-1972. Excluding undisbursed debt, the value of LDC outstanding debt was $83 billion at the end of 1973 compared to $72 billion at the end of 1972.

3. Distribution of LDC External Debt

For a number of years, a small number of countries has accounted for a large proportion of the recorded debt. In calendar year 1973, five developing countries, India, Brazil, Iran, Mexico, and Indonesia, accounted for 35 percent of total LDC debt. Seven countries, Algeria, Israel, Korea, Turkey, Argentina, Pakistan, and Chile together owed 25 percent of the total. In sum, 12 of the 86 developing countries accounted for about 60 percent of recorded LDC debt in 1973.

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Table 1

EXTERNAL PUBLIC DEBT OF
86 DEVELOPING COUNTRIES
AS OF DECEMBER 31, 1973
(in $ million)

	Amount	Percent of Total
Bilateral Official	$56.3	47
Multilateral	24.1	20
Private:	38.5	33
Suppliers	(12.8)	(11)
Banks	(17.8)	(15)
Other	(7.9)	(7)
TOTAL	$118.9	100

(Note: Comprises undisbursed and disbursed debt outstanding of over one-year original maturity.)

Source: World Bank

Table 2 presents the external debt of each of the 86 developing countries for 1972 and 1973, as grouped according to income levels. In 1973, the oil producing and higher income countries accounted for $75 billion, or about 60 percent of the total, a rise from $64 billion, or about 65 percent, in 1972. The debt of medium income countries rose from $13 billion in 1972 to about $16 billion in 1973, an increase of 23 percent. The debts of the lower income countries increased from $23 billion in 1972 to $27 billion in 1973, an increase of only 17 percent. When recorded, the data for calendar years 1974 and 1975 are expected to show that the oil producing countries were no longer accumulating debt at previous rates, while the non-oil countries increased their debt significantly. This reflects the fact that many non-oil LDC's borrowed heavily to finance large balance of payments deficits.

The external public debt of those countries designated as "Most Seriously Affected" (MSA's) by the United Nations was just under $30 billion as of December 31, 1973. This amount represented an increase of $3.8 billion, or 15 percent, compared to the $26 billion of MSA debt outstanding at the end of 1972. About 90 percent of the debt outstanding in 1973 and 90 percent of the increase between 1972 and 1973 was provided by bilateral official and multilateral institutions. Within the total MSA debt for 1973, three countries--India ($12.4 billion), Pakistan ($5.2 billion), and Egypt ($2.3 billion)--account for two-thirds of the total.

4. The Debt Service Ratio

One indicator which has been used widely to provide a rough estimate of the debt burden of a country is the debt service ratio. This is the ratio of annual external debt service to annual earnings from exports of goods and services. This ratio indicates the percentage of export earnings which are expended to service external debt in a given year. A ratio of 20 percent or more may indicate a rather heavy debt burden and potential difficulties in servicing external debt. Moreover, if the ratio increases sharply to this level, it could signify the onset of a potentially serious foreign exchange problem.

Table 2

OUTSTANDING EXTERNAL DEBT OF 86 DEVELOPING COUNTRIES
1972 AND 1973

(In $ Million)

Oil Producing Countries	1972	1973	Change
Algeria	2,827.0	4,788.9	1,961.9
Ecuador	466.4	549.0	82.6
Gabon	202.8	393.1	190.3
Indonesia	5,118.1	6,616.4	1,498.3
Iran	5,928.0	7,047.0	1,119.0
Iraq	460.0	736.8	276.8
Nigeria	1,035.2	1,101.2	66.0
Venezuela	1,629.1	1,901.2	272.1
Total	17,666.6	23,133.6	5,467.0
Percent of Total	17.7	19.5	28.7

Table 2 (cont'd)

High Income Countries	1972	1973	Change
Argentina	3,575.8	3,599.1	23.3
Turkey	3,364.4	3,778.1	413.7
Brazil	7,746.7	9,296.7	1,550.0
Chile	3,364.9	3,327.0	-37.9
China	1,593.6	1,813.2	219.6
Colombia	2,292.5	2,721.8	429.3
Costa Rica	275.0	340.9	65.9
Cypruss	73.4	79.1	5.7
Dominican Republic	317.4	430.4	113.0
Fiji Islands	29.9	64.7	34.8
Greece	1,744.0	2,250.1	506.1
Guatemala	199.8	192.3	-7.5
Guyana	204.4	228.7	24.3
Israel	3,863.6	4,766.1	902.5
Jamaica	335.2	458.9	123.7
Malaysia	979.0	1,119.6	140.6
Malta	21.8	22.5	.7
Mexico	4,842.1	7,031.1	2,189.0
Nicaragua	306.1	487.1	181.0
Panama	453.4	669.3	215.9
Peru	1,666.8	2,151.2	484.4
Singapore	436.7	525.7	89.0
Spain	2,064.2	1,980.3	-83.9
Trinadad & Tobago	134.3	182.7	48.4
Tunisia	1,091.1	1,265.8	174.7
Uruguay	492.8	453.3	39.5
Yugoslavia	3,040.7	2,443.0	597.7
Zambia	787.4	966.9	179.5
Total High Income	45,297.0	52,645.6	8,611.6
Percent of Total	42.2	41.3	36.8

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Table 2 (cont'd)

Middle Income Countries	1972	1973	Change
Bolivia	763.6	770.5	6.9
Cameroon	301.5	418.0	116.5
Peoples Republic Congo	318.0	355.5	37.5
Egypt	2,040.9	2,325.4	284.5
El Salvador	156.3	193.6	37.3
Ghana	624.7	666.8	42.1
Honduras	169.9	207.2	37.3
Ivory Coast	699.8	882.9	183.1
Jordan	221.6	323.0	101.4
Republic Korea	3,633.4	4,413.1	779.7
Liberia	179.4	196.0	16.6
Mauritius	90.0	99.5	9.5
Morocco	1,112.4	1,244.9	132.5
Papua New Guinea	184.5	274.8	90.3
Paraguay	183.4	212.3	28.9
Philippines	1,275.4	1,376.2	100.8
Senegal	191.0	347.2	156.2
Swaziland	36.6	34.7	-1.9
Syrian	510.4	435.5	-74.9
Thailand	661.7	750.0	88.3
Botswana	78.3	162.4	84.1
Total Middle Income	13,432.8	15,689.5	2,410.3
Percent of Total	16.9	16.4	14.0

Table 2 (cont'd)

Lower Income Countries	1972	1973	Change
Afghanistan	773.8	973.5	199.7
Haiti	48.8	71.2	22.4
Bangladesh	333.5	835.5	502.0
Burma	305.6	417.4	111.8
Burundi	8.1	8.6	.5
Central African Republic	61.8	71.9	10.1
Chad	27.2	55.3	28.1
Dahomey	90.7	137.5	46.8
East African Comm.	263.6	305.1	41.5
Ethiopia	359.8	437.6	77.8
Gambia	14.6	12.7	-1.9
Viet Nam	95.8	172.8	77.0
India	11,652.8	12,365.8	713.0
Kenya	510.3	596.1	85.8
Lesotho	8.3	12.8	4.5
Malagasy Republic	140.7	198.9	58.2
Malawi	231.2	267.0	35.8
Mali	324.0	399.3	75.3
Mauritania	82.3	92.0	9.7
Niger	70.2	116.7	46.5
Pakistan	4,646.5	5,151.2	504.7
Rwanda	14.2	43.1	28.9
Sierre Leone	100.5	122.7	22.2
Somalia	231.8	267.7	35.9
Sri Lanka	671.9	636.1	35.8
Sudan	382.1	550.1	168.0
Tanzania	645.9	739.9	;48.0
Togo	46.0	163.2	117.2
Uganda	214.5	235.2	20.7
Upper Volta	41.2	119.5	78.3
Zaire	762.6	1,519.1	756.5
Total Lower Income	23,160.3	27,078.3	3,912.2
Percent of Total	23.2	22.8	20.5
Overall Total	99,556.7	118,547.0	20,401.1

Source: World Bank

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This ratio has been criticized on the grounds that it may overstate or understate the debt burden of a country. The ratio may understate the situation as it excludes payments arising from private sector debts. The ratio can overstate the debt burden, both because it fails to reflect the fact that the real burden of debt service payments is reduced by inflation and because it does not take into account a country's export growth potential. In some instances, a high debt service ratio may cause unnecessary alarm, particularly if the country in question employs sound economic policies, maintains a good credit rating, and borrows heavily from private sources. Notwithstanding these shortcomings, the debt service ratio is widely used by financial analysts.

Table 3 shows that the average debt service ratio for the 86 developing countries was 9.4 percent in calendar year 1973, compared to 10.1 pecent in 1972. By income grouping, the debt service ratios for calendar year 1973 show that the ratio was 12.2 percent for low income countries, 9.8 percent for high income countries, and 8.9 percent for middle income countries. While the ratio for high income countries in 1973 was virtually unchanged from 1972, the ratios for middle and low income countries showed a substantial decline compared to 1972.

Table 4 ranks countries by debt service ratio and shows that in calendar year 1973 seven countries had debt service ratios in excess of 20 percent. These countries account for about one-third of the debt service payments for the 86 developing countries and only India is classified as an MSA. However, India's ratio at 20.1 percent in 1973 was down from 28 percent in 1970, in part owing to an increasing proportion of debt payments rescheduled in the period 1970-1973. The five countries with debt service ratios between 15 and 20 percent account for 9 percent of the total debt service payments of the 86 developing countries and, of these countries, only Pakistan is classified as an MSA. Pakistan's debt service ratio was just over 16 percent in 1973, compared to 24 percent in 1970. This reduction reflects a series of Pakistan's debt reschedulings associated with the events of 1971 in that country, and the subsequent division into two sovereign states, Pakistan and Bangladesh. Pakistan's debt service ratio may be further reduced as the final rescheduling of 1974 calls for partially relieving Pakistan of debt service payments falling due in the years 1974-1978.

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Table 3

DEBT SERVICE RATIOS
OF DEVELOPING COUNTRIES

1970-1973

	1970	1971	1972	1973
All Developing Countries	10.1	10.0	10.1	9.4
Oil Exporting Countries	6.4	7.0	9.0	7.5
Higher Income Countries	10.6	10.3	9.7	9.8
Middle Income Countries	10.4	10.6	10.6	8.9
Lower Income Countries	12.9	12.9	14.3	12.2

Source: World Bank, World Debt Tables

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Table 4

DEBT SERVICE RATIOS FOR COUNTRIES WITH RATIOS OVER 10 PERCENT, 1970 & 1973

Countries Grouped by 1973 Debt Service Ratios	1970 Debt Service Ratio (%)	1973 Debt Service Ratio (%)
Ratios over 20%		
Egypt	26.2	34.6
India	28.0	20.1
Israel	18.6	20.8
Mexico	25.2	25.2
Peru	13.7	22.8
Uruguay	18.4	30.1
Zambia	5.1	28.0
Ratios 15% to 20%		
Afganistan	20.1	19.9
Argentina	21.0	18.3
Burma	16.1	18.6
Nicaragua	10.6	17.8
Pakistan	24.3	16.1
Ratios 10% to 15%		
Algeria	7.4	11.3
Bolivia	10.9	14.8
Brazil	15.3	13.9
Chile	18.3	11.0
Colombia	11.9	13.0
Congo	2.8	10.7
Costa Rica	9.7	10.2
Iran	11.5	10.6
Korea	23.4	13.9
Sri Lanka	9.7	12.6
Sudan	9.2	11.1
Swaziland	4.7	10.5
Tunisia	19.5	13.8
Developing Countries	10.1	9.4

SOURCE: World Bank, *World Debt Tables*.

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Thirteen countries had debt service burdens in the moderate range of 10-15 percent. These countries account for nearly 30 percent of the total debt service payments of developing countries. Only two of these countries, Sri Lanka and Sudan, are classified as MSA's.

Chart 1 depicts the trend of debt service ratios of developing countries over the period 1967-1973. As this chart indicates, the debt service ratio for all developing countries in this period hovered around 10 percent per annum. The ratio for lower income countries rose slightly in 1969-72 and fell to just over 12 percent in 1973, which is a ratio nearly equal to that of 1967-1968. The ratio for middle income countries has generally paralleled the trend for all developing countries in 1970-1973. The ratio for the oil exporting countries increased from 3.6 percent in 1967 to 9 percent in 1972, and then fell sharply to 7.5 percent in 1973.

In calendar year 1974, the debt service ratio of the oil-exporting LDC's dropped sharply, reflecting the fact that exports of goods and services of these countries, i.e., oil, increased nearly threefold over 1973, while the rate of increase of debt service payments was nominal. For non-oil exporting LDC's, the debt service ratio appears to have declined. This reflects the fact that the 40 percent rate of growth of exports of goods and services exceeded the 20 percent rate of growth of debt service payments. For 1975 and 1976, the debt service ratio of the non-oil LDC's is expected to rise reflecting higher debt service payments incurred from short-term debt contracted to finance large balance of payments deficits.

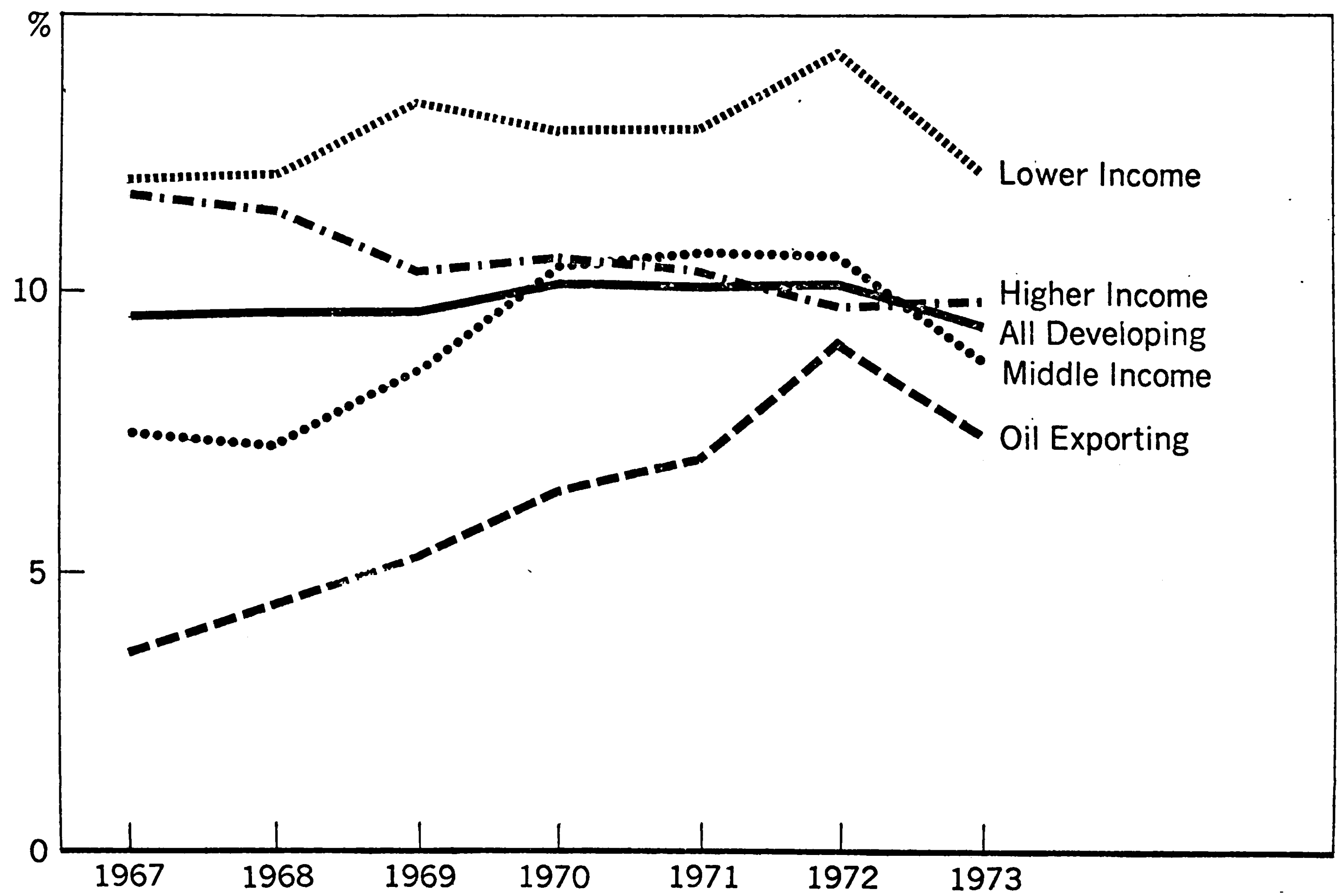
5. Annual Debt Service Payments to Debt Outstanding.

The ratio of annual debt service payments to total external debt outstanding is an indicator which is used frequently as an approximation for the maturity structure of a country's external debt. A low ratio suggests a relatively long maturity structure, while a high ratio suggests a relatively short maturity structure.

Chart 1

DEBT SERVICE RATIOS OF DEVELOPING COUNTRIES

1967 - 1973



Source: World Bank; World Debt Tables

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Table 5 below shows that the wealthier LDC's have a shorter maturity structure as indicated by a higher ratio of future debt service payments to debt outstanding. For example, the two-year ratio, which shows the proportion of debt service payments falling due in 1974 and 1975 to debt outstanding in 1973, is 24 percent for high income countries and 13 percent for low income countries. The 10 year ratio shows the percent of debt service payments on 1973 debt outstanding that falls due between 1974 and 1984. The 10 year ratio is larger for all countries than the 2 or 5 year ratios because a larger proportion of the debt service will be paid over the longer period.

Table 5

DEBT SERVICE PAYMENTS AS A PERCENT OF DEBT OUTSTANDING AS OF 1973

	2-Year Ratio	5-Year Ratio	10-Year Ratio
All developing countries	21	52	88
Oil exporting countries	24	56	93
Higher income countries	24	60	103 1/
Middle income countries	21	51	84
Lower income countries	13	33	58

Source: World Bank: World Debt Tables

6. Debt Service to GNP

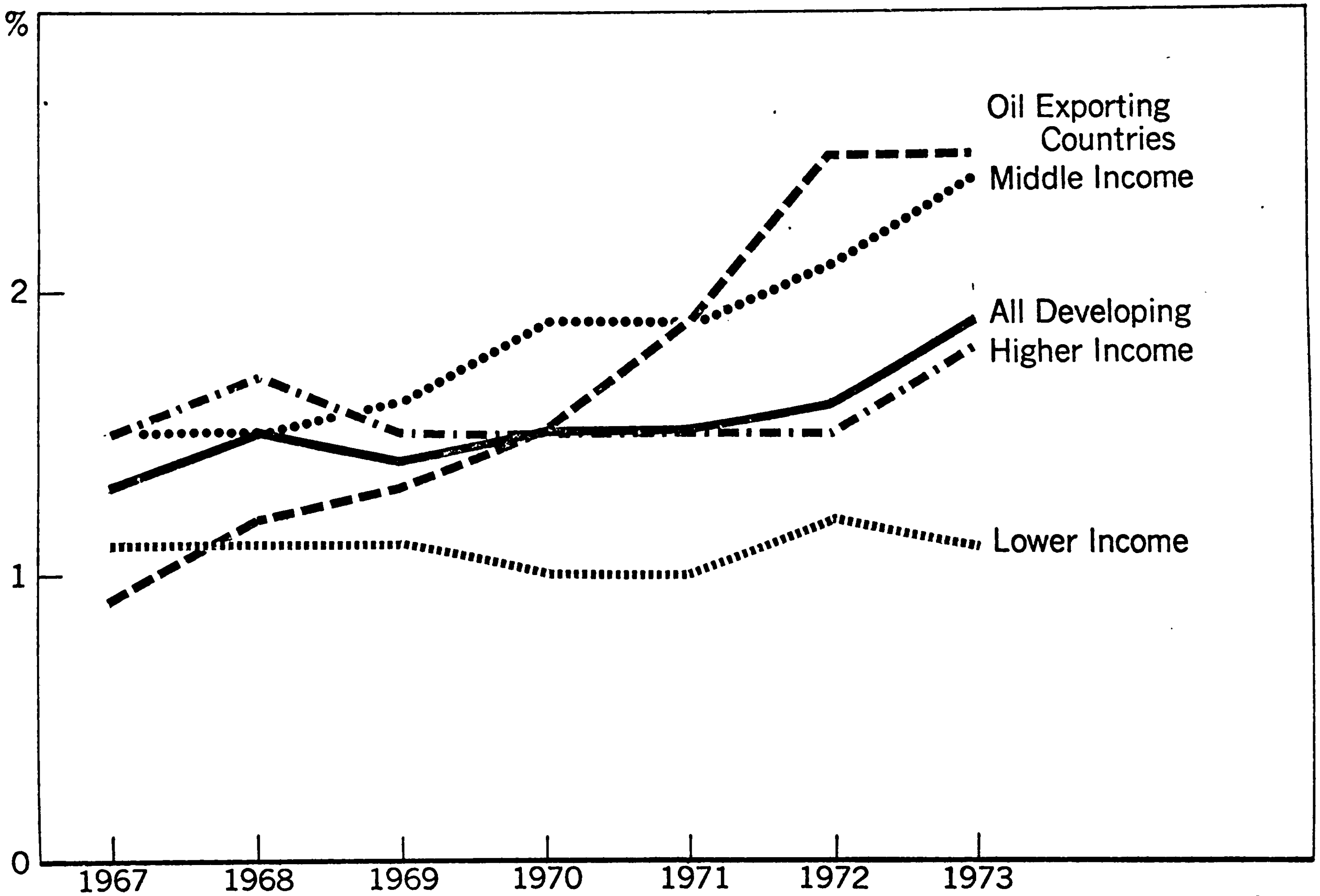
This ratio shows the proportion of a country's gross national product which is devoted to servicing external debt. Chart 2 and Table 6 show a general upward trend in this ratio from 1970 to 1973 for the middle and higher income LDC's and the oil exporters. This indicates that a larger proportion of the GNP from these countries was devoted to debt service, than was the case for the lower income countries.

1/ The 10-year ratio for higher income countries is above 100 percent because interest and amortization payments raise total debt service above debt outstanding.

Chart 2

DEBT SERVICE AS A PERCENT OF GNP

1967-1973



Source: World Bank; World Debt Tables

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Table 6

DEBT SERVICE AS A PERCENT OF GNP

	1970	1971	1972	1973
All Developing Countries	1.5	1.5	1.6	1.9
Oil Exporting Countries	1.5	1.9	2.5	2.5
Higher Income Countries	1.5	1.5	1.5	1.8
Middle Income Countries	1.9	1.9	2.1	2.4
Lower Income Countries	1.0	1.0	1.2	1.1

Source: World Bank: World Debt Tables

7. Grant Equivalents and Grant Element

The grant equivalent and grant element are used to measure the concessional element of a loan. The grant equivalent of a loan is the face value of a loan commitment less the discounted present value of the future flow of amortization and payments of interest, using a discount rate of 10 percent. The grant element of a loan is the grant equivalent expressed as a percentage of the face value of the loan. For example, if a $10 million loan is extended at a 4 percent annual rate of interest and repayable in 20 annual installments after five years' grace, the grant equivalent is $4.3 million. The grant element would be 43 percent.

Table 7 shows average grant equivalents for official external borrowing for the period 1971-1973. It can be seen that, in general, the low income countries have the largest grant equivalent while the oil exporters have the smallest grant equivalent. Lower income countries also have the highest grant element while the higher income countries have the lowest grant element.

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Table 7

AVERAGE GRANT EQUIVALENTS AND GRANT ELEMENTS OF OFFICIAL BORROWINGS OF 86 LDC'S

	Grant Equivalents (in $ M)	Grant Elements (in %)
Oil Exporting Countries	$1,318	36%
Higher Income Countries	2,204	23%
Middle Income Countries	1,604	41%
Low Income Countries	3,495	74%

Source: World Bank: World Debt Tables

8. The U.S. Government Stake

As of June 30, 1975, the less developed countries owed the United States government, their largest creditor, a total of almost $27 billion. An analysis of LDC debt by geographical region shows that South and East Asia is the U.S.'s largest LDC debtor with $10.7 billion. Latin America is second with a debt of $7.2 billion, and the Near East is third with a $4.2 billion debt. Table 8 shows LDC indebtedness to the U.S. by type of program and indicates that the foreign assistance programs have provided more than twice as many funds as were lent by the Department of Agriculture and the Eximbank combined. Table 9 shows the outstanding indebtedness of the 13 members of OPEC to the U.S. government as of June 30, 1974, and June 30, 1975. The indebtedness of Indonesia and Iran each exceeded $1 billion and, together, accounted for 77 percent of OPEC debt to the United States.

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Table 8

OUTSTANDING LONG TERM PRINCIPAL INDEBTEDNESS OF LDC'S ON U.S. GOVERNMENT CREDITS BY MAJOR PROGRAM

(As of June 30, 1975)

Program	Amount (in $ millions or equivalent)
Eximbank	$ 6,052
Foreign assistance and related acts	14,459
Agricultural Trade Development and Assistance	5,475
CCC	381
Lend-Lease, surplus property and other war accounts	226
Other credits	126
TOTAL	$26,719

Source: U.S. Treasury

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Table 9

OUTSTANDING INDEBTEDNESS OF OPEC COUNTRIES ON U.S. GOVERNMENT LONG TERM CREDITS

($ Million)

	6/30/74	6/30/75
Algeria	109	218
Ecuador	115	117
Gabon	2	8
Indonesia	1,125	1,250
Iran	1,107	1,006
Iraq	10	9
Kuwait	10	0
Libya	0	0
Nigeria	101	79
Qatar	0	0
Saudi Arabia	41	21
United Arab Emirates	0	0
Venezuela	213	205
TOTAL	2,813	2,913

Source: U.S. Treasury

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9. U.S. Debt "Early Warning System"

In October 1974, members of the National Advisory Council on International Monetary and Financial Policies reiterated their belief in the necessity of developing a debt "Early Warning System" which should serve to identify countries with potential debt problems and trigger Council consideration and coordination of appropriate courses of action. On September 22, 1975, an initial system was submitted to the NAC for its consideration. The system consists of two elements:

-- a quantitative element which seeks to identify those countries which may be headed for debt servicing difficulties,

-- an historical element which seeks to identify common characteristics of those countries which have rescheduled debts in the past.

The quantitative element involves the computation of an equation with several debt related variables which can be used to help identify one year in advance countries which may encounter debt servicing difficulties.

The historical element reviews countries which have rescheduled their debts to identify relevant common characteristics. These characteristics are then used for in-depth individual country debt reviews as a benchmark to assist in formulating judgments on the debt servicing capabilities of a country.

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10. Euro-currency Lending

Medium-term private bank Euro-currency lending to developing countries continued to be an important source of finance for the more wealthy LDC's in calendar year 1974 and the first three quarters of calendar year 1975. Euro-currency lending to developing countries was unusually low in the last two quarters of 1974 and the first quarter of 1975. This may reflect the depressed state of worldwide economic activity. Subsequently, Euro-currency credits extended to LDC's rose to $3.2 billion and $3.4 billion in the second and third quarters of 1975, respectively.

The largest increase in borrowing was among the oil producing and higher income countries which account for roughly 78 percent of the increase in the second quarter of 1975 and 91 percent in the third quarter. This may indicate that the poorer countries cannot afford to pay the higher costs of borrowing in this market, or do not represent an acceptable credit risk to the lender.

Apparently, the existence of a high level of debt outstanding has not been a barrier to borrowing from the Euro-currency market if the country is thought to have favorable long-term economic prospects. This is evidenced by the fact that countries with large debts are large borrowers from this market. Almost a half of the publicized lending for all non-oil LDC's in the second and third quarters of 1975 was to Brazil for $1,080 million and to Mexico for $990 million.

It should be noted that these country and aggregate data refer to new loans, a portion of which may have been undertaken to substitute for existing loans. Consequently, the net addition to a country's external debt might be substantially less than the gross magnitude of Euro-borrowing.

Table 10

PUBLICIZED EUROCURRENCY CREDITS BY COUNTRY:
DEVELOPING IBRD MEMBER COUNTRIES

(US$ millions)

Country of Borrower	1973	1974	1975 1st Qtr.	1975 2nd Qtr.	1975 3rd Qtr.	1975 Jan.-Sept.
OIL EXPORTERS						
Algeria	1,352.5	-	-	100.0	-	100.0
Ecuador	8.0	-	30.0	25.0	-	55.0
Gabon	64.0	67.0	-	-	30.0	30.0
Indonesia	478.0	348.5[1]	53.5	938.0	-	991.5
Iran	712.1	114.5	5.0	-	220.0	225.0
Iraq	-	-	-	-	500.0	500.0
Nigeria	-	20.0	-	-	-	-
Oman	35.0	14.0[1]	14.1	-	50.0	64.1
Saudi Arabia	4.9	-	-	-	-	-
United Arab Emirates	330.0	151.0	6.3	-	-	6.3
Venezuela	63.1	57.5	-	200.0	-	200.0
Sub-total	3,012.6	772.5	108.9	1,263.0	800.0	2,171.9
HIGHER INCOME COUNTRIES						
Argentina	87.3	558.6[1]	-	28.4	6.0	34.4
Bahamas	30.0	-	-	-	-	-
Bahrain	15.0	-	-	-	-	-
Brazil	718.1	1,667.5[1]	345.5	341.8	738.0	1,425.3
China, Republic of	-	197.0[1]	80.0	15.0	19.0	114.0
Colombia	170.0	8.0	-	100.0	-	100.0
Costa Rica	11.0	10.0	16.0	-	30.0	46.0
Dominican Republic	15.0	20.0	-	-	-	-
Greece	599.6	437.9	19.0	-	220.0	239.0
Guyana	12.5	15.0	-	24.0	-	24.0
Jamaica	35.6	95.0	-	53.0	-	53.0
Lebanon	20.0	93.1	-	-	-	-
Malaysia	-	140.0	-	150.0	75.0	225.0
Mexico	1,572.5	1,478.4[1]	209.0	394.6	595.0	1,198.6
Nicaragua	92.0	51.4	-	-	30.0	30.0
Panama	251.0	101.0	-	85.0	25.0	110.0
Peru	733.6	366.0[1]	90.0	50.0	23.3	163.3
Spain	467.3	1,169.0[1]	66.8	272.0	354.2	693.0
Trinidad and Tobago	30.0	22.5[1]	-	5.1	-	5.1
Uruguay	-	-	-	-	130.0	130.0
Yugoslavia	235.0	549.3[1]	11.6	-	61.0	72.6
Zambia	150.0	-	-	160.0	-	160.0
Sub-total	5,280.5	6,979.7	837.9	1,678.9	2,306.5	4,823.3

Table 10 (cont'd.)

PUBLICIZED EUROCURRENCY CREDITS BY COUNTRY: DEVELOPING IBRD MEMBER COUNTRIES

(US$ millions)

Country of Borrower	1973	1974	1975 1st Qtr.	1975 2nd Qtr.	1975 3rd Qtr.	1975 Jan.-Sept.
MIDDLE INCOME COUNTRIES						
Bolivia	6.0	52.0	8.0	35.0	21.5	64.5
Cameroon	-	10.0	-	-	-	-
Egypt	-	230.0	-	-	-	-
El Salvador	-	50.0	-	30.0	-	30.0
Ivory Coast	95.0	63.0	-	35.0	15.0	50.0
Korea, Republic of	142.0	264.0 1/	245.2	56.0	-	301.2
Morocco	-	-	-	-	200.0	200.0
Philippines	178.5	883.0 1/	-	85.1	-	85.1
Senegal	65.0	-	-	-	-	-
Thailand	-	9.7	-	5.0	-	5.0
Turkey	20.3	-	-	-	20.0	20.0
Sub-total	506.8	1,561.7	253.2	246.1	256.5	755.8
LOWER INCOME COUNTRIES						
Haiti	10.0	-	-	-	-	-
India	10.0	-	-	-	-	-
Kenya	4.5	-	-	-	-	-
Malawi	5.3	-	-	-	-	-
Pakistan	-	-	7.5	-	-	7.5
Sudan	-	220.0	-	11.5	25.3	36.8
Zaire	286.9	71.3	-	27.0	-	27.0
Sub-total	316.7	291.3	7.5	38.5	25.3	71.3
TOTAL	9,116.6	9,605.2	1,207.5	3,226.5	3,388.3	7,822.3

1/ Credits for which the date of completion is not available are excluded from quarterly date, but included in 1974 total. These credits amounted to $439.9 million for all borrowers included in this table.

Source: World Bank: Borrowing in International Capital Markets

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IV. INTERNATIONAL CONSIDERATION OF LDC DEBT, U.S. POLICY, AND DEBT RESCHEDULINGS IN FISCAL YEAR 1975.

1. International Consideration of LDC Debt

The debt problems of the LDC's continued to be examined in several international fora during fiscal 1975, including the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD), the United Nations Committee on Trade and Development (UNCTAD), and the World Bank.

With the increased balance of payments problems of the LDC's during 1974 and 1975, some countries including those that had accrued large amounts of external debt in previous years, initiated proposals in UNCTAD and other fora to obtain relief from their debt obligations. The relief these countries seek would take the form either of a multilateral debt moratorium or a generalized debt rescheduling for the poorest LDC's. The United States government has opposed a generalized debt rescheduling or debt moratorium. This position has also been taken by virtually all other creditor countries. In the U.S. view, these are not appropriate instruments to alleviate balance of payments financing difficulties of the LDC's. In addition, such proposals as have been advanced along these lines have serious shortcomings. For example, a generalized rescheduling or moratorium would be inequitable, since only twelve LDC's hold the bulk of this debt. As only two of the twelve are "MSA's", a general moratorium or rescheduling would provide only minor assistance to the poorest countries--those in greatest need of assistance--while other countries would receive windfall benefits. Most of these schemes either minimize or do not take into account debtor countries' monetary, fiscal, and exchange rate policies or the efforts of some debtor countries to deal effectively with their debt problems. Proposals of this character would tend to raise the cost of subsequent borrowing by LDC's in the short run and could affect adversely the flow of resources to LDC's in the long run.

2. U. S. Policy

It is U.S. government policy to extend credit on the explicit understanding that it will be repaid according to the schedule agreed upon by the borrower at the time the credit is authorized and signed. Accordingly, the United States does not consider debt rescheduling or relief to be appropriate instruments for alleviating the current financial difficulties of the developing countries nor does it deem such actions to be appropriate vehicles for providing official economic assistance to the LDC's.

Currently, the United States evaluates the merits of debt reorganization proposals on a case-by-case basis predicated on the principle of basic adherence to scheduled terms of credit payment. Within this framework, the U.S. objective is to encourage countries to undertake appropriate corrective policies in order to minimize the incidence of debt rescheduling and relief operations.

3. Rescheduling in Fiscal 1975

The developing countries have, by and large, an excellent record in honoring their debt obligations. It has been the exception, rather than the rule, that debt rescheduling has been provided to help ensure ultimate repayment by debtor countries. During fiscal 1975, the United States participated in two major multilateral debt reschedulings, India and Chile.

India

United States participation in the fiscal 1975 multilateral debt rescheduling arrangements for India related to developments which occurred during the previous fiscal year. At the June 1974 meeting of the Indian Aid Consortium, chaired by the World Bank, a $248 million debt rescheduling for India was proposed. The Bank based its proposal on the need to provide free foreign exchange to help deal with mounting pressures on the Indian balance of payments arising, in large part, from increases in the price of imported food, fertilizer and oil.

The United States' share of this debt rescheduling proposal for India would have been $64 million, compared to $29 million the previous year. Had the United States accepted the proposal, the U.S. would have financed $34 million of the $60 million aggregate increase in rescheduled debt from the previous year. The United States did not accept the Bank's proposal, but indicated a willingness to reschedule at a level well below the Bank's recommended share, with a pledge to review the situation at a later date.

In the following months, the United States reassessed the Indian economic situation and, on the basis of available information, concluded that India faced major economic problems and serious balance of payments difficulties. As a result, the United States agreed, in September 1974, to reschedule up to $45 million on terms providing a 62 percent grant element. A Memorandum of Understanding was signed by the World Bank on behalf of the Consortium members on October 30, 1974. The bilateral agreement between the United States and India implementing the U.S. share of the debt rescheduling was signed on May 2, 1975, subsequently sent to Congress for a 30-day review period on May 7, 1975, and became effective on June 13, 1975. (See Appendix.)

At the next Indian Aid Consortium meeting in June 1975, the World Bank proposed that the donor countries provide $248 million of debt relief as part of the economic assistance package for Indian Fiscal Year 1976 (April 1, 1975 - March 30, 1976). The United States share of this would have been $65 million. During this consortium meeting, the United States stated that it would not grant debt relief to India for its fiscal year 1976. The United States delegation noted that debt rescheduling was an inappropriate means of providing economic assistance under U.S. budgetary and legislative procedures but stated that this position should not deter other donor countries from providing debt reorganization if such action were appropriate under their governmental procedures. A World Bank proposal of agreed multilateral debt rescheduling for the Indian fiscal year 1976 which excluded participation by the U.S. was accepted by the Consortium members. Improved short-term economic prospects should enable India to continue servicing fully its debt to the U.S. in Indian fiscal year 1977 (April 1, 1976 - March 31, 1976).

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A loan authorized in 1971 for a nickel project in Australia was rescheduled. The original amount of the loan was $8,960,000, and the amount rescheduled includes $4,977,780 of principal and $134,031.78 of interest. This rescheduling is also for two and one-half years, with resumed payments to begin on March 31, 1979. The reason for the rescheduling was financial problems of the borrower brought on by inflation.

The third rescheduling was of a $2 million credit authorized in 1970 for relending in Nicaragua. The amount rescheduled is $245,371.53 of principal and $28,315.86 of interest. This rescheduling is for five years, with resumed repayment to begin on January 1, 1980. The borrower in this case has a negative net worth, and, hence, the rescheduling was deemed necessary to effect ultimate repayment.

Immediately, the effect of these reschedulings is to defer the reflow of funds to Eximbank and the balance of payments benefits of these reflows. On the other hand, rescheduling hopefully enhances the likelihood of ultimate repayment, as well as maintains the viability of the undertakings financed. Because of the relatively minor amounts rescheduled, there will be virtually no impact in Eximbank's ability to continue to make loans.

Defense Security Assistance Agency (DSAA)

Under authority granted by Section 31 (b) of the Foreign Military Sales Act, as amended, Israel was released from contractual liability to repay the United States government the $100 million in direct credit provided in FY 1975 for procurement of defense articles and defense services. This $100 million, combined with $1.5 billion released in prior years, brings the total amount from which Israel has been released to $1.6 billion.

Debt reschedulings or the granting of debt relief would have no effect on the availability of funds and the authority of DSAA to provide loans, credits, or guarantees to recipient countries.

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Commodity Credit Corporation (CCC)

With the exception of Chile, the CCC provided no major debt relief in FY 1975. However, some debt relief was made available to Korea through the Private Trade Agreements (PTA) authorized under Section 107 of P.L. 83-480. This relief was provided to two private trade entities. Korea-Cargill, Ltd., had $342 million in principal payments and 7-3/4 percent interest deferred from December 1974 to December 1975. Korea-Silo Company had its loan of $230 million with an interest rate of 9 percent deferred from December 1974 to July 1975. These obligations to CCC are fully covered by Korean bank commercial type letters of credit. Debt relief was provided to these two companies because their financial statements indicated that their continued operations were in jeopardy.

This debt relief had no effect on the availability of funds since CCC funds are provided under its statutory borrowing authorization. However, if CCC funds are used for debt relief, then less is available to provide credit.

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V. EFFECT OF DEBT RESCHEDULING ON THE EXTENSION OF NEW CREDITS

The relationship between debt rescheduling and the extension of new credits is complex. The effect of a rescheduling on the extension of new credits by the United States will depend on various factors such as the economic situation of the debtor country both before and after the rescheduling; the reasons for and the terms of the rescheduling; whether the United States had suspended the extension of credits to the debtor country as well as the nature of the new credits.

For example, a rescheduling may lead to extensions of new credits in those situations where the default by the debtor country lead to the placement of a legal prohibition on the extension of credit to that country. This prohibition is set forth in Section 620q of the Foreign Assistance Act. A rescheduling may also lead to extensions of additional credits because of the improvement in the creditworthiness of the debtor country. On the other hand, the necessity of a rescheduling and the fact that a country was unable to meet its current obligations may lead to greater caution by creditor countries and an unwillingness to provide new credits.

Although one cannot generalize about the effects of debt reschedulings on the extension of new credits, the level of new credits may be directly affected by the terms of the rescheduling because of certain legislative provisions. This was the case with regard to loans extended under the Foreign Assistance Act of 1961 and is presently the case for loans extended under the Export-Import Bank Act of 1945, and Public Law 480.

Prior to its amendment, Section 203 of the Foreign Assistance Act of 1961 made funds from the repayment of AID credits available for the extension of new credits. Therefore, if a debt rescheduling occurred, the funds from repayments would, of course, not be available, and this would reduce the flow of new credits. Section 203 has since been amended twice with the result that the impact of debt reschedulings on the extension of new credits has been reduced. Section 203 was first amended in 1973. This amendment provided

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that not more than 50 percent of dollar receipts payable in fiscal years 1974 and 1975 from loans made under the Foreign Assistance Act and predecessor foreign assistance legislation would be available for making new loans. The other 50 percent of the receipts would go to Treasury. As a result of this amendment, the effect of debt reschedulings on the availability of new credits was reduced. The second amendment to Section 203 of the Foreign Assistance Act of 1961 was enacted in December 1974. This amendment provided that after July 1, 1975, none of the dollar receipts from loans made under Part I of this Act or predecessor foreign assistance legislation would be available for new loans. All such receipts are to be deposited with Treasury. Thus, debt reschedulings have no direct effect on funds available for new loans. It should be noted that the removal of authority to use receipts does not affect the authority of the Executive Branch to reschedule debts.

The level of dollar credits which can be extended under P.L. 480 is also affected by debt reschedulings. Section 102 of P.L. 480 provides that the Commodity Credit Corporation is authorized to finance the sale and exportation of agricultural commodities. Funds for dollar credits can be obtained either through appropriations or by resorting to CCC's borrowing authority (15 U.S.C. 714b(i)). In determining the yearly appropriations for the P.L. 480 programs, one of the factors taken into account is the funds that will be received through debt repayments. To the extent that P.L. 480 debts are rescheduled and receipts diminished, CCC must seek additional appropriations or resort to use of its borrowing authority. Since there is a limit on the obligations that CCC can have outstanding, such financing by CCC represents a drain in the resources of CCC and makes these resources unavailable for other uses.

Debt reschedulings may also reduce the ability of the Export-Import Bank to make new loans, because of the limitation both on the commitment authority and on the obligations that Eximbank can have outstanding (Sections 6 and 7 of the Export-Import Bank Act of 1945, as amended).

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VI. A SUMMARY OF NET FINANCIAL FLOWS TO COUNTRIES RECEIVING MAJOR DEBT RELIEF

Comprehensive data on U.S. foreign assistance to all foreign countries from calendar year 1945 to calendar year 1974, the latest date for which complete data are available, can be found in the 1975 Annual Report to the National Advisory Council on International Monetary and Financial Policies. Table 11 is compiled from balance of payments information and shows the net foreign financial flows of the U.S. in calendar year 1974 to three major recipients: Chile, India, and Pakistan. These flows are categorized into grants, credits, and other assistance.

The amount of debt reorganization or debt rescheduling for each of these countries is noted in the first line of this table. Debt rescheduling of $101 million to Chile, $17 million to India and $64 thousand to Pakistan constituted a portion of the net financial flows to these countries in 1974.

Also noted in the first line of this table is the net total financial flows from the U.S. to these three countries. For calendar year 1974 these amounts are $122 million for Pakistan and $87 million for Chile. Recoveries from India exceeded all forms of new flows resulting in a net flow to the U.S. of $178 million dollars.

Table 11

Summary of major U.S. Government net foreign financial flows to Chile, India and Pakistan
Calendar year 1974, gross and returned, by type and program
(In thousands of dollars and equivalents)

	Chile		India		Pakistan	
	Total	Of which: Debt reorganization	Total	Of which: Debt reorganization	Total	Of which: Debt reorganization
NET TOTAL, ALL PROGRAMS (excluding interest collections)	87,019	100,602	- 178,196	16,959	122,077	64
Grants						
Total grants	5,864		2,138,042		23,644	
Under Foreign Assistance Act and related programs	840		2,306		16,434	
Under authorizations for farm products disposals:						
From foreign currencies under the Agricultural Trade Development and Assistance Act	---		2,039,870		3,861	
For famine, other urgent, and extraordinary relief, for economic development, and through private welfare agencies	4,447		94,981		3,349	
Peace Corps	577		885			
Credits						
Net	81,164	100,602	-2,114,249	16,959	94,554	64
Gross (new)	376,019	335,273	73,599	29,667	131,652	64
Under Export-Import Bank Act	259,775	257,369	7,641	---	25,276	---
Under Foreign Assistance Act and related programs:						
Country program loans	34,128	34,163	62,372	29,340	46,819	---
Financing of military sales	8,840	---	1,468	---	15	---
Social Progress Trust Fund	2,590	---	---	---	---	---
Investment incentive credits	25,389	25,389	---	---	---	---
Under Agricultural Trade Development and Assistance Act:						
Currency loans to foreign governments	4,031	4,031	---	---	---	---
Currency loans to private enterprises	---	---	2,118	327	64	64
Long-term dollar credits	14,321	14,321	---	---	26,015	---
Other credits	26,945	---	---	---	33,463	---
Under Commodity Credit Corporation Charter Act	26,931	---	---	---	33,463	---
Miscellaneous	14	---	---	---	---	---

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Table 11 (cont'd.)

Summary of major U.S. Government net foreign financial flows to Chile, India and Pakistan
Calendar year 1974, gross and returned, by type and program
(In thousands of dollars and equivalents)

	Chile		India		Pakistan	
	Total	Of which: Debt reorganization	Total	Of which: Debt reorganization	Total	Of which: Debt reorganization
Less principal collections	294,855	234,671	2,187,848	12,708	37,098	---
Under Export-Import Bank Act	236,043	202,494	29,540	---	8,311	---
Under Foreign Assistance Act and related programs:						
Country program loans	23,866	18,748	306,565	12,708	11,365	---
Financing of military sales	4,337	---	2,326	---	558	---
Social Progress Trust Fund	2,404	---	---	---	---	---
Investment incentive credits	4,621	---	---	---	---	---
Under Agricultural Trade Development and Assistance Act:						
Currency loans to foreign governments	2,460	2,152	1,836,099	---	2,948	---
Currency loans to private enterprises	---	---	11,651	---	2,268	---
Long-term dollar credit sales	13,281	11,277	---	---	4,093	---
Other credits	7,843	---	1,667	---	7,555	---
Under Commodity Credit Corporation Charter Act	7,843	---	---	---	7,555	---
Miscellaneous	---	---	1,667	---	---	---
Other Assistance (through Net Accumulation of Foreign Currency Claims)						
Net	- 9	---	- 202,989	---	3,879	---
Farm products sales: (Under Commodity Credit Corporation Charter Act)	---	---	73	---	63	---
From 2d-stage operation (under Agricultural Trade Development and Assistance Act)	8	---	1,872,049	---	11,920	---
Less currencies disbursed for grants, credits, and other uses	17	---	2,074,111	---	8,104	---
Under Mutual Security Acts	---	---	87	---	---	---
For economic grants and credits in recipient's currency	---	---	87	---	---	---
Under Agricultural Trade Development and Assistance Act	17	---	2,073,951	---	8,041	---
For economic grants and credits in recipient's currency	---	---	2,041,661	---	3,843	---
Other	17	---	32,290	---	4,198	---
Under Commodity Credit Corporation Charter Act:						
Other than for grants and credits	---	---	73	---	63	---

Table 11 (cont'd.)

Summary of major U.S. Government net foreign financial flows to Chile, India and Pakistan
Calendar year 1974, gross and returned, by type and program
(In thousands of dollars and equivalents)

	Chile		India		Pakistan	
	Total	Of which: Debt reorganization	Total	Of which: Debt reorganization	Total	Of which: Debt reorganization
MEMORANDUM: Interest Collections						
Total, interest collections	90,388	75,213	83,042	16,959	24,681	64
Under Export-Import Bank Act	62,547	54,875	10,676	---	3,456	---
Under Foreign Assistance Act and related programs:						
Country program loans	16,264	15,415	36,617	16,632	7,217	---
Financing of military sales	1,036	---	56	---	26	---
Social Progress Trust Fund	945	---	---	---	---	---
Investment incentive credits	1,418	---	---	---	---	---
Under Agricultural Trade Development and Assistance Act:						
Currency loans to foreign governments	1,995	1,879	17,322	---	6,023	---
Currency loans to private enterprises	---	---	7,304	327	745	64
Long-term dollar credit sales	3,736	3,044	9,817	---	5,571	---
Other credits	---	---	---	---	---	---
Under Atomic Energy Act	---	---	1,250	---	---	---
Under Commodity Credit Corporation Charter Act	2,447	---	---	---	1,643	---
MEMORANDUM: Investment guaranty payments by OPIC						
Guaranties paid	12,454	---	---	---	---	---
Recovery on guaranties	25,389	25,389	---	---	---	---
MEMORANDUM TOTAL: Net assistance, interest, collections, and investment guaranty transactions	-16,304	---	-261,238	---	97,396	---

NOTE: Excludes military grant assistance. For other important qualifications affecting this table and for definitions of terms, see the explanatory note to the corresponding tables in the statistical appendix to the Annual Report of the National Advisory Council on International, Monetary and Financial Policies.

SOURCE: Compiled by Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

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APPENDIX

1. Letters to Congress on Indian Rescheduling.

2. U.S./Indian Bilateral Agreement for 1974 (dated May 2, 1975).

3. Letters to Congress on Chilean Rescheduling.

4. U.S./Chilean Bilateral Agreement dated July 3, 1975.

LETTERS TO CONGRESS ON INDIAN RESCHEDULING

July 31, 1974

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Honorable Thomas E. Morgan, Chairman
Committee on Foreign Affairs
House of Representatives
Washington, D.C.

Dear Mr. Chairman:

The Secretary has asked me to inform you of the status of discussions on debt taking place in the Aid-to-India Consortium, an organization of thirteen creditor countries chaired by the World Bank. Although there have been no new United States bilateral loan commitments to India since 1971, the United States has continued to participate in Consortium-sponsored debt rescheduling exercises begun six years ago. Last year the United States rescheduled $29 million of the total $179 million rescheduled by the Consortium creditors. However, India still paid debt service totalling $115 million to the United States.

At the two meetings of the Consortium held this year, attention has focused on India's debt and aid needs in the light of the country's economic problems. These problems are dominated by needs for petroleum, fertilizer, and foodgrains and for measures to meet balance of payments problems resulting from the sharply higher costs of these essential imports. I shall refer shortly to another aspect of the Indian economic situation, that of its nuclear development program.

Of course, India's long run development depends mainly on India's own efforts to mobilize its resources in the most efficient manner possible. For the present year, however, members of the Consortium agreed that 1974 will be particularly difficult for the Indian economy and people. In view of India's economic difficulties, most Consortium members have already scheduled increases in their economic assistance programs to India.

In addition, the World Bank proposed at a Consortium meeting on June 13-14 that the thirteen Consortium creditors reschedule 45 percent of the roughly $550 million in Indian

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debt payments due them this Indian fiscal year, ending March 31, 1975. The proposal would provide total debt relief of $248 million. Since debt falling due to the United States from India this year is just over $145 million, the United States share of relief under the Bank's proposal would have amounted to approximately $64 million.

Most members accepted the Bank proposal but the United States did not. The United States stated a willingness to reschedule at a level well below the Bank's suggested share for us, with a pledge to review India's situation later in the year if such was warranted by economic conditions.

During the Consortium discussions with the Indian delegation most of the creditors, including the United States, referred to India's nuclear explosion. The general views were that the explosion had raised questions of India's economic priorities for the future, and that its economic implications would have to be carefully examined. In our judgment, no significant transfer of Indian economic resources is involved in its nuclear explosion. India's annual budget is about $12 billion. Total expenditures for nuclear development in FY-1973 were $91 million, the vast bulk of which was used on nuclear power development, to provide electricity badly needed for the Indian development effort. The total cost of the nuclear explosion, including prior research and development, was less than one-tenth of one percent of India's budget.

At the present time, the World Bank is reportedly attempting to revise its debt relief proposal in a manner that would be acceptable to all Consortium creditors. I will be happy to provide any additional information on this subject, and will keep you informed of any further developments.

Cordially,

Linwood Holton
Assistant Secretary
for Congressional Relations

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July 31, 1974

Honorable J. William Fulbright, Chairman
Committee on Foreign Relations
United States Senate
Washington, D.C.

Dear Mr. Chairman:

The Secretary has asked me to inform you of the status of discussions on debt taking place in the Aid-to-India Consortium, an organization of thirteen creditor countries chaired by the World Bank. Although there have been no new United States bilateral loan commitments to India since 1971, the United States has continued to participate in Consortium-sponsored debt rescheduling exercises begun six years ago. Last year the United States rescheduled $29 million of the total $179 million rescheduled by the Consortium creditors. However, India still paid debt service totalling $115 million to the United States.

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In addition, the World Bank proposed at a Consortium meeting on June 13-14 that the thirteen Consortium creditors reschedule 45 percent of the roughly $550 million in Indian debt payments due them this Indian fiscal year, ending

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March 31, 1975. The proposal would provide total debt relief of $248 million. Since debt falling due to the United States from India this year is just over $145 million, the United States share of relief under the Bank's proposal would have amounted to approximately $64 million.

Most members accepted the Bank proposal but the United States did not. The United States stated a willingness to reschedule at a level well below the Bank's suggested share for us, with a pledge to review India's situation later in the year if such was warranted by economic conditions.

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Cordially,

Linwood Holton
Assistant Secretary
for Congressional Relations

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August 20 1974

Honorable Thomas E. Morgan, Chairman
Committee on Foreign Affairs
House of Representatives
Washington, D.C.

Dear Mr. Chairman:

Pursuant to the provisions of Section 4 of the Foreign Disaster Assistance Act of 1974, (the "Act") the Department of State is to notify you prior to the United States entering into discussions which could have the impact of liberalizing the repayment terms of any debt owed to the United States by a foreign government for loans extended under the authority of the Foreign Assistance Act of 1961, as amended. Section 4 of the Act also requires that the text of each bilateral rescheduling agreement with a debtor foreign government be transmitted to the Speaker of the House of Representatives and to the Chairman of the Senate Committee on Foreign Relations at least thirty days before its entry into force.

To initiate implementation of the above mentioned legislation, the Secretary has asked me to inform you of the status of all pending matters covered by Section 4. At the present time these consist of the recent understanding within the Aid-to-Pakistan Consortium which resolved the complex issues of Pakistan/Bangladesh debt, and the ongoing discussions taking place in the Aid-to-India Consortium.

On June 28, 1974, the World Bank, acting in its capacity as chairman of the thirteen member Aid-to-Pakistan Consortium, signed a Memorandum of Understanding with the Government of Pakistan providing for a rescheduling of approximately $650 million payments owed by Pakistan over the four year period beginning July 1, 1974. The United States' share of relief to be provided over the four years is about $211 million, or approximately 32.5 percent of the total. (In order to lower somewhat the amount of debt relief granted in the first years of the rescheduling period, the United States elected to reschedule about $230 million over 5-1/2 years which in terms of discounted present value is equivalent to the $211 million/four year figure.) My June 27 letter to you on this topic provides additional background to the unique circumstances -- arising out of the 1971 war and the independence of Bangladesh -- leading up to this understanding.

Directly related to the understanding negotiated with Pakistan is an agreement by the Government of Bangladesh to assume the responsibility to service payments on debt -- formerly the responsibility of a united Pakistan -- for projects visibly located in Bangladesh. About $80 million in such debt to the United States will now be serviced by Bangladesh. All the members of the Aid-to-Pakistan Consortium have agreed to provide generous terms on the debt which Bangladesh agrees to service. The bilateral agreements implementing our understandings with Pakistan and Bangladesh will be forwarded to you as soon as they are prepared and will not enter into force until at least thirty days after being transmitted to you.

My July 31 letter to you regarding discussions on debt taking place in the Aid-to-India Consortium provides some of the background on the status of a possible debt rescheduling agreement with India. Although the United States has participated in Consortium-sponsored debt rescheduling exercises begun six years ago, the United States did not accept a recent World Bank proposal calling on the thirteen Consortium creditors to reschedule 45 percent of the roughly $550 million in Indian debt payments due to them this Indian fiscal year, ending March 31, 1975. Since debt falling due to the United States from India this year is just over $145 million, the United States share of relief under the Bank's proposal would have amounted to approximately $64 million. The Bank is currently attempting to revise its proposal in a manner that would be acceptable to all Consortium creditors.

I will be happy to provide any additional information on these matters, and will notify you of all other pertinent developments affecting these and any other debts owed to the United States under the Foreign Assistance Act.

Cordially,

Linwood Holton
Assistant Secretary
for Congressional Relations

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August 14, 1974

Honorable J. William Fulbright, Chairman
Committee on Foreign Relations
United States Senate
Washington, D.C.

Dear Mr. Chairman:

Pursuant to the provisions of Section 4 of the Foreign Disaster Assistance Act of 1974 (the "Act"), the Department of State is to notify you prior to the United States entering into discussions which could have the impact of liberalizing the repayment terms of any debt owed to the United States by a foreign government for loans extended under the authority of the Foreign Assistance Act of 1961, as amended. Section 4 of the Act also requires that the text of each bilateral rescheduling agreement with a debtor foreign government be transmitted to you in your capacity as Chairman of the Senate Foreign Relations Committee and to the Speaker of the House of Representatives at least 30 days before its entry into force.

To initiate implementation of the above mentioned legislation, the Secretary has asked me to inform you of the status of all pending matters covered by Section 4. At the present time these consist of the recent understanding within the Aid-to-Pakistan Consortium which resolved the complex issue of Pakistan/Bangladesh debt, and the on-going discussions taking place in the Aid-to-India Consortium.

On June 28, 1974, the World Bank, acting in its capacity as chairman of the thirteen member Aid-to-Pakistan Consortium, signed a Memorandum of Understanding with the Government of Pakistan providing for a rescheduling of approximately $650 million in payments owed by Pakistan over the four year period beginning July 1, 1974. The United States' share of relief to be provided over the four years is about $211 million, or approximately 32.5

percent of the total (in order to lower somewhat the amount of debt relief granted in the first years of the rescheduling period, the U.S. elected to reschedule about $230 million over 5-1/2 years which in terms of discounted present value is equivalent to the $211 4 year figure). My June 27 letter to you on this topic provides additional background to the unique circumstances - arising out of the 1971 war and the independence of Bangladesh - leading up to this understanding.

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I will be happy to provide any additional information on these matters, and will notify you of all other pertinent developments affecting these and any other debts owed to the United States under the Foreign Assistance Act.

Cordially,

Linwood Holton
Assistant Secretary
for Congressional Relations

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October 10 1974

Honorable Thomas E. Morgan, Chairman
Committee on Foreign Affairs
House of Representatives
Washington, D.C.

Dear Mr. Chairman:

The Secretary has asked me to inform you of current developments with respect to a rescheduling of India's debt to the United States. As I noted in my letter of August 13, the United States was not able to accept a World Bank proposal requesting the thirteen creditors of the Aid-to-India Consortium to reschedule 45 percent of the Indian debt service falling due this Indian fiscal year. Under this proposal, the United States share of relief would have amounted to $64 million.

After careful consideration of India's current economic problems and the serious balance of payments difficulties that she confronts, the United States has advised the World Bank that it is willing to reschedule up to a maximum of $45 million. It is our hope that this offer will facilitate early agreement by creditors on a rescheduling for India within the Consortium. Even though this represents about 31 percent of Indian debt service falling due to the United States, the World Bank is hopeful that most of the other creditors will participate at the 45 percent rate requested in the original Bank proposal.

Pursuant to the provisions of Section 4 of the Foreign Assistance Act of 1974, the text of any bilateral rescheduling agreement negotiated with India will be transmitted to the Chairman of the Senate Foreign Relations Committee and to the Speaker of the House of Representatives at least 30 days before its entry into force.

I will be happy to provide any additional information on this subject.

Cordially,

Linwood Holton
Assistant Secretary
for Congressional Relations

October 10, 1974 2833

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Honorable J. William Fulbright, Chairman
Committee on Foreign Relations
United States Senate
Washington, D.C.

Dear Mr. Chairman:

The Secretary has asked me to inform you of current developments with respect to a rescheduling of India's debt to the United States. As I noted in my letter of August 15, the United States was not able to accept a World Bank proposal requesting the thirteen creditors of the Aid-to-India Consortium to reschedule 45 percent of the Indian debt service falling due this Indian fiscal year. Under this proposal, the United States share of relief would have amounted to $64 million.

After careful consideration of India's current economic problems and the serious balance of payments difficulties that she confronts, the United States has advised the World Bank that it is willing to reschedule up to a maximum of $45 million. It is our hope that this offer will facilitate early agreement by creditors on a rescheduling for India within the Consortium. Even though this represents about 31 percent of Indian debt service falling due to the United States, the World Bank is hopeful that most of the other creditors will participate at the 45 percent rate requested in the original Bank proposal.

Pursuant to the provisions of Section 4 of the Foreign Assistance Act of 1974, the text of any bilateral rescheduling agreement negotiated with India will be transmitted to you in your capacity as Chairman of the Senate Foreign Relations Committee and to the Speaker of the House of Representatives at least 30 days before its entry into force.

I will be happy to provide any additional information on this subject.

Cordially,

Linwood Holton
Assistant Secretary
for Congressional Relations

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Honorable Carl Albert, Speaker
House of Representatives
Washington, D.C.

Dear Mr. Speaker:

Section 4 of the Foreign Disaster Assistance Act of 1974 requires that the Department of State transmit to you in your capacity as Speaker of the House of Representatives and to the Chairman of the Senate Foreign Relations Committee the text of any international agreement proposing a modification in the terms of debt owed to the United States by a foreign government no less than thirty days prior to its entry into force.

To implement this provision the Secretary has asked me to transmit the enclosed bilateral agreement (Tab A) which will reschedule $45 million in Indian debt service which became due to the United States during the Indian fiscal year ending March 31, 1975. This agreement will implement an understanding reached with India by the World Bank, in its capacity as chairman of the Aid-to-India Consortium, on October 31, 1974. Chairman Morgan of the International Relations Committee was informed of the debt rescheduling negotiations taking place last year by the Consortium in letters dated July 31, August 13, and October 10, 1974 (Tab B). Other debt service payments of approximately $100 million due to the United States from India during the fiscal year are not affected by the agreement and have been paid.

As we noted in our letters to Chairman Morgan (and in the Administration's "Report on Debt Relief Granted by the United States to Developing Countries" transmitted to Congress on February 28, 1975), last year's Consortium discussions focused on India's balance of payments problems resulting from the sharply higher costs of such essential imports as petroleum, fertilizer, and foodgrains. The World Bank proposed that the creditor countries of the Consortium reschedule 45 percent of the Indian debt payments due them. The United States' share of relief under the Bank's proposal would

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have amounted to approximately $64 million. While the United States agreed that 1974 would be a particularly difficult year for the Indian economy and people, we did not accept the Bank's proposal although most other creditors did. After careful consideration of India's economic problems and balance of payments difficulties, the United States advised the World Bank that it was willing to reschedule $45 million, representing about 31 percent of Indian debt service falling due to the United States. Following the United States offer, the World Bank reached an understanding with India on behalf of the Consortium creditors.

The debt relief package totals $194 million. France and the United Kingdom will reschedule 40 percent of Indian debt service due. Seven other creditors will reschedule at least 45 percent of debt service due. In addition, Italy has indicated it would participate but has not yet determined the amount to be rescheduled while Norway had already written off the full stock of public debt held by India. In terms of the volume of debt to be rescheduled, the largest participants are Germany ($57.70 million), the United States ($45.0 million), Japan ($43.4 million) and the United Kingdom ($21.8 million).

The bilateral agreement between the United States and India will defer payments due on 49 loans over an approximate seven month period. In accordance with the multilateral understanding, repayments will be made over a 25 year period including seven years grace with an interest rate of 1.72 percent. This is the average weighted interest in the original agreements covered.

The United States is India's largest creditor, and as of March 31, 1974, accounted for $3.3 billion of India's $10.2 billion outstanding (and disbursed) external public debt. Given the difficult economic situation which confronted India last year, we believe the agreement to be in the United States' interest in that the $45 million in United States relief -- as well as the $149 million in relief from other creditors -- furthered economic stability in India and thus enhanced the probability of repayment of all debts to the United States and other creditors. We believe it may be possible for India to fully service its $145 million debt to the United States in 1975.

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I will be happy to provide you with any additional information on this matter, and will continue to notify you of all other pertinent developments affecting debts owed to the United States under the Foreign Assistance Act.

Sincerely,

Robert J. McCloskey
Assistant Secretary
for Congressional Relations

Enclosures:

1. Tab A - Bilateral agreement
2. Tab B - Consortium letters

5/6/75 739

Honorable John Sparkman, Chairman
Committee on Foreign Relations
United States Senate
Washington, D.C.

Dear Mr. Chairman:

Section 4 of the Foreign Disaster Assistance Act of 1974 requires that the Department of State transmit to you in your capacity as Chairman of the Senate Foreign Relations Committee and to the Speaker of the House of Representatives the text of any international agreement proposing a modification in the terms of debt owed to the United States by a foreign government no less than thirty days prior to its entry into force.

To implement this provision the Secretary has asked me to transmit the enclosed bilateral agreement (Attachment A) which will reschedule $45 million in Indian debt service which became due to the United States during the Indian fiscal year ending March 31, 1975. This agreement will implement an understanding reached with India by the World Bank, in its capacity as chairman of the Aid-to-India Consortium, on October 30, 1974. Former Chairman Fulbright was informed of the debt rescheduling negotiations taking place last year by the Consortium in letters dated July 31, August 14, and October 10, 1974 (Attachment B). Other debt service payments of approximately $100 million due to the United States from India during the fiscal year are not affected by the agreement and have been paid.

As we noted in our letters to Chairman Fulbright, (and in the Administration's "Report on Debt Relief Granted by the United States to Developing Countries" transmitted to Congress on February 28, 1975) last year's Consortium discussions focused on India's balance of payments problems resulting from the sharply higher costs of such essential imports as petroleum, fertilizer, and foodgrains. The World Bank proposed that the creditor countries of the Consortium reschedule 45 percent of the Indian debt payments due them. The United States share of relief under the Bank's proposal would have amounted to approximately $64 million. While the United States agreed that 1974 would be a particularly difficult year for the Indian economy and people, we did not accept the Bank's proposal although most other creditors did. After careful consideration of India's economic problems and balance of payments difficulties, the United States advised the World Bank that it was willing to reschedule $45 million, representing about 31 percent of Indian debt service falling due to the United States. Following the United States offer, the World Bank reached an understanding with India on behalf of the Consortium creditors.

The debt relief package totals $194 million. France and the United Kingdom will reschedule 40 percent of Indian debt service due. Seven other creditors will reschedule at least 45 percent of debt service due. In addition, Italy has indicated it would participate but has not yet determined the amount to be rescheduled while Norway had already written off the full stock of public debt held by India. In terms of the volume of debt to be rescheduled, the largest participants are Germany ($57.70 million), the United States ($45.0 million), Japan ($43.4 million), and the United Kingdom ($21.8 million).

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The United States is India's largest creditor, and as of March 31, 1974, accounted for $3.3 billion of India's $10.2 billion outstanding (and disbursed) external public debt. Given the difficult economic situation which confronted India last year, we believe the agreement to be in the United States' interest in that the $45 million in United States relief -- as well as the $149 million in relief from other creditors -- furthered economic stability in India and thus enhanced the probability of repayment of all debts to the United States and other creditors. We believe it may be possible for India to fully service

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its $145 million debt to the United States in 1975.

I will be happy to provide you with any additional information on this matter, and will continue to notify you of all other pertinent developments affecting debts owed to the United States under the Foreign Assistance Act.

Sincerely,

Robert J. McCloskey
Assistant Secretary
for Congressional Relations

Enclosures:

1. Attachment A - Bilateral agreement
2. Attachment B - Consortium letters

AGREEMENT BETWEEN
THE GOVERNMENT OF THE UNITED STATES OF AMERICA
AND THE GOVERNMENT OF INDIA
REGARDING THE CONSOLIDATION AND RESCHEDULING OF
CERTAIN DEBTS OWED TO THE
UNITED STATES GOVERNMENT AND ITS AGENCIES

The Government of the United States of America and the Government of India agree as follows:

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ARTICLE I

Application of the Agreement

1. Pursuant to the provisions and mutual undertakings, hereby incorporated into this Agreement, of the Record of Understanding among the member countries of the Indian Consortium signed in Washington on October 30, 1974, by the Government of India and the International Bank for Reconstruction and Development as Chairman of the Consortium, the Government of the United States of America and the Government of India agree to defer and reschedule certain dollar obligations to the United States Government and its agencies falling due between August 28, 1974, and March 31, 1975, under the agreements listed in Annex A, as provided in this Agreement.

2. The United States of America, acting through the Agency for International Development ("A.I.D."), has made certain loans to, or for the benefit of, the President of India ("Borrower"), pursuant to the loan agreements and special loan repayment agreements listed in Annex A to this Agreement and any prior amendments thereto ("Original Agreements"), and the Borrower has undertaken certain payment obligations to A.I.D. pursuant to such Original Agreements.

3. The amount to be deferred and rescheduled under the terms and conditions of this Agreement will be $45,000,000, as indicated in said Record of Understanding. The estimated amounts available for deferral and rescheduling are listed in Annex B to this Agreement.

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ARTICLE II

Definitions

For purposes of this Agreement:

1. The term "Original Agreements" shall refer to the agreements concluded between the Borrower and the Agency for International Development which are listed in Annex A.

2. The term "Consolidated Debt" shall refer to the principal, interest, and credit fees due and payable to the Government of the United States of America between August 28, 1974 and March 31, 1975, under the Original Agreements, which is computed to be $45,000,000, as set forth in Annex B to this Agreement.

3. The term "Consolidation Interest" shall refer to interest accruing and payable on the Consolidated Debt after the respective due dates under the Original Agreements.

ARTICLE III

Terms and Conditions of Payment

1. Deferral and terms of repayment shall be as follows:

(a) Payment of all interest and credit fees and repayment of all installments of principal due and payable to A.I.D. by the Borrower pursuant to the Original Agreements during the period commencing on August 28, 1974, and terminating on March 31, 1975, amounting to $45,000,000 ("Consolidated Debt") as set forth in Annex B to this Agreement, shall be deferred.

(b) The Borrower shall pay the Consolidated Debt to A.I.D. in nineteen equal annual installments on April 1 of each year commencing on April 1, 1982.

(c) The Borrower shall pay annually to A.I.D., on April 1 of each year, interest on the unpaid balance of the Consolidated Debt ("Consolidation Interest"), and on any Consolidation Interest due and unpaid, at the rate of 1.72 percent per annum computed on the basis of a three hundred and sixty (360) day year. Such interest shall commence to accrue on the due date specified in each of the Original Agreements for each payment of interest or credit fee and each repaym of principal deferred pursuant to subsection (a) of this Section. The first payment of Consolidation Interest shall be due and payable on April 1, 1975.

2. The amortization schedule for payment of the Consolidated Debt and Consolidation Interest is set forth in Annex C of this Agreement.

3. Except as otherwise expressly provided herein, payment of obligations which become due and payable by Borrower to A.I.D. pursua to each of the Original Agreements shall be paid in accordance with t existing terms of each.

ARTICLE IV

Entry into Force

1. To the extent not amended herein, or rendered inconsistent hereby, the terms and conditions of the Original Agreements, includir but not limited to, events of default and remedies upon default, sha remain in full force and effect.

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2. Except as A.I.D. may otherwise agree in writing, within thirty (30) days from the date of this Agreement, and as a condition to the effectiveness of this Agreement, Borrower shall furnish to A.I.D., in form and substance satisfactory to A.I.D., a legal opinion of counsel satisfactory to A.I.D. that this Agreement has been duly authorized or ratified by, and executed and delivered on behalf of the Borrower and constitutes a valid and legally binding obligation of the Borrower in accordance with its terms.

3. This Agreement will enter into force when the Government of the United States notifies the Government of India in writing that domestic United States laws and regulations covering debt rescheduling have been complied with.

DONE at Washington in duplicate this second day of May, 1975.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:

Paul H. Boeker

FOR THE GOVERNMENT OF INDIA:

ANNEX A

INDIA - AGENCY FOR INTERNATIONAL DEVELOPMENT

LIST OF LOANS RESCHEDULED

AID LOAN NUMBER	DATE OF AGREEMENT	TITLE	INTEREST RATE GRACE	INTEREST RATE AMORT.	INITIAL AMORT. DATE
386-B-001	06-15-51	Food Grain Assistance	2-1/2	2-1/2	06-30-57
386-H-052	02-26-62	Canbar Thermal Power Project	3/4	3/4	04-06-72
386-H-055	06-21-62	Non-Project Imports	3/4	3/4	08-28-72
386-H-056	06-21-62	Bandal Thermal Power Project	3/4	3/4	10-01-72
386-H-057	06-21-62	Patherdih Coal Washery	3/4	3/4	11-01-72
386-H-058	06-21-62	Fourth Railway	3/4	3/4	03-18-73
386-H-059	06-28-62	Second Premier Automobiles	3/4	3/4	12-03-73
386-H-060	06-11-62	Rayon Tire Cord Project	3/4	3/4	07-15-73
386-H-061	06-28-62	Pamba-Kakki Hydroelectric Project	3/4	3/4	08-09-73
386-H-062	06-28-62	Industrial Finance Corporation - Second Loan	3/4	3/4	06-19-74
386-H-063	06-11-62	Trombay Thermal Power Station	3/4	3/4	01-02-73
386-H-066	11-08-62	Hindustan Motor Loan	3/4	3/4	08-23-73
386-H-067	09-25-62	Telco Truck Expansion	3/4	3/4	03-28-73
386-H-068	05-21-63	Ramagundam Thermal Power	3/4	3/4	06-18-75
386-H-069	03-08-63	Delhi "C" Thermal Power Extension Station	3/4	3/4	01-21-75
386-H-077	03-08-63	Satpura Thermal Power	3/4	3/4	10-30-74
386-H-081	10-21-63	Central Ropeway "F" Project	3/4	3/4	11-27-74
386-H-082	02-25-63	Second Non-Project Loan	3/4	3/4	05-06-73
386-H-084	10-21-63	Chandrapura Thermal Elec. Power Proj., Stage II	3/4	3/4	01-18-75
386-H-086	10-21-63	Fifth Railway	3/4	3/4	01-06-75
386-H-087	11-29-63	Dugda Coal Washery Plant II	3/4	3/4	06-02-74
386-H-091	12-07-63	Tarapur Nuclear Power	3/4	3/4	06-24-74
386-H-101	07-21-64	National Engineering Industries Ltd.	3/4	3/4	10-14-76
386-H-103	02-24-64	Commodity Program Assistance - 63-64	3/4	2	08-10-74
386-H-104	06-19-64	Trombay Methanol and Fertilizer Project	3/4	2	09-09-74
386-H-109	11-30-64	Sharavathi Hydroelectric Project III	3/4	2	09-27-76
386-H-111	11-30-64	Commodity Program "L"	3/4	2	04/13/75
386-H-115	03-31-65	Consulting Services "L"	3/4	2	10-19-75
386-H-118	05-03-65	Hindustran Motors - Trucks	3/4	2	04-18-76
386-H-119	05-03-65	Hindustan Motors - Shovels	3/4	2	01-12-76
386-H-120	12-31-64	Telco Truck Expansion	3/4	2	06-10-75
386-H-121	11-30-64	Sixth Railway	3/4	2	06-28-75
386-H-137	06-17-65	Seventh Railway	1	2-1/2	05-17-75
386-H-138	06-17-65	Commodity Program Assistance - 1964-1965	1	2-1/2	09-28-75

A.I.D.

AID LOAN NUMBER	DATE OF AGREEMENT	TITLE	INTEREST RATE GRACE	INTEREST RATE AMORT.	INITIAL AMORT. DATE
386-H-141	05-25-66	Operation Hardrock	1	2-1/2	03-13-78
386-H-143	06-01-66	Dhuvaran Thermal Power II	1	2-1/2	01-08-78
386-H-152	01-04-66	Fertilizer Commodity Loan - 1966	1	2-1/2	02-25-76
386-H-155	05-13-66	Commodity Program Assistance - 1966	1	2-1/2	08-05-76
386-H-160	07-08-66	Commodity Program Assistance - 1966	1	2-1/2	01-18-77
386-H-164	06-02-67	Indian Higher Education	1	2-1/2	12-16-78
386-H-168	05-10-67	Commodity Program Assistance - 1967	1	2-1/2	12-04-77
386-H-176	10-28-67	Commodity Program Assistance - 1967	1	2-1/2	04-02-78
386-H-184	05-12-68	Production Loan - 1968	2	2-1/2	08-16-78
386-H-188	07-19-68	Fertilizer Commodity Loan - 1968-1969	2	2-1/2	09-25-78
386-H-196	12-26-68	Production Loan - 1969	2	3	06-24-79
386-H-200	10-16-69	Private Sector Capital Equipment Loan - 1970	2	3	08-03-80
386-H-201	06-18-71	Indian Farmers Fertilizer Cooperative Ltd.	2	3	07-13-81
386-H-207	06-23-70	Production Loan - 1970	2	3	09-14-80
386-H-212	03-13-71	Commodity Program Loan	2	3	06-17-81

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12/11/74

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ANNEX B

India - Agency for International Development
Payments Subject to Rescheduling
For the Period from August 28, 1974 to March 31, 1975
(in U.S. Dollars)

Loan No.	Due Date	Principal	Interest	Total
386-B-001	12-31-74	3,522,647.47	1,473,057.79	4,995,705.26
386-H-052	10-06-74	543,389.28	113,971.50	657,360.78
055	08-28-74	3,274,194.21	227,542.71	3,501,736.92 1/
055	02-28-75	3,274,194.21	687,580.78	3,961,774.99
056	10-01-74	612,992.01	131,024.97	744,016.98
057	11-01-74	65,105.16	13,916.23	79,021.39
058	09-18-74	703,938.21	153,089.45	857,027.66
058	03-18-75	703,938.21	150,449.68	854,387.89
059	12-03-74	47,108.52	10,246.10	57,354.62
060	01-15-75	131,253.22	28,547.58	159,800.80
061	02-09-75	297,756.04	64,301.44	362,057.48
062	12-19-74	281,353.84	63,308.69	344,662.53
063	01-02-75	290,418.07	62,076.86	352,494.93
066	02-23-75	255,447.97	55,583.78	311,031.75
067	09-28-74	223,317.15	48,571.48	271,888.63
067	03-28-75	223,317.15	47,734.04	271,051.19
068	12-18-74	-	28,529.75	28,529.75
069	01-21-75	226,973.90	51,804.11	278,778.01
077	10-30-74	313,509.67	71,685.88	385,195.55
081	11-27-74	121,792.90	27,403.40	149,196.30
082	11-06-74	3,908,132.83	850,018.89	4,758,151.72
084	01-18-75	194,777.74	44,547.91	239,325.65
086	01-06-75	257,996.24	58,941.13	316,937.37
087	12-02-74	81,916.13	18,431.12	100,347.25
091	12-24-74	1,178,869.24	265,204.33	1,444,073.57
101	10-14-74	-	15,923.66	15,923.66
103	02-10-75	2,715,621.16	2,217,761.57	4,933,382.73
104	09-09-74	81,874.23	25,632.68	107,506.91
104	03-09-75	82,692.98	67,535.08	150,228.06
109	09-27-74	-	6,827.57	6,827.57
109	03-27-75	-	6,827.57	6,827.57
111	10-13-74	-	183,909.86	183,909.86
115	10-19-74	-	1,930.93	1,930.93
118	10-18-74	-	82,574.36	82,574.36
119	01-12-75	-	10,392.76	10,392.76
120	12-10-74	-	44,114.44	44,114.44
121	12-28-74	-	26,751.60	26,751.60
137	11-17-74	-	18,996.38	18,996.38
138	09-28-74	-	943,908.00	943,908.00
138	03-28-75	-	943,908.00	943,908.00
141	09-13-74	-	16,626.58	16,626.58
141	03-13-75	-	16,626.58	16,626.58
143	01-08-75	-	87,366.06	87,366.06
152	02-25-75	-	249,835.63	249,835.63
155	02-05-75	-	483,492.99	483,492.99
160	01-18-75	-	747,164.52	747,164.52
164	12-16-74	-	36,522.54	36,522.54
168	12-04-74	-	657,304.63	657,304.63
176	10-02-74	-	249,474.23	249,474.23
184	02-16-75	-	2,237,423.39	2,237,423.39
188	02-05-75	-	230,000.00	230,000.00
196	12-24-74	-	1,932,626.73	1,932,626.73
200	02-03-75	-	169,913.26	169,913.26
201	01-13-75	-	177,857.01	177,857.01
207	09-14-74	-	1,551,076.65	1,551,076.65
207	03-14-75	-	1,593,096.05	1,593,096.05
212	12-17-74	-	1,604,501.35	1,604,501.35
49 Loans		23,614,527.74	21,385,472.26	45,000,000.00

1/ Principal $3,274,194.21 and interest $699,859.01 totalling $3,974,053.22 were paid. Upon signing of the agreement, AID will refund the total amount rescheduled, under Loan No. 386-H-055, $3,501,736.92 to the Government of India.

April 1975

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ANNEX C

India - Agency for International Development
Schedule of Repayment Resulting from Rescheduling
Certain Dollar Payments Due August 28, 1974 to March 31, 1975

Due Date	Total	Interest 1.72%	Principal	Outstanding Balance
				45,000,000.00
April 1, 1975	194,927.00	194,927.00 1/		
April 1, 1976	774,000.00	774,000.00		
April 1, 1977	774,000.00	774,000.00		
April 1, 1978	774,000.00	774,000.00		
April 1, 1979	774,000.00	774,000.00		
April 1, 1980	774,000.00	774,000.00		
April 1, 1981	774,000.00	774,000.00		
April 1, 1982	3,142,421.10	774,000.00	2,368,421.10	42,631,578.90
April 1, 1983	3,101,684.21	733,263.16	2,368,421.05	40,263,157.85
April 1, 1984	3,060,947.37	692,526.32	2,368,421.05	37,894,736.80
April 1, 1985	3,020,210.52	651,789.47	2,368,421.05	35,526,315.75
April 1, 1986	2,979,473.68	611,052.63	2,368,421.05	33,157,894.70
April 1, 1987	2,938,736.84	570,315.79	2,368,421.05	30,789,473.65
April 1, 1988	2,898,000.00	529,578.95	2,368,421.05	28,421,052.60
April 1, 1989	2,857,263.15	488,842.10	2,368,421.05	26,052,631.55
April 1, 1990	2,816,526.31	448,105.26	2,368,421.05	23,684,210.50
April 1, 1991	2,775,789.47	407,368.42	2,368,421.05	21,315,789.45
April 1, 1992	2,735,052.63	366,631.58	2,368,421.05	18,947,368.40
April 1, 1993	2,694,315.79	325,894.74	2,368,421.05	16,578,947.35
April 1, 1994	2,653,578.94	285,157.89	2,368,421.05	14,210,526.30
April 1, 1995	2,612,842.10	244,421.05	2,368,421.05	11,842,105.25
April 1, 1996	2,572,105.26	203,684.21	2,368,421.05	9,473,684.20
April 1, 1997	2,531,368.42	162,947.37	2,368,421.05	7,105,263.15
April 1, 1998	2,490,631.58	122,210.53	2,368,421.05	4,736,842.10
April 1, 1999	2,449,894.73	81,473.68	2,368,421.05	2,368,421.05
April 1, 2000	2,409,157.89	40,736.84	2,368,421.05	-0-
Total	57,578,926.99	12,578,926.99	45,000,000.00	

1/ Interest is computed from last due date of individual loan to March 31, 1975 at contractual interest rate on total amount rescheduled.

April, 1975

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LETTERS TO CONGRESS ON CHILEAN RESCHEDULING

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March 13, 1975

Honorable Thomas E. Morgan, Chairman
Committee on Foreign Affairs
House of Representatives
Washington, D.C.

Dear Mr. Chairman:

Pursuant to the provisions of Section 4 of the Foreign Disaster Assistance Act of 1974 (the "Act"), the Department of State is to notify you prior to the United States entering into discussions which could have the impact of liberalizing the repayment terms of any debt owed to the United States by a foreign government for loans extended under the authority of the Foreign Assistance Act of 1961, as amended.

The purpose of this letter is to advise you that the United States Government will be participating in a meeting requested by Chile on March 24 and 25 as a member of a group of creditor nations (the "Paris Club") to consider rescheduling certain amounts of Chile's public external debt due in 1975.

Chile previously sought and received rescheduling through the Paris Club of its public external debt in 1930, 1965, 1972 and 1974. Relevant documentation and background information concerning the two latter cases were submitted to the Congress under the terms of the Case Act. In both the 1972 and 1974 reschedulings, the creditors insisted that Chile enter into an economic stabilization program, preferably under the auspices of the International Monetary Fund (IMF). This "stand-by arrangement" with the IMF was made in conjunction with the 1974 rescheduling and is being repeated in 1975.

The current Chilean economic situation is such that the IMF is again recommending a rescheduling of Chile's debts. Given the status of their economy, the choices to the creditors are either to reschedule or accept default. In spite of the stabilization measures adopted in 1974, Chile's 1975 economic prospects are poor largely because of external forces: the four-fold increase in the price of oil (Chile imports most of its consumption) and the precipitous drop in the price of copper, which accounts for almost 80 percent of Chile's foreign exchange earnings, to a level less than one-half the price reached in mid-1974. These factors have undermined much of the economic progress made in 1974 and the IMF now predicts that in spite of Chile's best efforts, there will be an extremely large unfinanced balance of payments gap in 1975.

The forum for this meeting, the creditor club, is the traditional multilateral mechanism for debt rescheduling. Its function is to examine a nation's ability to meet its debt service payments and, if it determines that the debtor is temporarily unable to meet its obligations, it may agree to reschedule the debtor country's service payments for the purpose of facilitating future repayments. Judgments for rescheduling are based on financial and other economic criteria and debt rescheduling is not used by the creditor governments for providing development assistance. Debt renegotiations have usually occurred within a multilateral framework, with creditors insisting upon the most favored nation principle to ensure that all creditors share the burden of rescheduling identically. The terms of rescheduling have in the past varied, depending on the composition and structure of the debt to be rescheduled and on the economic circumstances and prospects of the debtor country. Since Chile's 1975 debt service is heavily weighted by non-concessional borrowings, rescheduling terms are likely to be established on a near commercial basis.

Should a multilateral agreement setting parameters for rescheduling be concluded, creditor nations negotiate bilaterally with the debtor to establish final terms, including interest rates and, depending upon the specificity of the Paris Club Agreement, perhaps also some details of the repayment schedule. The United States creditor agency involved which extended loans authorized by the Foreign Assistance Act is the Agency for International Development (which is owed approximately $16.1 million in 1975, not all of which will be eligible for rescheduling in the Paris Club). The Department of

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Agriculture ($24.9 million), the Export-Import Bank ($45.3 million) and the Overseas Private Investment Corporation ($8.7 million) will also be included. This does not include previously rescheduled debt, which will not be further rescheduled. The portion of debt due these United States agencies to be rescheduled, if any, will be determined by the terms of the Paris Club Agreement.

I will be happy to provide any additional information on this matter, and will continue to notify you of all other pertinent developments affecting these and any other debts owed to the United States under the Foreign Assistance Act.

Sincerely,

Robert J. McCloskey
Assistant Secretary
for Congressional Relations

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March 13, 1975

Honorable John J. Sparkman, Chairman
Committee on Foreign Relations
United States Senate
Washington, D.C.

Dear Mr. Chairman:

Pursuant to the provisions of Section 4 of the Foreign Disaster Assistance Act of 1974 (the "Act"), the Department of State is to notify you prior to the United States entering into discussions which could have the impact of liberalizing the repayment terms of any debt owed to the United States by a foreign government for loans extended under the authority of the Foreign Assistance Act of 1961, as amended.

The purpose of this letter is to advise you that the United States Government will be participating in a meeting requested by Chile on March 24 and 25 as a member of a group of creditor nations (the "Paris Club") to consider rescheduling certain amounts of Chile's public external debt due in 1975.

Chile previously sought and received rescheduling through the Paris Club of its public external debt in 1930, 1965, 1972 and 1974. Relevant documentation and background information concerning the two latter cases were submitted to the Congress under the terms of the Case Act. In both the 1972 and 1974 reschedulings, the creditors insisted that Chile enter into an economic stabilization program, preferably under the auspices of the International Monetary Fund (IMF). This "stand-by arrangement" with the IMF was made in conjunction with the 1974 rescheduling and is being repeated in 1975.

The current Chilean economic situation is such that the IMF is again recommending a rescheduling of Chile's debts. Given the status of their economy, the choices to the creditors are either to reschedule or accept default. In spite of the stabilization measures adopted in 1974, Chile's 1975 economic prospects are poor largely because of external forces: the four-fold increase in the price of oil (Chile imports most of its consumption) and the precipitous drop in the price of copper, which accounts for almost 80 percent of Chile's foreign exchange earnings, to a level less than one-half the price reached in mid-1974. These factors have undermined much of the economic progress made in 1974 and the IMF now predicts that in spite of Chile's best efforts, there will be an extremely large unfinanced balance of payments gap in 1975.

The forum for this meeting, the creditor club, is the traditional multilateral mechanism for debt rescheduling. Its function is to examine a nation's ability to meet its debt service payments and, if it determines that the debtor is temporarily unable to meet its obligations, it may agree to reschedule the debtor country's service payments for the purpose of facilitating future repayments. Judgments for rescheduling are based on financial and other economic criteria and debt rescheduling is not used by the creditor governments for providing development assistance. Debt renegotiations have usually occurred within a multilateral framework, with creditors insisting upon the most favored nation principle to ensure that all creditors share the burden of rescheduling identically. The terms of rescheduling have in the past varied, depending on the composition and structure of the debt to be rescheduled and on the economic circumstances and prospects of the debtor country. Since Chile's 1975 debt service is heavily weighted by non-concessional borrowings, rescheduling terms are likely to be established on a near commercial basis.

Should a multilateral agreement setting parameters for rescheduling be concluded, creditor nations negotiate bilaterally with the debtor to establish final terms, including interest rates and, depending upon the specificity of the Paris Club Agreement, perhaps also some details of the repayment schedule. The United States creditor agency involved which extended loans authorized by the Foreign Assistance Act is the Agency for International Development (which is owed approximately $16.1 million in 1975, not all of which will be eligible for rescheduling in the Paris Club). The Department of

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Agriculture ($24.9 million), the Export-Import Bank ($45.3 million) and the Overseas Private Investment Corporation ($8.7 million) will also be included. This does not include previously rescheduled debt, which will not be further rescheduled. The portion of debt due these United States agencies to be rescheduled, if any, will be determined by the terms of the Paris Club Agreement.

I will be happy to provide any additional information on this matter, and will continue to notify you of all other pertinent developments affecting these and any other debts owed to the United States under the Foreign Assistance Act.

Sincerely,

Robert J. McCloskey
Assistant Secretary
for Congressional Relations

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July 29, 1975

Honorable Carl Albert, Speaker
House of Representatives
Washington, D.C.

Dear Mr. Speaker:

Section 4 of the Foreign Disaster Assistance Act of 1974 requires that the Department of State transmit to you in your capacity as Speaker of the House of Representatives and to the Chairman of the Senate Foreign Relations Committee the text of any international agreement proposing a modification in the terms of debt owed to the United States by a foreign government no less than thirty days prior to its entry into force.

To implement this provision the Secretary has asked me to transmit the enclosed bilateral agreement (Attachment A) which will reschedule $96 million in Chilean debt service falling due to the United States in 1975. On March 13 we advised Chairman Morgan of the Committee on Foreign Affairs (Attachment B) that the United States would be participating in a meeting requested by Chile of a group of creditor nations (the "Paris Club") to consider rescheduling certain amounts of Chile's external debt. This agreement will implement the May 6 multilateral understanding reached among Canada, France, Germany, Japan, Spain, Switzerland and the United States. These seven countries hold more than 80 percent of Chile's debt.

As we noted in our March 13 letter, the current Chilean economic situation is such that the IMF recommended debt rescheduling. The fact that the servicing of foreign debt due in 1975 to creditors would amount to almost one-third the value of projected exports made total settlement of the debts beyond Chile's capacity at least in the present year. Given the weak state of the Chilean economy, the choices open to the creditors

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were either to reschedule or to accept default. Cognizant of the unfavorable financial precedent that would be established by default, the creditors determined a rescheduling to be justified.

Creditors agreed that the maturities to be rescheduled should be limited to those falling due in 1975, and they specifically excluded debt service falling due on loans that had been renegotiated in previous reschedulings. Creditors also agreed that 30 percent of the eligible maturities would be due in the amount of 10 percent in 1975, 10 percent in 1976, and 10 percent in 1977. The remaining 70 percent would be paid in 13 semi-annual installments beginning January 1, 1978. The understanding specified that the Government of Chile would accord to each of the represented creditor countries treatment no less favorable than that which may be accorded to any other country not represented.

The bilateral United States-Chile agreement fully conforms to the multilateral understanding. The debt service to be rescheduled by United States Government lending agencies totals approximately $96 million; Agency for International Development ($16.1 million), Commodity Credit Corporation ($9.5 million) Export-Import Bank ($58 million), Overseas Private Investment Corporation ($8.8 million) and PL-480 ($3.7 million). The interest rate shall be approximately at the weighted average of 6.16 percent per annum.

We believe this agreement to be in the best interest of the United States in that it will maximize the possibility of ultimate repayment of the full amount of the debt. As the world's largest bilateral creditor, we lay great importance on the tradition of treating debt crisis situations such as that being encountered by Chile in accordance within overall creditor financial interests and within the context of traditional multilateral arrangements.

I will be happy to provide you with any additional information on this matter, and will continue to notify

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you of all other pertinent developments affecting debts owed to the United States under the Foreign Assistance Act.

Sincerely,

Robert J. McCloskey
Assistant Secretary
for Congressional Relations

Enclosures:
As stated.

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July 29, 1975

Honorable John Sparkman, Chairman
Committee on Foreign Relations
United States Senate
Washington, D.C.

Dear Mr. Chairman:

Section 4 of the Foreign Disaster Assistance Act of 1974 requires that the Department of State transmit to you in your capacity as Chairman of the Senate Foreign Relations Committee and to the Speaker of the House of Representatives the text of any international agreement proposing a modification in the terms of debt owed to the United States by a foreign government no less than thirty days prior to its entry into force.

To implement this provision the Secretary has asked me to transmit the enclosed bilateral agreement (Attachment A) which will reschedule $96 million in Chilean debt service falling due to the United States in 1975. On March 13 we advised you (Attachment B) that the United States would be participating in a meeting requested by Chile of a group of creditor nations (the "Paris Club") to consider rescheduling certain amounts of Chile's external debt. This agreement will implement the May 6 multilateral understanding reached among Canada, France, Germany, Japan, Spain, Switzerland and the United States. These seven countries hold more than 80 percent of Chile's debt.

As we noted in our March 13 letter, the current Chilean economic situation is such that the IMF recommended debt rescheduling. The fact that the servicing of foreign debt due in 1975 to creditors would amount to almost one-third the value of projected exports made total settlement of the debts beyond Chile's capacity at least in the present year. Given the weak state of the Chilean economy, the choices open to the creditors were either to reschedule or to accept default. Cognizant of the unfavorable financial precedent that would be established by default, the creditors determined a rescheduling to be justified.

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The bilateral United States-Chile agreement fully conforms to the multilateral understanding. The debt service to be rescheduled by United States Government lending agencies totals approximately $96 million; Agency for International Development ($16.1 million), Commodity Credit Corporation ($9.5 million), Export-Import Bank ($58 million), Overseas Private Investment Corporation ($8.8 million) and PL-480 ($3.7 million). The interest rate shall be approximately at the weighted average of 6.16 percent per annum.

We believe this agreement to be in the best interest of the United States in that it will maximize the possibility of ultimate repayment of the full amount of the debt. As the world's largest bilateral creditor, we lay great importance on the tradition of treating debt crisis situations such as that being encountered by Chile in accordance within overall creditor financial interests and within the context of traditional multilateral arrangements.

I will be happy to provide you with any additional information on this matter, and will continue to notify you of all other pertinent developments affecting debts owed to the United States under the Foreign Assistance Act.

Sincerely,

Robert J. McCloskey
Assistant Secretary
for Congressional Relations

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AGREEMENT BETWEEN
THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND
THE GOVERNMENT OF CHILE
REGARDING THE CONSOLIDATION AND RESCHEDULING OF
CERTAIN DEBTS OWED TO,
GUARANTEED OR INSURED BY THE
UNITED STATES GOVERNMENT AND ITS AGENCIES

The Government of the United States of America and the Government of Chile agree as follows:

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ARTICLE I

Application of the Agreement

1. In accordance with the provisions of the Understanding reached by representatives of certain creditor nations, including the United States, of the Government of Chile on May 6, 1975 and agreed to by the Government of Chile on May 8, 1975, the Government of the United States of America and the Government of Chile hereby agree to consolidate and reschedule certain Chilean debts owed to, guaranteed or insured by the United States Government and its Agencies, as provided for in this Agreement.

2. The Agreement shall be implemented by separate bilateral agreements between the Agency for International Development, the Export-Import Bank of the United States, the Overseas Private Investment Corporation, the Commodity Credit Corporation, and the United States Government with respect to P. L. 480 Agreements and the Government of Chile.

ARTICLE II

Definitions

For purposes of this Agreement:

1. The term "original agreements" shall refer to those agreements between the Government of the United States, and its agencies, and the Government of Chile, and its agencies, which are listed in Annex A. No prior agreement

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regarding the consolidation and rescheduling of Chilean debts concluded between the Government of the United States and its agencies, and the Government of Chile and its agencies is listed.

2. The term "consolidated debt" shall refer to seventy percent (70%) of the sum of dollar principal and interest payments falling due from January 1, 1975, through December 31, 1975, in accordance with the "original agreements," as designated in the separate bilateral agreements referred to in Article I, paragraph 2.

3. The term "non-consolidated debt" shall refer to thirty percent (30%) of the sum of dollar principal and interest payments falling due from January 1, 1975 through December 31, 1975, in accordance with the "original agreements," as designated in the separate bilateral agreements referred to in Article I, paragraph 2.

4. The term "consolidation period" shall refer to the period from January 1, 1975 through December 31, 1975.

5. The term "consolidation interest" shall refer to interest on the consolidated debt. The term "non-consolidation interest" shall refer to interest on the non-consolidated debt. Consolidation interest and non-consolidation interest shall begin to accrue on the due dates specified ineach of the original agreements for each payment of principal or interest which is part of the consolidated or non-consoli-

dated debt.

ARTICLE III

Terms and Conditions of Payment

1. The Government of Chile agrees to repay the consolidated debt in accordance with the following terms and conditions:

(a) The consolidated debt amounting to $67.2 million shall be repaid in 13 equal semi-annual installments on January 1 and July 1 of each year beginning January 1, 1978 and ending January 1, 1984.

(b) The consolidation interest rate shall be at a weighted average of 6.16 percent _per annum_ on the outstanding balance of the consolidated debt. All interest shall accrue and be payable as specified in the implementing bilateral agreements referred to in Article I, paragraph 2.

(c) A table summarizing the amounts of the consolidated debt owed to the United States Government and each Agency is attached as Annex B.

2. The Government of Chile agrees to repay the non-consolidated debt in accordance with the following terms and conditions:

(a) The non-consolidated debt amounting to $28.8 million shall be repaid in accordance with the following schedule:

(1) Thirty-three and one third percent

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(33-1/3%) in 1975.

(2) Thirty-three and one third percent (33-1/3%) in 1976.

(3) The balance of thirty-three and one third percent (33-1/3%) in 1977.

Payments shall be made pursuant to the repayment terms specified in the implementing bilateral agreements referred to in Article I, paragraph 2.

(b) The weighted average of the non-consolidation interest rate shall be 6.16 percent <u>per annum</u> on the outstanding balance of the non-consolidated debt. All interest shall accrue and be payable as specified in the implementing bilateral agreements referred to in Article I, paragraph 2.

(c) A table summarizing the amounts of the non-consolidated debt owed to the United States Government and each Agency is attached as Annex C.

3. It is understood that minor adjustments may be made in the amounts specified in paragraphs 1 and 2 of this Article by amendment of the implementing bilateral agreements referred to in Article I, paragraph 2.

ARTICLE IV

General Provisions

1. The Government of Chile agrees to grant the Government of the United States of America and its agencies treatment no less favorable than that which may be accorded to any other creditor country for the consolidation of comparable debts.

2. The provisions of paragraph 1 above shall not be applicable to creditor countries where claims in respect of

principal and interest on comparable debts during the consolidation period constitute less than SDRs 1 million.

3. The Government of the United States and the Government of Chile agree that the interest rates provided in this Agreement may be reviewed and appropriately revised if the weighted average of the interest rates provided in other agreements between the Government of Chile and creditor countries relating to the consolidation of comparable debts are significantly higher or lower than the weighted average of the interest rates provided for in this agreement. In any revision resulting from this review, the United States shall have the option of exercising the right to require an increase in the interest rate provided for in this Agreement, up to the weighted average of interest rates resulting from agreements between the Government of Chile and other creditors on comparable debts.

4. The Government of Chile agrees to guarantee the free transferability of payments relating to the credits covered by this Agreement.

ARTICLE V

Entry into Force

1. This Agreement will enter into force when the Government of the United States notifies the Government of Chile in writing that domestic United States laws and regula-

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tions covering debt rescheduling have been complied with.

2. The Government of the United States of America shall be represented by the Honorable Paul H. Boeker and the Government of the Republic of Chile shall be represented by His Excellency, Manuel Trucco, Ambassador of Chile in the United States, who also represented the Autonomous Fund for Amortization of the Public Debt. The Fund is authorized by its charter to act on behalf of the Government of Chile and debtor corporations in concluding agreements with creditors.

DONE at Washington in duplicate this third day of July, 1975.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:

Paul H. Boeker

FOR THE GOVERNMENT OF CHILE:

Manuel Trucco

ANNEX A

LOAN AGREEMENTS SUBJECT TO RESCHEDULING

Agency for International Development

under 40 years	40 years
513-B002	513-L017
513-G003	513-L018
513-A006	513-L019
513-M011	513-L020
513-L026	513-L021
	513-L022
	513-L023
	513-L024
	513-L025
	513-L028
	513-L030
	513-L031
	513-L033
	513-L034
	513-L036
	513-L037
	513-L040
	513-L041

Commodity Credit Corporation (GSM-4)

GSM Numbers

12011
12013
12014
12015

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Export-Import Bank

DIRECT CREDITS

Credit No.
808
1172
1299
1340
2139
2187
2221
2381
2382
2383
2390
2393
2416
2418
2435
2436
2437
2471
2486
2551
2601
2609

EXPORTER CREDITS

GUARANTEES

Guarantee No.	
G-6-166	G-47-359
G-7-54	G-50-239
G-10-219	G-50-240
G-10-245	G-50-245
OG-12-215	G-50-265
G-20-5	G-50-269
G-21-30	G-56-9
G-40-256	G-138-9
G-40-271	G-161-3
G-40-283	
G-41-18	
G-45-49	

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EXPORTER CREDITS

INSURANCE

Policy No.

MT-4756
MT-5485
MT-0-5644
MT-6032
MT-6249
MT-6290
MT-6291
MT-6325
MT-6384
MT-6405
MT-6444
MT-6460
MT-6480
MT-6584
MT-6596
MT-6648
MT-6719
MT-6746
MT-6782
MT-6785
MT-6820
MT-6891
MT-0-6921
MT-7825
MT-8055
MT-8056
MT-8058
MT-8059
MT-8060

OVERSEAS PRIVATE INVESTMENT CORPORATION

Series A Promissory Notes issued by Sociedad Minera El Teniente, S.A. to Braden Copper Company and guaranteed by the Republic of Chile pursuant to instruments of guarantee dated as of May 4, 1967.

P.L. 480

Agreements dated:

August 7, 1962
December 29, 1967
A - January 23, 1969
January 29, 1969

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During the negotiation of the Agreement Between the Government of the United States and the Government of Chile Regarding the Consolidation and Rescheduling of Certain Debts Owed to, Guaranteed or Insured by the United States Government and its Agencies signed today, it was agreed, with respect to Article III of that Agreement, that the particular interest rates (resulting in a weighted average of 6.16 percent) shall be as follows:

a) seven percent (7%) _per annum_ on the outstanding balance of the consolidated and non-consolidated debt due to Export-Import Bank of the United States, the Overseas Private Investment Corporation, and the Commodity Credit Corporation and

b) three percent (3%) _per annum_ on the outstanding balance of the consolidated and non-consolidated debt due to the Agency for International Development, and to the United States Government with respect to P.L. 480 Agreements.

Paul H. Boeker

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA

FOR THE GOVERNMENT OF CHILE

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ANNEX B

SUMMARY OF CONSOLIDATED DEBT*
(Millions of Dollars)

Agency for International Development	11.3
Commodity Credit Corporation	6.6
Export-Import Bank	40.6
Overseas Private Investment Corporation	6.2
PL-480	2.6
TOTAL	67.2

*Totals do not add up due to rounding and are subject to revision per Article III, Paragraph 3

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ANNEX C

SUMMARY OF NON-CONSOLIDATED DEBT*
(Millions of Dollars)

Agency for International Development	4.8
Commodity Credit Corporation	2.9
Export-Import Bank	17.4
Overseas Private Investment Corporation	2.6
PL-480	1.1
TOTAL	28.8

*Totals are rounded and subject to revision per Article III, Paragraph 3

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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March 1, 1976

AIRPORT ARRIVAL STATEMENT
SAUDI ARABIA
BY
THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY

It is a personal pleasure for my wife, Carol, and me to be back in Saudi Arabia. From the air I readily saw the pace of new construction of office buildings and homes which has taken place since my first visit to the Kingdom a year and a half ago.

I have come to Riyadh for the second session of the U.S.-Saudi Arabian Joint Commission on Economic Cooperation which Minister Aba Al-Khail and I serve as co-chairmen. It has been the hope of the United States Government and my personal desire that the Joint Commission will contribute to our desire to build closer economic ties between our countries and usefully serve the people of Saudi Arabia. We believe that American skills and technology can contribute substantially to the quality of life which will go with those new buildings. As important, we believe that economic cooperation can assist us in our desire to achieve lasting peace in the Middle East.

My visit is not limited to the business of the Joint Commission. I also come to convey the warm wishes of President Ford and the American people to his Majesty King Khalid and the people of the Kingdom of Saudi Arabia.

My visit symbolizes the growing friendship between the United States and Saudi Arabia. More Saudis now seek higher eduction in the United States and more Americans live and work in Saudi Arabia than ever before.

I am looking forward to warm and cordial discussions with King Khalid, Crown Prince Fahd, Minister Aba Al-Khail and other distinguished members of His Majesty's government.

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e Department of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR IMMEDIATE RELEASE March 1, 1976

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2.9 billion of 13-week Treasury bills and for $3.7 billion of 26-week Treasury bills, both series to be issued on March 4, 1976, were opened at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing June 3, 1976		
	Price	Discount Rate	Investment Rate 1/
High	98.685 a/	5.202%	5.34%
Low	98.663	5.289%	5.44%
Average	98.671	5.258%	5.40%

a/ Excepting 2 tenders totaling $4,070,000
b/ Excepting one tender of $75,000

Tenders at the low price for the 13-week bills
Tenders at the low price for the 26-week bills

13-wk 26-wk

4.870 Last week 5.204

5.258 To-day 5.724

High since 5.340 12/19/75

12/15/75 5.914

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESER

District	Received	Accepted	Recei	
Boston	$ 63,110,000	$ 60,300,000	$ 9	
New York	3,710,620,000	2,290,620,000	4,50	
Philadelphia	49,840,000	49,840,000	5	
Cleveland	43,860,000	43,860,000	11	
Richmond	33,285,000	33,285,000	10	
Atlanta	32,595,000	32,055,000	5	
Chicago	197,715,000	92,715,000	45	
St. Louis	48,375,000	32,375,000	6	
Minneapolis	17,750,000	13,725,000	3	
Kansas City	46,905,000	43,280,000	39,640,000	34,450,000
Dallas	22,575,000	22,575,000	21,225,000	15,845,000
San Francisco	230,570,000	186,070,000	212,870,000	164,920,000
TOTALS	$4,497,200,000	$2,900,700,000 c/	$5,765,595,000	$3,700,185,000 d/

c/ Includes $396,290,000 noncompetitive tenders from the public.
d/ Includes $ 195,330,000 noncompetitive tenders from the public.
1/ Equivalent coupon-issue yield.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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Contact: L.F. Potts
Extension 2951
March 2, 1976

FOR IMMEDIATE RELEASE

TREASURY ANNOUNCES WATER CIRCULATING PUMPS, WET MOTOR TYPE, SUITABLE FOR USE IN RESIDENTIAL AND COMMERCIAL HYDRONIC HEATING SYSTEMS, FROM THE UNITED KINGDOM, ARE BEING SOLD AT LESS THAN FAIR VALUE

The Treasury Department announced today that water circulating pumps, wet motor type, suitable for use in residential and commercial hydronic heating systems, from the United Kingdom, are being, or are likely to be, sold at less than fair value within the meaning of the Antidumping Act of 1921, as amended. Notice of the determination will be published in the FEDERAL REGISTER of March 3, 1976.

The case will now be referred to the U.S. International Trade Commission for a determination as to whether an American industry is being, or is likely to be, injured. In the event of an affirmative determination, dumping duties will be assessed on all entries of the subject merchandise from the United Kingdom which have not been appraised and on which dumping margins exist.

A "Withholding of Appraisement Notice", published in the FEDERAL REGISTER of November 26, 1975, stated that there was reasonable cause to believe or suspect that there were sales at less than fair value. Pursuant to this notice, interested persons were afforded the opportunity to present oral and written views prior to the final determination in this case.

During the period February 1975 through June 1975, imports of the subject merchandise from the United Kingdom were valued at roughly $235,000.

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The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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ADDRESS BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY OF THE UNITED STATES
TEL AVIV UNIVERSITY
ISRAEL
TUESDAY, MARCH 2, 1976, AT 3:30 P.M.

Economic Development In a Changing World Economy

It is a special privilege for me to be here today to accept this honorary doctorate degree from Tel Aviv University. This institution symbolizes the dedication to education and intellectual achievement that exists in this country.

As you know, America is celebrating this year the two hundredth anniversary of our birth as a nation. Our Bicentennial has prompted a great reawakening of interest in America's founding fathers, that outstanding first generation of leaders that included such men as Washington, Jefferson, Adams, and Hamilton.

As we gather here, we are standing in the shadow of one of Israel's founding fathers -- Pinhas Sapir -- who, not only helped win the struggle for independence, but spent his life working to achieve a system of economic prosperity and stability for his new nation. As a world leader, Mr. Sapir was almost as well-known in America as he was in Israel and, in both countries, he was deeply respected for his seemingly boundless energy, his strength of character, and his dedication to an economically strong Israel.

Perhaps the vision and the hope that Mr. Sapir had for Israel is best summed up in a blessing from the book of Psalms: "Peace be within thy walls, and prosperity...." Certainly, the quest for peace and prosperity guided his unfailing efforts during much of his life.

Yet, neither peace nor prosperity became a permanent reality in Mr. Sapir's lifetime. Great progress was made; great obstacles were overcome: Some of them directly through Mr. Sapir's leadership. Yet the completion of his quest falls to us.

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This challenge comes at a difficult time. The world's economy has sustained several severe shocks in the last decade, and those jolts have had an enormous impact on the economies of both developed and developing nations. There can be no doubt that the world's economic order is intimately tied to the world's political order and fluctuations in one will lead to changes in the other. Peace and prosperity go hand in hand.

Today, after three decades of proud independence during which the Israeli people have repeatedly proven their strength their resourcefulness, and their endurance, both our economies face major problems.

Here in Israel, inflation, the pressing need for capital investment and the high cost of defense are formidable challenges. However, these problems are not insurmountable. I remain convinced that Israel has the spirit and leadership and dedication, borne of hard times, that will see you through the period ahead. In the United States, through patience, foresight and the proper balance of fiscal and monetary policy, we are overcoming our economic difficulties.

The most urgent task that lies before us is to work together in restoring to the world economy the foundation for sustained, durable, non-inflationary growth.

Certainly, the United States bears a heavy responsibility in this endeavor. A quarter of a century ago it was commonplace to observe that when the U.S. sneezed, the world caught a cold, and when the U.S. caught a cold, the world came down with pneumonia. That is no longer as true today as it was then. Yet the United States is still the major economic force in the world. With less than 6 percent of the world's popululation, we account for over 25 percent of the world's annual production. Our exports and imports are each running about $100 billion a year -- more than that of any other single country.

The health of the United States economy thus remains very important to the economic health of other nations. In the past two years, we have all learned that no nation or group of nations can solve its economic problems in isolation. We have witnessed how inflation and recession affect us all. We have seen that no country can achieve success by attempting to export its economic difficulties. Now, as we work together for solutions, we must remember that the most significant contribution we can make to economic progress in the world is to restore durable prosperity in our domestic economies.

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As we work to meet the economic challenges that confront us, the United States will continue to assist Israel and other countries to meet their development objectives. However, in order for America to continue this effort to support others, America must remain a bastion of world economic strength. Despite temporary setbacks in the last few years, America remains the beneficiary of the strongest economic system that the world has ever known. Our economy is in the midst of a healthy and strong recovery.

During 1975:

-- Our rate of inflation was cut nearly in half. The year 1975 opened with inflation ranging at 13 percent; now it is about 6 percent.

-- Our unemployment rate has been reduced from 8.9 percent to 7.8 percent, and virtually all of the jobs lost during the recession have now been restored.

-- During the third quarter of 1975, we registered the largest single increase in our GNP in 25 years.

Other important indices reaffirm that our economic climate is improving -- such as higher industrial production, and growing retail sales.

Thus, we made considerable headway in 1975, and we will make even more in 1976. But, the current strength of our recovery must not lull us into complacency. The accomplishment of our economic goals will require sustained effort and much patience. The unemployment rate is far higher than we can tolerate. And inflation is by no means firmly under control and remains the most dangerous enemy of future economic growth. The ruinous inflation that crested in 1974 was the chief cause of the severe recession of 1975; and if we embark once again upon excessive fiscal and monetary policies resulting in double digit inflation, I will guarantee an even worse recession than before. We must not permis the pain and suffering of the 1974-75 recession to be in vain.

We continue to believe that the solutions to every nation's economic problems must begin at home. Of course, in a highly interdependent world, it is essential that nations pursue a course of close cooperation and consultation in their economic policies. But international discussions and international agreements must be a complement to -- not a substitute for -- sound economic policies within each country.

I believe that the success of American foreign policy today rests more heavily upon the strength of our domestic economy than ever before in our history. Only if America's voice reflects effective economic policies at home can it speak effectively in chancelleries abroad. Only with a growing economy can America maintain a strong national defense and also afford socially desirable domestic programs. If we have a strong economy at home, we will be strong abroad. But if our domestic economy is weak, so, too, will be our foreign position. Much of what we can do beyond our own shores thus depends upon what we achieve at home.

As we approach the problems of a changing world economy, we remain committed to certain fundamental principles. We must work together to reduce trade and investment barriers between nations. Our goal must be a free and open international trading community. With fewer restrictions, international trade can serve as a powerful engine for international growth and as a means of reducing the pressure of inflation.

We must also seek better ways to balance the desire for national independence with the reality of growing international interdependence. It is clear that when the policies of all industrialized democracies are mutually supportive, all nations benefit. When they are incompatible,all nations suffer. Our experience with "beggar-thy-neighbor" policies in the 1930's should leave no doubt about the need for a high degree of economic cooperation among nations. This is not to suggest that we desire to discourage diversity among peoples and nations. We wish to retain our sovereignty as does Israel and other nations. The only practical answer under these circumstances is intensified cooperation, undertaken with both a sense of realism and an understanding of the problems of others.

It is with this in mind that I cannot overemphasize the importance of the fine work being done by the U.S.-Israel Joint Committee on Trade and Investment. That Committee is working to further cooperative economic relations between our two countries in the areas of capital investment, trade development, industrial research and development, and reciprocal scientific advancement. Underlying these efforts is a belief that one answer to Israel's economic problems lies in increasing capital investment. We are committed to working with your government to facilitate involvement of our private companies and to help improve the climate for investment in Israel.

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The economic changes taking place in Israel and in other nations reflect the changing world economy. They underline the importance of making the best possible use of our resources -- to maximize our common growth potential for the benefit of all peoples. As cooperation between developed and developing countries evolves, nations together must strive to permit market forces and the private sector to make the enormous contributions to growth and to human well-being which lies clearly within their potential. We must seek increased production and improved efficiency, not just transfer of wealth. Development assistance should be thought of not as an international welfare program to achieve an immediate redistribution of the world's wealth, but as an important international investment to achieve over a period of years an increased rate of economic growth in developing nations and to provide higher living standards for the people of every nation.

More specifically, in considering how the present system might be improved to the mutual benefit of all nations, we should be guided by the following principles:

-- Development by its nature is a long-term process; increasing productivity is the basis of development, not increased transfers of wealth which are one-time in nature. Foreign aid can help, but what others do will be marginal; that developing countries do for themselves will be decisive. The effectiveness of assistance depends ultimately upon the ability of the developing countries themselves to assure the best use of all the resources available to them.

-- The role of the private sector is critical. There is no substitute for a vigorous private sector mobilizing the resources and energies of the peoples of the developing countries. The technology and management expertise that the private sector commands in the industrial countries is badly needed by the developing nations, and private markets can provide the essential capital resources they need for investments.

-- A free market is not perfect but it is better than any alternative system. In general the effort should be to improve conditions for the developing nations -- both internally and externally -- by removing unnecessary and burdensome government controls, not by imposing additional barriers to market forces.

The basic focus must be on increasing investment and making the institutional and policy improvements which will maximize growth. Because of the major differences among developing countries and limits on available resources, programs must be targeted on specific conditions and needs.

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In short, our economic relations with Israel as well as other nations should be based on approaches which both are responsive to individual needs and consistent with the preservation of these principles. The United States believes that cooperation among industrialized and developing, oil producing and oil consuming nations promotes our common well-being. Lasting peace around the globe will depend not only on containing conflict, but on mounting progress. It requires not merely the preservation of stability but the fulfillment of human respirations. President Ford is committed to a world of cooperation rather than a world ruled by intimidation, pressure or force. With his leadership, we will achieve that goal.

The Scriptures tell us that "he that keepeth Israel shall neither slumber nor sleep." Let that be our joint resolve then in the challenging but promising times ahead. Let us work together to transform the dream for peace and prosperity in the Middle East into concrete plans and a lasting reality for the people of Israel and for her neighbors as well.

This was the goal to which Pinhas Sapir dedicated his life. The finest monument we can give him -- and the greatest lift we can leave for our posterity -- is the completion of his unfinished dream during our lifetime.

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The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

FOR RELEASE AT 4:00 P.M. March 2, 1976

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TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $6,100,000,000 , or thereabouts, to be issued March 11, 1976, as follows:

91-day bills (to maturity date) in the amount of $2,700,000,000, or thereabouts, representing an additional amount of bills dated December 11, 1976, and to mature June 10, 1976 (CUSIP No. 912793 ZL 3), originally issued in the amount of $3,302,205,000, the additional and original bills to be freely interchangeable.

182-day bills, for $3,400,000,000, or thereabouts, to be dated March 11, 1976, and to mature September 9, 1976 (CUSIP No. 912793 A8 9).

The bills will be issued for cash and in exchange for Treasury bills maturing March 11, 1976, outstanding in the amount of $6,109,450,000, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $ 3,000,515,000. 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 non-competitive 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 Standard time, Monday, March 8, 1976. 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

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(OVER)

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 March 11, 1976, in cash or other immediately available funds or in a like face amount of Treasury bills maturing March 11, 1976. 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.

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Department of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR IMMEDIATE RELEASE Wednesday, March 3, 1976

LEAHY TO HEAD TREASURY'S

NEW YORK COMPLIANCE OFFICE

Warren F. Brecht, Assistant Secretary (Administration) has announced the selection of Joseph F. Leahy as manager of the New York regional office for equal employment opportunity contract compliance, effective March 1.

Leahy will be responsible for Treasury's compliance review program in New York and the New England area. Similar offices operate in other parts of the country to ensure that banking institutions comply with equal employment opportunity and affirmative action regulations as delegated to Treasury by the Office of Federal Contract Compliance.

"The opening of the New York field office will enable Treasury to provide more efficient on-site compliance reviews and technical assistance to the large banking community in the Northeast " Mr. Brecht stated. Previously, the area had been serviced by the Washington field office.

Before his Treasury appointment, Leahy served as regional contract compliance chief for the Department of Health, Education and Welfare in New York for eight years, and as a contract compliance officer with the Atomic Energy Commission and the Department of Defense.

He is a graduate of Fordham University in Business Administration and has an M.B.A. from New York University where he also has done work toward a doctorate. He resides in Midland Park, New Jersey.

"The New York office, like the other field compliance offices, will operate on a decentralized basis, reporting to the Departmental headquarters office in Washington," Mr. Brecht said.

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The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR IMMEDIATE RELEASE March 3, 1976

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $3,100 million of 52-week Treasury bills to be issued to the public, to be dated March 9, 1976, and to mature March 8, 1977, were opened at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS: (Excepting 1 tender of $1,000,000)

	Price	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)
High -	93.952	5.982%	[illegible]
Low -	93.903	6.030%	[illegible]
Average -	93.923	6.010%	[illegible]

52-week
2/4/76 5.572
Today 6.010
Highest
since 12/10/75 6.439

Tenders at the low price were allotted 66%.

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL R

District	Received	
Boston	$ 133,395,000	[illegible]
New York	4,334,005,000	[illegible]
Philadelphia	41,065,000	[illegible]
Cleveland	113,730,000	[illegible]
Richmond	135,830,000	[illegible]
Atlanta	33,650,000	22,140,000
Chicago	360,175,000	135,875,000
St. Louis	44,155,000	11,445,000
Minneapolis	13,995,000	3,995,000
Kansas City	34,060,000	15,115,000
Dallas	46,165,000	18,955,000
San Francisco	371,335,000	71,415,000
TOTAL	$5,661,560,000	$3,100,420,000

The $3,100,420,000 of accepted tenders includes $ 73,380,000 of noncompetitive tenders from the public and $973,840,000 of tenders from Government accounts and from Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities accepted at the average price.

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The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR RELEASE ON DELIVERY

STATEMENT OF THE HONORABLE EDWIN H. YEO III
UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS
BEFORE THE SENATE FINANCE COMMITTEE
THURSDAY, MARCH 4, 1976
11:00 A.M.

Mr. Chairman and Members of this distinguished Committee:

As you know, on Wednesday, February 25, the House acted to authorize the Treasury to borrow up to $627 billion through the end of the current fiscal year for the purpose of financing the expenditures of the Federal Government. The House also approved an additional $2 billion of authority to issue bonds outside the 4¼% limitation and approved an increase to 10 years in the maximum maturity of Treasury notes. In addition, the House adopted an amendment requiring the Federal Government to provide a return on savings bonds of not less than 4% per annum, compounded semi-annually, for each full month during which bonds are held.

It is, of course, not easy to reconcile the manifold demands for more Government spending, on the one hand, with our willingness and ability to pay the bills, on the other. But while the budget, and particularly the substantial budget deficit, is closely related to the purpose of this hearing, our problem is not to deal with proposals to increase or reduce the size of the deficit. Rather, we are here to consider how best to finance that deficit. This will necessitate a substantial increase in the present debt ceiling. But in addition, the Treasury has urgent need for additional debt management flexibility.

I have been gratified by this Committee's strong support on two previous occasions for Treasury's proposals to amend the Second Liberty Bond Act, first, to increase the maximum maturity of notes issued pursuant to that Act from seven years to ten years, and, second, to increase the amount of bonds exempted from the 4¼ percent rate ceiling imposed by the Act by an additional $10 billion.

These are even more important today than when you first considered them. The reasons upon which the restrictions in existing law were originally based no longer apply. Indeed, there are few, if any, observers of the capital markets who believe the existing restrictions are healthy for the Government, for the capital markets, for the economy or for the people of the Nation.

Realistically, however, we cannot object to the smaller amount of bond authority contained in the House Bill. It seems unlikely that we would wish to issue more than $2 billion of additional bonds before June 30. Moreover, since under the House Bill, we would have to return during June for a higher debt limit for the transition quarter at a minimum, there would then be another opportunity to examine the bond authority.

You will recall that we have also proposed that the 6 percent rate ceiling on savings bonds be removed. Such action would permit the rate on savings bonds to be varied from time to time, reflecting the interests of both taxpayers and savers. Since we have no immediate intent to raise savings bonds rates, however, consideration of this provision can also be postponed until the next debt limit hearings without adverse consequences for the program.

DEBT LIMIT

Let me now address the primary question facing this Committee today: The increase in the temporary debt limitation.

As you know, the present temporary debt ceiling of $595 billion (enacted on November 14, 1975) will expire on March 15, a week from this coming Monday, at which time the limit will revert to the permanent ceiling of $400 billion. Moreover, next week, the actual amount of debt subject to limit will approach the temporary limit. As a result of some apparent improvement in our cash position, however, we now believe that this will not hinder the effective management of the Treasury's debt and cash balance during this period.

In accordance with our usual practice, I have provided you with a monthly record of the debt subject to limit from June 30, 1975, through September 30, 1977, and interim monthly estimates for months in which the peak does not occur on the last day of the month. While we are now concerned primarily with establishing a debt limit for the near term, the debt limit data through fiscal 1977 are indicators of our financing requirements based upon the President's budget through fiscal 1977. As I will discuss in detail later, these requirements have serious debt management implications.

Specific Requirements

The Second Concurrent Resolution on the 1976 Budget provided for levels of public debt of $622.6 billion at the end of the fiscal year 1976 and $641.0 billion at the end of the Transition Quarter. It is, however, not clear what level for cash balance was assumed in the Congressional Budget Resolution. Furthermore, the level of debt in the Resolution apparently does not provide for agency debt that is subject to the statutory limitation. As a technical matter, moreover, depending on the cash balance assumptions adopted, the peak debt levels would be reached on June 15 and August 31.

In the Federal budget for fiscal year 1977, debt subject to statutory limitation is estimated at $624.2 billion at the end of fiscal year 1976 and $643.1 billion on September 30. These figures assume a $9 billion cash balance. The Treasury estimates assume debt limit needs of $630 billion at the June peak and $645 billion at the August peak, to allow a $6 billion cash balance and a $3 billion margin for contingencies.

The $627 billion limit through June 30 approved by the House would allow a balance of as much as $6 billion on June 15, assuming no contingencies occur, and a balance of as much as $2 billion on June 30, on the same assumption.

SECOND LIBERTY BOND ACT AMENDMENTS

Let me now turn to the current confinement of Treasury borrowing to maturities of seven years or less.

We believe this restriction poses severe risks to the capital markets and provides nothing in the way of economic benefits.

Objectives of Treasury Debt Management

Federal borrowing now accounts for almost 80 percent of all financing in our Nation's capital markets. As a result, all other credit markets, all other financial assets are directly influenced by the debt management operations of Treasury and by the structure of the Federal debt. What we do, how we structure the debt, will contribute to economic stabilization or detract from it. It is my view, therefore, that we must use every available tool to insure that Federal borrowing needs are met in a way that will minimize the resulting cost, measured both in terms of interest rates and economic and financial dislocation.

Given these objectives, it is no longer possible to justify severe and anachronistic constraints that result in a debt structure that has been very expensive in both an economic, and a financial sense.

Moreoever, in light of our massive borrowing needs, these constraints would have an even grater adverse impact in the future. The extensive economic work which has been done in the area of debt structure has not only confirmed the potential for harm, but has also demonstrated conclusively that there are no countervailing benefits.

Consequences of the Current Restrictions

We know what the current restrictions have meant in absolute terms: a decline of more than 33 percent in the average maturity of the publicly held debt in the last three years alone and more frequent and larger Treasury borrowings. But the question I want to concentrate on today is why we care: why we believe there are serious dangers in confining Treasury borrowing to only the short end of the market.

We care primarily because over-reliance on short-term financing, as reflected in a short and shortening maturity structure and the resulting lack of balance in the over-all debt structure exposes us to adverse financial and economic effects:

-- First, it poses the risk of higher Federal borrowing costs and imposes unnecessary transaction costs;

-- Second, it contributes to a more volatile market environment, placing substantial burdens on financial intermediaries and threatening the ability of the private sector -- and particularly small and medium-sized businesses -- to meet financing needs;

-- Finally, it poses an unmeasurable and uncontrollable threat to sound fiscal and monetary policies.

Cost

Our concerns begin with the fact that unless the Treasury is authorized to balance its borrowing throughout the maturity ranges, the taxpayer will be vulnerable to short-run changes in interest rates. Moreover, whatever may happen with respect to interest rates, a debt structure weighted heavily to the short end imposes unnecessary transaction costs.

In periods of unexpected rises in interest rates, such as we have experienced during most of the last decade, the average cost of borrowing in the short-term market, and subsequent refunding in this market, may well exceed the rate for borrowing long term in the first place. In fact, our analysis shows that if we had had reasonable access to the long-term market from

1966 to 1971 (a period when we in fact had no authority to issue bonds with coupons in excess of 4¼ percent) the interest on the public debt would have been reduced.

But in pursuing these proposals, it is not our purpose to suggest that interest cost considerations ought to be of primary importance. Rather, I am suggesting that, from the standpoint of costs, it is imprudent to have statutory limitations that in effect mandate further dramatic shortening in the maturity structure of the debt. We need a balanced debt structure, not an extreme one.

In addition to possible interest-rate costs, when Treasury borrowings are confined to the short-term area, a large amount of debt rollover is necessary, relative to what would be necessary if we could borrow more in the long-term area. Each time there is a rollover, there are inevitable direct transaction costs. Moreover, the proliferation of short-term borrowings means that dealers have to carry larger inventories of securities. The cost of carrying such larger inventories adds further to the transaction price, increasing the over-all cost which is ultimately borne by the taxpayer.

Effect on Private Borrowers

A concentration of Treasury financing in the short-term area has potentially adverse affects on private users of short-term credit. With the Treasury constantly tapping the short-term market for substantial funds, both short-term interest rates and the availability of short-term financing become vulnerable to episodes of market congestion and to changes in the general monetary environment.

To understand the potential risks involved, we must first examine the enormous change in the magnitude of the Treasury's demands upon the market. Just in the last two years, the over-all amount of privately held marketable Federal debt outstanding has grown from $171 billion to $263 billion. When this over-all growth is viewed in the context of a shortening maturity structure -- occasioned primarily by the limitations which concern us today -- the results are even more disturbing. For the first two months of this year, Treasury borrowed an average $9½ billion per week. For the comparable period in 1974, the figure was $5½ billion.

Part of this increase is, of course, due to our large new money requirements, primarily to finance the deficits. But the bulk of the borrowing is to finance the rollover of maturing debt. And the shorter the debt structure, the greater the rollover burden.

From the market's standpoint, there is virtually no difference between the two components. Each type of borrowing requires a new underwriting and investment decision. Roll-overs are not automatic: a holder of a maturing bill is free to choose between lending to the Treasury, lending to another borrower, or spending the proceeds. Accordingly, all of the costs and pressures of borrowing are there, irrespective of the purpose of the borrowing.

Let's be clear about the implications.

First, there are substantial pressures on intermediaries: Given a greater amount of securities outstanding and a sharp growth in periodic refunding, dealers must take larger and larger positions. To the degree that dealers cannot, or will not, increase their position-taking capacity, the breadth, depth and resilency of the market suffers, the market becomes thinner, and prices -- that is interest rates -- become more volatile.

Volatility is also enhanced by other factors. The enormous supply of riskless, liquid Treasury securities provides a tempting alternative for investors with psychological concerns about other assets; e.g., commercial paper or certificates of deposits. Thus, in effect, our debt structure facilitates large-scale and highly disruptive shifts of funds from one short-term sector to another, irrespective of whether such shifts are economically justifiable.

Finally, the sheer increase in the number of decisions the market must make enhances the possibility of distortions.

Consider the process. The dealers on which we depend to distribute our securities must decide, separately, the amount they will purchase from us, and the price, as well as the terms on which they will sell to their customers. Holders of maturing instruments have to decide whether and where to reinvest the proceeds, giving them an opportunity to rethink their needs in terms of the type of security to purchase as well as the maturity. And other investors have to decide whether they are going to buy our new securities, how much, and at what price. In terms of volatility versus stability, what kind of debt structure would we prefer: one that causes this unsettling process to occur less than 100 times a year, as was the case only a few years ago? Or today's, under which the process occurs, on average, nearly every business day.

What are volatility's ultimate by-products? At a minimum, we are likely to see an increase in rates on new short-term debt and a higher dealer mark-up on debt trading in the secondary market. These phenomena are the natural reaction of investors and dealers to a condition markets do not tolerate well: uncertainty.

If the uncertainty reaches greater levels -- for example, as might be the case if market disruption is accompanied by perceptions of change in Federal Reserve policy -- many market participants may temporarily withdraw from the market altogether.

In such circumstances, Treasury's ability to finance is obviously impaired. But, more importantly, the non-Federal portion of the market may feel far more serious repercussions. Local governmental units, small and medium-sized business -- indeed all but the top-rated credits -- may find themselves facing serious difficulties as they are cut off from sources of funds to rollover maturing short-term debt.

Moreover, these shocks are not confined to the short-term market. They spread rapidly into the intermediate and longer term markets and begin to interfere with orderly financing plans of business corporations and state and municipal governments, as well as with the growing volume of mortgage financing which is handled through securities markets.

Again, the impact is particularly acute on the smaller or lower rated issuers. Because of the risks set forth above, investors know that such entities are more vulnerable to even normal changes in the business cycle, especially when they have substantial short-term debt outstanding.

In the final analysis, therefore, perhaps the most dangerous consequence is a further reluctance on the part of investors to make long-term commitments to our nation's capital growth. This reaction, which accentuates the pressures on long-term investment caused by fears of future inflation, has grave implications for our future economic growth. It discourages outlays for new expansion, it discourages risk taking and it discourages entrepreneurship at precisely the time in our nation's economic history when such conduct is needed most.

Impact on Economic Policy

Another aspect of this continued trend toward a shorter and shorter debt maturity -- which if carried to an extreme could give us a national debt with zero maturity, i.e., a huge stock of green pieces of paper called money -- is growing liquidity in the economy. By pumping more and more liquidity into the system, spending may be increased at the expense of savings and investment.

Even more disturbing is the fact that these consequences are largely unpredictable and uncontrollable. Such spending effects could come at any time, irrespective of the course of fiscal and monetary policy at the time. And if the dam bursts, so to speak, in a period of growing inflation, the resulting sharp acceleration of the inflationary trend may be invulnerable to fiscal and monetary efforts.

We believe debt management should complement long-run economic and financial stabilization goals. An unbalanced debt structure poses the risk that policy efforts to control cyclical excesses -- such as might be appropriate at a future time when the economy is expanding rapidly -- will be thwarted by an accumulation of liquidity; and accumulation in the form of short-term Treasury securities. Given that such debt structure is in effect mandated by the size of recent deficits and the maturity limitations, this risk is serious.

Impact on Interest Rate Structure

The old argument against these proposals is that more long-term Federal borrowing would drive up long-term interest rates; in other words, that a balanced debt structure and judicious borrowing in all maturities would somehow be harmful to the long-term market. This argument, taken at face value, would imply that the Government should always finance in the short-term markets -- a conclusion which not only is wrong in concept, but has also been extremely costly in both financial and economic terms.

Long-term interest rate levels respond primarily to investors' views regarding inflation and the future course of inflation. If inflation is expected to persist, investors demand to be compensated not only for the use of their money, but also for the fact that when the money is repaid, it is worth less, as a consequence of inflation, than when it was lent out. The result is higher long-term rates.

In addition, inflation makes all borrowers -- but particularly the smaller or lower rated firms -- more vulnerable to economic reversals. Accordingly, it tends to enhance the investment risk, with respect to many long-term investments. Again, this higher investment risk will be reflected in the interest rate, providing another source of upward pressure on long-term rate levels.

Other factors in the level of long-term interest rates include expectations about the future course of short-term rates and existing short-term rates. If short-term interest rates are expected to rise, a potential long-term investor will demand a rate which compensates him not only for the principal risk presented by the investment, but also for the lost opportunity to rollover short-term debt at higher and higher returns.

Current short-term rate levels also play a role because many financial intermediaries rely on short-term credit as a principal source of funds. Thus, for example, if a savings and loan association is forced to pay higher rates on short-term deposits, the higher costs must ultimately be reflected in the rate at which it is willing to make long-term mortgage loans, and in the amount of long-term credit it is able to supply.

By contrast, there is no evidence that greater Treasury access to the longer maturities -- if judiciously employed -- would play any role whatsoever in the determination of long-term rates.

Indeed, for at least two reasons, just the contrary is likely to be the case. First, as we have shown, concentration of Federal borrowing in the short-term area can lead to greater uncertainty and, at some point, inflation in the economy. This leads to an increase both in short-term rate expectations and in the inflation premium demanded by long-term investors, and hence, to an increase in long-term interest rates.

Second, as heavy Treasury short-term borrowing drives up short-term rates, disintermediation takes place. As outflows occur, the ability of intermediaries to make long-term loans is curtailed and what loans are made are at higher rates, reflecting the relative scarcity of this form of credit.

In short, as we would expect, the distortion of the market mechanism caused by the artificial maturity limitations has no demonstrable benefits in terms of long-term interest rates or any other legitimate objective.

Debt Management in 1976-77

I have dwelled at length on the principles involved because they are crucial to an understanding of the issues. But let me turn now to the very real practical problems we face in the immediate future.

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Our Government securities market is an immensely flexible, immensely capable market. Perhaps a good comparison is a freeway. With all lanes open, a freeway can handle a tremendous volume of traffic at the most efficient speeds. But when overloaded, either because traffic volume is simply too high, or because an accident or construction has closed some of the lanes efficiency drops precipitously. Not only is traffic on the freeway slowed, but the effects spill over on to other roads.

The capital markets today are hampered by the fact that, in effect, two of the four lanes are blocked off, insofar as the Treasury is concerned. We are forced to confine ourselves to the below two-year and two-to-seven year ranges and these lanes, Mr. Chairman, have become severely congested.

Congestion exists not only because we must enter the market to raise new funds to finance our deficits and meet other new needs, but also because we must borrow to retire maturing debt. Looking first at new borrowing alone, by the end of this month, the Treasury will have borrowed nearly $16 billion in the market in 1976. And during the remainder of the fiscal year, through June, we will need to borrow an additional $19-24 billion of new funds: A total of $35-40 billion in the first six months of 1976. In later periods, we will need to borrow nearly $20 billion in the transition quarter, and some $50 billion of new money in the market in fiscal year 1977.

All in all, our new money market borrowing needs in the next 19 months -- based on the President's budget -- will total upwards of $90 billion.

This is nearly $5 billion a month and more than $1 billion every week.

On top of these new money borrowing requirements, we also have an immense refunding job to do. In the same nineteen-month period, over $51 billion of privately-held coupon debt will mature. Our weekly issues of 13 and 26-week bills are now in the $7 billion range and will inevitably increase. And our issues of 52-week bills, every four weeks, are now in the $3 billion range and may well be in the $4 billion range by the end of fiscal year 1977. In short, our total requirements for both purposes are some ten times our new money needs: approaching $2 billion of borrowing every day.

To meet these needs, since 1972, we have relied primarily on the auction technique: That is, the yield on a particular issue is determined by public bids. While the auction technique has resulted in substantial savings to the taxpayer, it has one important limitation. We have found from experience that, given the absorptive capacity of the market, auctions of much more than $2.5 billion at one time result in disporportionately high interest costs.

All in all, we face a formidable financing job. It is one that can be managed, but there are severe costs and serious risks. And I hope, in my testimony this morning, I have conveyed some of these concerns to you.

Let me add that there is another legacy in this dilemma, one that will be faced by my successor, and yours as well. Even if we are successful in reducing the size of our deficits and the consequent need for new money financing, the enormous concentration of short-term financing will require similar magnitudes of financing, just for refunding, week after week far into the future.

Accordingly, I must urge this Committee, as strongly as I can, to respond to these immediate needs. What is done in managing the public debt this month, and this year, will have a direct affect on the strength and sustainability of the economic recovery. Treasury must promptly minimize its reliance on short-term bills and maximize its use of the longer intermediate and longer-term markets. If, instead, we are forced to rely on short-term financing, we will be obliged to come to the market more frequently and for larger amounts. The excessive liquidity injected into the economy as a result of shorter term financing, when coupled with these more frequent incursions, will destabilize the over-all market environment and will pose a continuing threat to all other borrowers and to the financial institutions on which the housing industry, small business, and all of us must rely.

Let me briefly address the amendment adopted by the House establishing a 4% floor on savings bond rates. The amendment was designed to address the fact that, under existing procedures, holders who redeem Series E bonds within the first year receive a reduced level of interest: no interest for the first 6 months and up to 3.78% for the remainder of the year. This policy is consistent with the underlying principle of the savings bond program to encourage long-term thrift. The House, however, concluded that it imposed an unfair burden on a substantial number of savings bond holders who choose to redeem within the first year.

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Treasury opposed the amendment in the House because it deviated from the thrift principle, and because it would involve higher costs and additional administrative burdens. However, notwithstanding our opposition in the House, I am not urging the Senate to reject the House amendment.

As I indicated at the outset of my testimony, the existing temporary debt limit expires in slightly more than one week. Moreover, as I also indicated, the bill as passed by the House contains certain debt management provisions which Treasury has long sought with, I might add, the much appreciated support of this Committee. These provisions must be preserved in the final legislation. Time factors, as well as the highly desirable features on the House bill, cause us to urge this Committee to adopt the House bill without amendment and to seek similar approval on the Senate floor. Such procedure will insure delivery of an enrolled bill to the President well within the time constraints which face us. From the standpoint of our immediate financing needs, as well as the over-all health of our capital markets, we believe this would be the appropriate approach to follow.

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DEBT LIMIT
BRIEFING MATERIAL
HOUSE COMMITTEE ON WAYS AND MEANS

PUBLIC DEBT
SUBJECT TO LIMITATION
FISCAL YEAR 1977

Based on: Budget Receipts of $351 Billion,
Budget Outlays of $394 Billion,
Off-Budget Outlays of $11 Billion

($ Billions)

	Operating Cash Balance	Public Debt Subject to Limit	With $3 Billion Margin for Contingencies
1976		- Estimated-	
September 30	6	640	643
October 31	6	650	653
November 30	6	659	662
December 31	6	663	666
1977			
January 31	6	665	668
February 28	6	680	683
March 31	6	695	698
April 15	6	703	706
April 30	6	691	694
May 31	6	705	708
June 15 (peak)	6	694	697
June 30	6	694	697
July 31	6	699	702
August 31	6	704	707
September 30	6	707	710

DATE: March 2, 1976

BUDGET RECEIPTS AND OUTLAYS BY FUND GROUP

($ Billions)

	Fiscal Year 1975 Actual	Fiscal Year 1976 Estimated	Transition Quarter Actual
Receipts:			
Federal Funds...............	$187.5	$198.4	$54.8
Trust Funds.................	118.6	134.8	33.8
Interfund Transactions......	-25.1	-35.6	-6.6
Unified Budget..............	281.0	297.5	81.9
Outlays:			
Federal Funds...............	238.5	276.9	69.8
Trust Funds.................	111.2	132.2	34.9
Interfund Transactions......	-25.1	-35.6	-6.6
Unified Budget..............	324.6	373.5	98.0
Surplus or Deficit (-):			
Federal Funds...............	-51.0	-78.5	-15.0
Trust Funds.................	7.4	2.5	- 1.1
Unified Budget..............	-43.6	-76.0	-16.1

DATE: February 12, 1976

UNIFIED BUDGET MONTHLY FISCAL YEAR 1976 AND TRANSITION QUARTER

($ Billions)

	Receipts	Outlays	Surplus or Deficit (-)
1975	- Actual -		
July	$ 20.2	$ 31.2	$-11.1
August	23.6	30.6	- 7.0
September	28.6	29.0	- .4
October	19.3	32.4	-13.1
November	21.7	29.4	- 7.7
December	26.0	13.8	- 5.8
1976			
January	25.6	30.7	- 5.1
	- Estimated -		
February	20.4	30.7	-10.3
March	17.7	31.9	-14.2
April	35.1	33.3	1.8
May	23.3	31.7	- 8.4
June	36.0	30.8	5.3
Fiscal Year	$297.5	$373.5	$-76.0
July	22.8	34.3	-11.5
August	26.8	32.2	- 5.4
September	32.3	31.5	.8
Transition Quarter	$ 81.9	$ 98.0	$-16.1

DATE: March 2, 1976

TRUST FUNDS RECEIPTS, OUTLAYS AND SURPLUS OR DEFICIT FISCAL YEAR 1976

($ Billions)

	Receipts	Outlays	Surplus or Deficit (-)
Federal Old-Age Survivors, and Disability Insurance Trust Funds	$70.8	$73.8	$-3.0
Health Insurance Trust Funds.....	18.6	17.4	1.1
Unemployment Trust Fund..........	16.7 1/	18.5	-1.8
Railroad Employees Retirement Funds..........................	3.3	3.5	- .2
Federal Employee Retirement Funds..........................	13.0	8.5	4.5
Airport and Airway Trust Funds...	1.1	.8	.3
Highway Trust Funds..............	6.3	6.6	- .3
Foreign Military Sales Trust Fund...........................	6.5	5.9	.6
Veteran Life Insurance Trust Fund...........................	.9	.7	.2
Other Trust Funds................	7.0	5.9 2/	1.1
Total Trust Funds................	$134.8	$132.2	$ 2.5

1/ Includes $8.5 billion advances from general fund.
2/ Includes net activity of trust revolving funds of $-1.1 billion.

Detail may not add to total due to rounding.

DATE: February 12, 1976

TRUST FUNDS RECEIPTS,
OUTLAYS AND SURPLUS OR DEFICIT
TRANSITION QUARTER

($ Billions)

	Receipts	Outlays	Surplus or Deficit (-)
Federal Old-Age Survivors, and Disability Insurance Trust Funds	$18.9	$19.9	$-1.1
Health Insurance Trust Funds.....	5.1	4.6	.5
Unemployment Trust Fund..........	3.4 1/	3.7	- .3
Railroad Employees Retirement Funds........................	.5	.9	- .4
Federal Employee Retirement Funds	2.1	2.3	- .2
Airport and Airway Trust Funds...	.3	.3	*
Highway Trust Funds.............	1.9	1.9	*
Foreign Military Sales Trust Fund..........................	1.7	1.6	.1
Veteran Life Insurance Trust Fund..........................	.2	.1	.1
Other Trust Funds................	1.8	1.6 2/	.2
Total Trust Funds................	$33.8	$34.9	$-1.1

1/ Includes $1.1 billion advances from general fund.
2/ Includes net activity of trust revolving funds of $- .2 billion.
* Less than $50 million.

DATE: February 12, 1976

OFF-BUDGET AGENCY OUTLAYS MONTHLY FISCAL YEAR 1976 AND THE TRANSITION QUARTER

	Federal Financing Bank 1/	Other 2/	Total
1975	- Actual -		
July	$ .6	*	$ .6
August	.7	$-1.0	- .3
September	.1	.5	.6
October	.5	.8	1.3
November	.6	.3	.9
December	.2	.6	.8
1976			
January	1.3	.3	1.5
	- Estimated -		
February	.8	.3	1.1
March	.5	.5	1.0
April	.2	.5	.7
May	.1	.5	.6
June	.1	.5	.6
Fiscal Year	$5.6	$ 3.8	$9.3
July	1.8	.1	1.9
August	.7	.4	1.1
September	.4	.8	1.2
Transition Quarter	$2.8	$ 1.3	$4.1

1/ The outlays of the Federal Financing Bank reflect only its purchase of Government-guaranteed obligations, not its purchases of agency debt, in order to prevent double counting. Virtually all of the other off-budget activity is financed through debt issued to the Federal Financing Bank.

2/ Export-Import Bank, Postal Service and U.S. Railway Association.

DATE: March 3, 1976

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OPTIONAL FORM NO. 10
MAY 1962 EDITION
GSA FPMR (41 CFR) 101-11.6

UNITED STATES GOVERNMENT

Memorandum

Department of the Treasury
Washington, D.C. 20220

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TO : Mr. Snyder

DATE: February 12, 1976

FROM : Mr. Cook RHC

SUBJECT: Federal Financing Bank

The Federal Financing Bank has saved the Federal and federally-guaranteed borrowers who use the Bank $340 million in the 20 months of the Bank's existence.

The amount of savings is based on the conservative assumption that the agencies who have borrowed from the Bank on the average could have raised funds in the market at a cost of 1/2 of 1% above marketable Treasury obligations of similar maturities.

Whereas one or two of these agencies who were established in the market, for instance the Tennessee Valley Authority, were able to raise funds at rates reasonably close to Treasury's cost, many of the guaranteed borrowers whose debt was less well known and who raised funds through negotiated offerings paid rates substantially above the Treasury curve.

5010-108

Buy U.S. Savings Bonds Regularly on the Payroll Savings Plan

AMERICAN REVOLUTION BICENTENNIAL 1776-1976

Federal Revenue Estimate Assumptions

The Department of Treasury is responsible for estimating Federal revenues as a basis for budget planning. These estimates are based importantly upon GNP forecasts by a trio of the Treasury, the Council of Economic Advisors and the Office of Management and Budget. The key components for revenue estimating purposes are nominal Gross National Product, personal income, wages and salaries, and corporate profits. As contained in Budget (p. 25), these forecasts are: (in billions)

	Calendar Year 1976	1977
GNP	$1,684	$1,890
Personal income	1,386	1,538
Wages and salaries	892	1,001
Corporate profits (after tax)	156	181

Using these general forecasts and specific revenue information obtained from a variety of sources, the Treasury prepares collection estimates.

The estimating process obviously depends upon several factors: (1) the accuracy of the GNP forecasts; (2) changes in the mix of economic results which cause adjustments in estimates of personal income and expenditures, business spending and profits, unemployment, government transfer payments, etc.; (3) the refinement of statistical estimating procedures; and (4) the frequent revision of tax legislation which can be anticipated only in part. As a result, actual receipts always vary from those which are forecast. However, the discrepancy usually is relatively small. Budget estimating errors over the past six years together with 1950 and 1960 are summarized in Table 1.

PROJECTIONS

SHORT-RANGE ECONOMIC FORECAST

[Calendar years; dollar amounts in billions]

Item	Actual 1974	Forecast 1975	Forecast 1976	Forecast 1977
Gross national product:				
Current dollars:				
Amount	$1,407	$1,499	$1,684	$1,890
Percent change	7.7	6.5	12.4	12.2
Constant (1972) dollars:				
Amount	$1,211	$1,187	$1,260	$1,332
Percent change	−1.8	−2.0	6.2	5.7
Incomes (current dollars):				
Personal income	$1,155	$1,246	$1,386	$1,538
Wages and salaries	763	802	892	1,001
Corporate profits	132	118	156	181
Price level (percent change):				
GNP deflator:				
Year over year	9.7	8.7	5.9	6.2
Fourth quarter over fourth quarter	11.4	6.3	5.9	6.3
Consumer price index:				
Year over year	11.0	9.1	6.3	6.0
December over December	12.2	6.9	5.9	5.9
Unemployment rates (percent):				
Total	5.6	8.5	7.7	6.9
Insured [1]	3.8	7.2	6.3	5.4
Average Federal pay raise, October (percent)	5.5	5.0	4.7	8.6
Interest rate, 91-day Treasury bills (percent) [2]	7.9	5.8	5.5	5.5

[1] Insured unemployment as a percentage of covered employment.
[2] Average rate on new issues within period; the rate shown for 1976 was the current market rate at the time the estimates were made.

Budget Estimating Errors

Fiscal year	Overestimate (+) or Underestimate (-) as a Percent of the Actual Figure			
	Estimates made 18 months prior to the end of the fiscal year		Estimates made 6 months prior to the end of the fiscal year	
	Outlays	Receipts	Outlays	Receipts
1950 1/	+4.1	+10.3	+7.8	+1.9
1960 1/	-0.3	-1.7	+1.6	+0.2
1970 2/	-0.7	+2.6	+0.7	+2.9
1971 2/	-5.0	+7.3	+0.6	+3.1
1972 2/	-1.1	+4.3	+2.0	-5.2
1973 2/	-0.1	-4.9	+1.3	-3.1
1974 2/	+0.1	-3.4	+2.3	+1.9
1975 2/	-6.2	+5.0	-3.4	-0.8

Office of the Secretary of the Treasury
Office of Tax Analysis

September 19, 1975

1/ Administrative budget.

2/ Unified budget. The first estimate on a unified budget basis was prepared in January 1968.

Net Change in Federal Reserve Holdings of Treasury Securities

($ millions)

	Net Change in Holdings	Net Purchases of Bonds Over 4-1/4%	Net Change in Other Securities
1975			
Jan.	844	28	816
Feb.	-258	82	-340
Mar.	332	201	131
Apr.	6,428	165	6,263
May	-2,224	3	-2,227
Jun.	-873	109	-982
Jul.	-2,866	—	-2,866
Aug.	663	47	616
Sep.	4,452	124	4,328
Oct.	186	—	186
Nov.	-2,047	244	-2,291
Dec.	2,797	73	2,724
1976			
Jan.	1,948	64	1,884
Feb.	1,056	59	997

Office of the Secretary of the Treasury
Office of Debt Analysis

March 3, 1976

FRB Market Purchases of Bonds Issued Under $10 Billion Authority
July 1974 to date
($ millions)

Month	Total 1/	7% Aug 81	6 3/8% Feb 82	6 3/8% Aug 84	6 1/8% Nov 86	7 1/2% Aug 88-93	6 3/4% Feb 93	7% May 93-98	8 1/2% May 94-99	8 1/4% May 90	7 7/8% Feb 95-00	8 1/4% May 00-05	8 3/8% Aug 95-00
1974													
July	+ 36					7	8	4	16				
Aug													
Sep	+ 35		2	1		2	3	3	24				
Oct													
Nov	+ 25				2	8		7	8				
Dec	+ 22		5	1		3	2	2	9				
1975													
Jan	+ 28		1		2		1		23				
Feb	+ 82				1	15	1	5	12		49		
Mar	+201			1		18	10	21	107		44		
Apr	+165			2		15	2	14	64	52	15		
May	+ 3											3	
June	+109							5	10	45	4	45	
July													
Aug	+ 47					1			2	13	3	5	23
Sept	+124	1				8		4	8	18	2	24	60
Oct													
Nov	+244					1	3		12	17	17	3	191
Dec	+ 73	1.	2	1		1	3	1	10	10	2	8	34
1976													
Jan	+ 64	2				1			9	21	1	9	22
Feb	+ 59					10		2	5	5		18	19

Office of the Secretary of the Treasury
Office of Debt Analysis

March 3, 1976

Note: Figures may not add to totals due to rounding.

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Treasury Borrowing Program

During the next nineteen months the Treasury will be required to raise $85-90 billion of new money in marketable securities to refund over $51 billion of maturing marketable securities held by private investors.

In accomplishing this unprecedented financing job, the Treasury will, insofar as its statutory authorities and market conditions permit, make maximum use of the coupon market in order (1) to minimize the build-up in floating, highly liquid short-term debt and (2) to avoid, insofar as possible, increasing the already severe structural problems summed up in the decline in the average maturity of the privately-held marketable debt.

The instruments available to Treasury for these purposes, until such time as its statutory authorities are amended, include:

--13 and 26 week bills, auctioned weekly, in current amounts now in the $7 billion range,

--52 week bills, auctioned every four weeks, in current amounts now in the $3 billion range,

--2-year cycle notes, at the end of each calendar month, which have been auctioned in amounts of up to about $3 billion,

--4-year cicle notes, at the end of each calendar quarter, which have also been auctioned in amounts up to $2.5 billion,

--Refunding issues, typically with 3, 5, or 7-year maturities, which have been auctioned in amounts from $3.5 billion for the shorter issues to $2.5 billion for the longer issues; with an overall limit of around $6 billion in any refunding.

--5-year cycle notes, which have been auctioned on an experimental basis in the first month of a calendar quarter to mature on a regular quarterly refunding date. Use of 5-year cycle notes, however, will likely preclude use of this maturity in regular refundings.

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Apart from the auction method, either on a price basis against a fixed coupon or on a yield basis, the Treasury has recently used fixed pricing of a coupon issue; e.g., the 7-year note offered at par in the February 1976 refunding. This technique appears to allow a larger offering to be made than the auction technique by placing more debt directly with final investors, but raises policing problems to assure that the interest attracted is primarily investment interest.

	Estimated Market Borrowing Requirements		
	New Money	Refunding	Total
March 1-June 30, 1976	$19-24	9-3/4	28-3/4-33-3/4
July 1-September 30, 1976	18-1/2	7-3/4	26-1/4
October 1, 1976-September 30, 1977	47-1/2	34-1/4	81-3/4
Total	$85-90	51-3/4	136-3/4-141-3/4

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7-Year Note Offering

The Treasury has been gratified by the market response to a major effort towards achieving significant debt restructuring and reducing the amount of very short-term Treasury debt in the market by issuing a significant amount of longer-term notes.

The seriousness of the debt management problems facing the Treasury today can hardly be overestimated. In addition to $85-90 billion of new money needs over the next nineteen months, the Treasury is faced with refunding $51 billion of maturing coupon issues in the same period. Moreover, the tremendous buildup in the debt, including a $95 billion increase in the privately-held marketable debt in 1975 and the first two months of 1976, has severely impacted the financing calendar and greatly reduced the options for placing new Treasury debt in a constructive fashion.

These problems have been further exacerbated by the exhaustion of the authority to issue additional long-term bonds without regard to the 4-1/4% interest rate ceiling and by the limitation of the maximum maturity of notes to seven years. The prospect, unless these restrictions are eased, is for a further decline in the average maturity of the public debt and for a further increase in the annual refunding burden. The consequence would be further calendar congestion, more difficulty in issuing coupon securities, and, therefore, increasing pressure to resort to the bill market to meet financing requirements, further shortening the average length of the debt and building up an already large, highly volatile pool of extremely liquid short-term Treasury debt in the hands of the public.

The offering of the 7-year, 8% notes at par represented a deliberate decision by Treasury to break away from the traditional pattern of debt offerings in order to, at least temporarily, relieve the structural problem.

Under the auction technique, which has been the standard offering method for Treasury securities since 1972, a considerable distributive burden is placed on the dealer community in its underwriting capacity. Unlike underwriters

for corporate and municipal securities, however, government dealers receive no price concession beyond the marginal advantage afforded them by their close contact with the market and technical expertness. The spread between the average bid on new Treasury issues and the low bid, however, is typically quite small; i.e., 2 to 4/32, which, at best, would represent a price advantage to a dealer of $1.25 per bond, compared to a concession of $5 to $10 to $20 on corporate and municipal issues, depending on the maturity of the security and the credit rating and marketability of the issue.

As a result, while the auction technique is highly efficient for Treasury offerings of moderate size, say, up to $2.5 billion in a single issue and up to $6 billion in a multiple issue offering, the distributive mechanism is overloaded by larger offerings. Thus, a judgment was reached that to sell an issue, even as large as the $3-1/2 billion initially offered, it would be necessary to change the offering technique so as to place more of the debt directly with final investors.

The response to the offering was unexpectedly strong, with more than 105 thousand individual tenders, totalling more than $29 billion, being received. Thus, the amount of the issue was increased to $6 billion, a 71% increase, and the maximum amount awarded to any subscriber was reduced to $200,000.

The subsequent market judgment is that the issue has been, in fact, well placed and that the speculative interest was held to small proportions. Indeed, the major complaint has been that there is an inadequate floating supply in the market to afford normal trading opportunities.

In contrast, the much smaller, much shorter 3-year, $3 billion issue initially was much less well placed, and temporarily overhung the market. This appears to confirm the judgment regarding the pricing of the 7-year issue.

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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For information on submitting tenders in the Washington, D. C. area: PHONE WO4-2604

FOR IMMEDIATE RELEASE January 27, 1976 820

TREASURY ANNOUNCES FEBRUARY REFINANCING

The Department of the Treasury will sell $3.0 billion of 3-year notes, $3.5 billion of 7-year notes and $0.4 billion of 29-year 3-month bonds to refund $4.3 billion of notes held by the public maturing February 15, 1976, and to raise $2.6 billion of new cash.

Additional amounts of the notes may be issued to the Federal Reserve Banks for themselves and as agents for foreign and international monetary authorities and to certain Government accounts in exchange for maturing notes held by them in the amount of $3.8 billion, and to the Federal Reserve Banks as agents for foreign and international monetary authorities for cash. Government account holdings of the maturing notes in the amount of $0.5 billion will not be exchanged for the new issues but may be exchanged for special non-marketable issues.

The securities to be issued will be:

Treasury Notes of Series H-1979 dated February 17, 1976, due February 15, 1979 (CUSIP No. 912827 FG 2) with interest payable on August 15, 1976, and thereafter on February 15 and August 15. These notes will be sold at auction. The coupon rate will be determined after tenders are allotted.

8% Treasury Notes of Series A-1983 dated February 17, 1976, due February 15, 1983 (CUSIP No. 912827 FH 0) with interest payable on August 15, 1976, and thereafter on February 15 and August 15. These notes will be sold at par. Subscriptions will be received subject to allotment.

An additional amount of 8-1/4% Treasury Bonds of 2000-05 dated May 15, 1975, due May 15, 2005, callable at the option of the United States on any interest payment date on and after May 15, 2000 (CUSIP No. 912810 BU 1) with interest payable on May 15 and November 15. These bonds will be sold at auction.

The 3-year notes will be issued in registered and bearer form in denominations of $5,000, $10,000, $100,000 and $1,000,000. The 7-year notes and the bonds will be issued in registered and bearer form in denominations of $1,000, $5,000, $10,000, $100,000 and $1,000,000. Both the notes and the bonds will be available for issue in book-entry form to designated bidders. Payment for the securities may not be made through tax and loan accounts.

The subscription books for the 7-year notes will be open through Tuesday, February 3 except that subscriptions for $500,000 or less will be considered timely received if they are mailed to an official agency under a postmark no later than February 2. Subscriptions must be in multiples of $1,000.

Tenders for the 3-year notes and bonds will be received up to 1:30 p.m., Eastern Standard time, Thursday, February 5. Noncompetitive tenders will be considered timely received if they are mailed to an official agency under a postmark

WS-615

no later than February 4. Tenders for the 3-year notes must be in the amount of $5,000 or a multiple thereof. Tenders for the bonds must be in the amount of $1,000 or a multiple thereof. Each tender for the 3-year notes must state the yield desired, and each tender for the bonds must state the price desired, if a competitive tender, or the term "noncompetitive", if a noncompetitive tender. Fractions may not be used in tenders. The notation "TENDER FOR TREASURY NOTES OF SERIES H-1979" or "TENDER FOR TREASURY BONDS" should be printed at the bottom of envelopes in which tenders are submitted.

Tenders and subscriptions will be received at any Federal Reserve Bank or Branch and at the Bureau of the Public Debt, Washington, D. C. 20226.

Competitive tenders for the 3-year notes must be expressed in terms of annual yield in two decimal places, e.g., 7.11, and not in terms of a price. Tenders at the lowest yields, and noncompetitive tenders, will be accepted to the extent required to attain the amount offered. After a determination is made as to which tenders are accepted, a coupon yield will be determined to the nearest 1/8 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 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. Tenders at a yield that will produce a price less than 99.501 will not be accepted. Noncompetitive bidders will be required to pay the average price of accepted competitive tenders; the price will be 100.000 or less.

Competitive tenders for the bonds must be expressed in terms of price, in two decimals, e.g., 100.00. Tenders at a price less than 92.76 will not be accepted. Tenders at the highest prices will be accepted to the extent required to attain the amount offered. Successful competitive bidders will be required to pay for the bonds at the price they bid. Noncompetitive bidders will be required to pay the average price of all accepted competitive tenders; the price may be 100.00, or more or less than 100.00.

The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders and subscriptions, in whole or in part, and his action in any such respect shall be final. Subject to these reservations noncompetitive tenders for $500,000 or less for the 3-year notes and the bonds will be accepted in full at the average price of accepted competitive tenders, and subscriptions for the 7-year notes in the amount of $500,000 or less will be allotted in full. Subscriptions over $500,000 for the 7-year notes may be allotted on a percentage basis but not less than $500,000.

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 and subscriptions for the account of customers, provided the names of the customers are set forth therein. Others will not be permitted to submit tenders or subscriptions except for their own account.

Tenders and subscriptions will be received without deposit from commercial and other banks 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, Federal Reserve Banks, and Government accounts. Tenders and subscriptions from others must be accompanied by payment of 5 percent of the face amount of securities applied for. However, bidders who submit checks in payment on tenders or subscriptions submitted directly to a Federal Reserve Bank or the Treasury may find it necessary to submit full payment for the securities with their tenders or subscriptions in order to meet the time limits pertaining to checks as hereinafter set forth. Allotment notices will not be sent to bidders who submit noncompetitive tenders or subscriptions for $500,000 or less.

Payment for accepted tenders and subscriptions for the notes and bonds must be completed on or before Tuesday, February 17, 1976, and in the case of the bonds include accrued interest from November 15, 1975, to February 17, 1976, in the amount of $21.30495 per $1,000 of bonds allotted. Payment must be in cash, 6-1/4% Treasury Notes of Series A-1976 or 5-7/8% Treasury Notes of Series F-1976, which will be accepted at par, in other funds immediately available to the Treasury by the payment date or by check drawn to the order of the Federal Reserve Bank to which the tender or subscription is submitted, or the United States Treasury if the tender or subscription is submitted to it, which must be received at such Bank or at the Treasury no later than: (1) Wednesday, February 11, 1976, 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) Monday, February 9, 1976, 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. Where full payment is not completed on time, the allotment will be canceled and the deposit with the tender or subscription up to 5 percent of the amount of securities allotted will be subject to forfeiture to the United States.

TREASURY ANNOUNCEMENT

In view of the substantial public response to the current 7-year note offering, the Treasury reminds investors that it has reserved the right to increase the size of the current offering of 8 percent notes due in 1983 or reduce below $500,000 the maximum amount to be awarded in full.

Consistent with sound debt management principles, either or both of these actions may be taken depending upon the extent of subscriptions received in amounts of $500,000 or less.

February 3, 1976

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MEMORANDUM TO THE PRESS January 29, 1976

The response to the Treasury's financing package announced Tuesday has been highly favorable. To assure that the 7-year 8 percent note, which was announced as a part of the package, attracts investor interest, as distinct from interest of a more transitory nature, the Treasury is raising the downpayment requirement to 20 percent from the initially announced 5 percent.

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FOR 10:00 A.M. RELEASE FEBRUARY 5, 1976

RESULTS OF OFFERING OF 8 PERCENT 7-YEAR TREASURY NOTES

Preliminary figures indicate that approximately 106,000 subscriptions totalling $29.2 billion were received for the offering of $3.5 billion of 8 percent, 7-year Treasury Notes of Series A-1983.

Due to the overwhelming response to the offering, the Secretary of the Treasury has found it necessary to exercise his authority to reduce the amount of notes to be allotted on subscriptions in amounts over $200,000. Accordingly, all subscriptions for $200,000 or less will be alloted in full and subscriptions over that amount will be allotted $200,000.

Approximately $6.0 billion of the notes will be allotted to the public. In addition, $1.9 billion of the notes have been allotted to Government accounts and Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities.

ie Department of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 964-2041

FOR IMMEDIATE RELEASE

February 5, 1976

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RESULTS OF AUCTIONS OF 3-YEAR NOTES AND 29-1/4-YEAR BONDS

The Treasury has accepted $3.0 billion of the $4.4 billion of tenders for the 3-year notes, Series H-1979, and $0.4 billion of the $0.7 billion of tenders for the 29-1/4-year 8-1/4% bonds maturing May 15, 2005, received from the public for the notes and bonds auctioned today.

The range of accepted competitive bids for the notes was as follows:

Lowest yield	7.00% 1/
Highest yield	7.09%
Average yield	7.05%

The interest rate on the notes will be 7%. At that rate, the above yields result in the following prices:

Low-yield price	100.000
High-yield price	99.761
Average-yield price	99.867

The range of accepted competitive bids for the bonds was as follows:

	Price	Approximate Yield To First Callable Date	Approximate Yield To Maturity
High	102.14	8.04%	8.05%
Low	101.42	8.11%	8.12%
Average	101.75	8.08%	8.09%

The $3.0 billion of accepted tenders for the notes includes 15 % of the amount of notes bid for at the highest yield and $0.5 billion of noncompetitive tenders from the public accepted at the average yield.

The $0.4 billion of accepted tenders for the bonds includes 68 % of the amount of bonds bid for at the low price and $25 million of noncompetitive tenders from the public accepted at the average price.

In addition, $ 1.7 billion of tenders for the notes and $0.2 billion of tenders for the bonds were accepted at the average yields/prices from Government accounts and from Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities.

1/ Excepting 4 tenders totalling $2,510,000

WS-631

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UNITED STATES DEPARTMENT OF TREASURY

Washington, D. C.

PRESS CONFERENCE

Held by:

EDWIN H. YEO

Under-Secretary for

Monetary Affairs

and

RALPH M. FORBES

Special Assistant to

the Secretary

and

EDWARD P. SNYDER

Director, Office of

Debt Analysis

4:00 p.m.
Tuesday, January 27, 1976

Treasury Building
Room 4121
15th and Penn. Avenue, NW
Washington, D. C.

The above-entitled press conference was convened, pursuant to notice, at 4:10 p.m.

ASSISTANT SECRETARY YEO: We have I think an interesting and important job to do today. I am going to go slowly because we have a good many numbers to discuss.

First, our total requirements through the end of June. In other words, our requirements for the period January June, 1976, are in the range of $38 to 43 billion of borrowing from the public.

Market borrowing is in a range of $35 to 40 billion, the difference being essentially savings bonds. Through yesterday we had announced new cash financing totaling $8.6 billion. This includes the weekly bill to be settled on January 29 and the two-year note which will be settled on February 2.

Taking our first set of assumptions, the $38 to 43 billion, market borrowing $35 to 40 billion, deducting what we have announced through yesterday, gives you a net balance in terms of market borrowing from now through the end of June in the range of $26 to 31 billion.

The $26 to 31 billion range, coincidentally, covers the amount of net borrowing we have before us to get through our low point in April.

We have some temporary borrowing to do in June at our low point, but our net cash needs in the last 2-1/2 months of the fiscal year, based on our present estimates -- I would like to emphasize that -- are quite moderate.

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The exact amount is really dependent on what sort of end-of June balance we wish to arrive at. I think that if you take the combination of what we have done plus what we are going to announce, plus the concept involving the use of cash management bills to smooth out financing needs, you can see that we have a large but ~~easily~~ readily manageable debt management task before us.

As a matter of fact, we have already achieved a significant amount in terms of meeting with or dealing with this job.

Looking ahead, one of our objectives will be to minimize pressures on the bill market, making as much use as possible of the two- and four-year cycle notes, and we are also giving serious consideration to establishing a five-year note cycle.

This would be during the first month of each quarter. You could take a -- you could view our January financing as a start.

Now for the financing, we are planning on raising $6.3 billion of new money financing in February. We will need somewhere between $9 and $11 billion the first half of March. This amount is substantial, but the requirement can be met quite readily through the use of the two-year note cycle, well established within the market structure; four-year note cycle; and ~~additions~~ to the weekly and annual bills and cash

management bills in the form of additions to late April or late June.

From mid-March through the April low point we estimate our needs between $12 and $13 billion of new money for borrowing.

As you know, there is a two-year note maturing at the end of March, and as I mentioned, the possibility of a five-year note issued in early April. The balance of requirements can be met through bill additions and further additions to regular bills, and further cash management bills.

Today we are announcing a $700 million addition to the weekly bill which settles on February 5 and the terms of the re-funding which settles on February 16.

There is a total of $4.4 billion maturing on February 16, and we will be offering $6.9 billion of new securities in three issues. This will raise $2-1/2 billion in new money, and bring the total amount through this announcement since the start of the year to $11.8 billion.

So you can see we have a rather, I think, good start.

The three re-funding issues include the following: $3 billion of a three-year note due February 15;$3-1/2 billion of a seven-year note due February 15, 1983; and $400 million in the reopening of outstanding eight-and-a-quarters of 5-15, 2,000 ~~and~~ 2005.

The three-year note and the reopened bond will be auctioned on Thursday, February 5. The three-year note auction will be a yield auction. The bond auction will be a price auction, since the coupon is already established.

The seven-year note will be offered at par with an 8 percent coupon, with the books open through Tuesday, February 3.

Now if you don't mind, it is probably redundant, but I would like to go over this again a little faster.

Our total requirements through the end of June, $38 to $43 billion of borrowing from the public. Market borrowing total is in the range of $35 to $40 billion, with the difference being savings bonds.

Through yesterday we had announced new cash financing totaling $8.6 billion. That includes a weekly bill settled on January 29, a two-year note which will be settled on February 2. As a result, we have a balance of net market borrowing from now through the end of June in the range of $26 to $31 billion.

The $26 to $31 billion range for market borrowing covers the amount of net borrowing. We still have before us to get through the low point in April.

QUESTION: Mid-month?

ASSISTANT SECRETARY YEO: Yes.

While we will have to do some temporary borrowing

to handle our June low point, our cash needs in the last 2-1/2 months of the fiscal year appear to be quite moderate.

I mentioned that one of our objectives will be to continue to minimize pressures on the bill market using the two- and four-year note cycles, and that we are considering establishment of a five-year note cycle.

I mentioned that we are planning on raising $6.3 billion in February and the re-funding, and in the weekly one-year bills, the weekly and one-year bills, and that we will have to raise $10 billion. I gave you a range of $9 to $11 billion, which I think is a better way to approach it, in the first half of March.

In terms of our financing, $3 billion of a three-year note, $3-1/2 billion of a seven-year note due February 15, 1983, $400 million in the reopening of the outstanding eight-and-a-quarters, 5-15, 2,000 and 2,005, a three-year note and the bond auction on Thursday, February 5, the note at yield auction, the bond at price auction because of coupons established, the seven-year note offered at par with an 8 percent coupon, with the books open through Tuesday, February 3.

Incidentally, on our re-funding, the settlement is February 17, not the 16th, which I mentioned.

This represents an outline plan for dealing with our financing needs this half. We think that it is important that we use the bill market, but use it in such a way that we are

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not totally dependent on it.

We think that it is important that we continue to use our 2, 4, and possibly 5-year note cycles. But I would be less than candid if I told you that that was the solution to our overall debt management challenges, because if you have looked at our developing maturity structure, you can see that we are starting to fill up slot after available slot.

It is for this reason that we have asked Congress for additional long bond authority. It is for this reason that we have asked that notes be redefined from seven-year maturity to ten-year maturity.

What we are seeking to construct is a balanced debt structure, one that will not provide a legacy for the future in terms of massive amounts of short-term finance resulting in the Treasury being in the market constantly in very, very significant size.

I personally think that a debt structure that involved very considerable amounts of short-term maturities results in increased volatility, reduced efficiency, and over the course of events, a higher net interest cost to be paid by the American public.

I think that we have seen over the last two years both domestically and internationally, the effects -- adverse effects -- of market volatility, which in part resulted from heavy reliance, not just on the part of the Treasury, but on the

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part of most borrowers -- heavy reliance on short-term finance.

We are using a pricing sale on the seven-year note with the objective of eliciting the maximum interest, and maximum response. It is related to another problem, which is that we are going to have to increase the size of amounts of individual maturities.

On the present basis we are exhausting the calendar. We think that the eights at par represent an attractive investment from the standpoint of potential buyers and an attractive financing medium for the Treasury.

In terms of one of our concerns, the longer-run effects on our system of thrift intermediaries, the challenge is to move in the direction of a debt structure that contributes to, among other things, less interest rate volatility, rather than tends to facilitate it.

That is our financing, and I will try to answer any questions you might have.

QUESTION: Can you explain why you are not auctioning that seven-year note on a yield basis?

ASSISTANT SECRETARY YEO: I am not auctioning it on a yield basis because we think that we can elicit a larger response by pricing it, putting it out wherever one can see it.

We have the feeling that there are institutional buyers and non-institutional buyers that from time to time can benefit from the use of this particular technique.

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QUESTION: Looking ahead, can you estimate whether the borrowing needs in the last half of the calendar year wil. be greater or smaller than the first half?

ASSISTANT SECRETARY YEO: I would just as soon not get into borrowing needs in the second half of the calendar year, Ed. I can say that I would expect that taking the seco half of Calendar 1975 and the first half of Calendar 1976, that we will have completed the largest fiscal year financing that is prospective, assuming that ~~is~~ the policies that we advocate in terms of the budget are agreed to by the Congress.

In other words, we are in a sense thinking in term of fiscal year. We are well on our way to completing a very large financing task that confronted us at the start of Fiscal '76.

QUESTION: What is borrowing totaling in the first half of the fiscal year?

ASSISTANT SECRETARY YEO: 48.

QUESTION: And just a small point -- the amount that is maturing on February 15 -- is that $4.4 or $4.3 billi

ASSISTANT SECRETARY YEO: 4.3.

UESTION: You said that the total through this announcement would be $11.8 billion. If you add the $8.6 billion plus the $2.6 billion you are announcing today plus t $700 million of additional weekly notes for next week, you g $11.9 billion. Which one should we use?

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ASSISTANT SECRETARY YEO: That is because you used the 4.3. It balances.

QUESTION: Did I understand you to say that for the remainder of February it is this announcement and bills and that is it?

ASSISTANT SECRETARY YEO: That is correct.

QUESTION: Also -- just a matter of memory -- did you suggest -- was there a five-year note sold in January?

ASSISTANT SECRETARY YEO: Yes.

QUESTION: So that could be the start of a cycle?

ASSISTANT SECRETARY YEO: Yes. We announced the five-year note at the end of last year. I don't want to labor the point, but this is necessary, given the large use of the two-year cycle and the four-year note cycle, and while we are making a very decided effort to produce a balanced financing program, we are still of course using the bill market heavily.

QUESTION: Will you go over how you get the $11.8 billion?

ASSISTANT SECRETARY YEO: The $8.6 billion that we announced, $700 million in bills, $2.5 billion in terms of the financing.

QUESTION: So the first paragraph should be changed to 2.5 instead of 2.6?

ASSISTANT SECRETARY YEO: It depends on how you round. Ed will give you the figure.

MR. SNYDER: The amount of maturing securities publicly held we have been carrying in our own minds as a 4.4, and the Fed in its operations from time to time has picked up some coupon issues, and I suppose some of the agencies in their trust accounts have picked up some of the stuff, too. It is very close to 4.35, so you pay your money and take your choice.

ASSISTANT SECRETARY YEO: 4.35 is the precise figure.

QUESTION: So if you use 4.4, then we should have 2 ~~4~~.5 in the net?

ASSISTANT SECRETARY YEO: Yes, sir. Why don't we just agree on that?

QUESTION: 4 ~~2~~.4 and 2.5?

ASSISTANT SECRETARY YEO: Yes.

QUESTION: We will change the release.

QUESTION: I don't quite understand how, with the seven-year notes, this receiving subscriptions subject to allotment, works. Can you give me a brief description of that?

ASSISTANT SECRETARY YEO: We are announcing to the public that investors with a thousand dollars or multiples of $1,000 can subscribe to a seven-year note with an 8 percent coupon placed as par, and the subscriptions are taken by the various Reserve Banks and by financial institutions that in effect submit those subscriptions for their customers.

So that a person -- say that you wanted to invest

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in one of our 8 percent seven-year notes, you would go to your bank or Federal Reserve Bank and tender your subscription.

We set it out in detail in the announcement that you have -- the procedure.

QUESTION: If I want to buy just $1,000 in one bond and there was an allotment of 50 percent or something, what happens?

ASSISTANT SECRETARY YEO: It is up to $500,000.

QUESTION: I see.

QUESTION: You are assuming that you will get enough subscriptions to make the $3.5 billion?

ASSISTANT SECRETARY YEO: Yes, sir.

QUESTION: What happens if you get more than that?

3.5

ASSISTANT SECRETARY YEO: After the initial $500,000 we allot on a pro rata basis. Let me give you an example.

5.5 4.5 with 1.5

We are offering 3.5, and let's say just as an example, we had a billion-and-a-half in subscriptions allotted in full. On top of that we had $4 billion and that would mean somewhat over a 50 percent allotment.

1.5

QUESTION: Why did that ~~1.4~~ get a full allotment?

ASSISTANT SECRETARY YEO: Because we have indicated that subscriptions up to --

QUESTION: I see -- okay. So the small investor is pretty well assured of getting the full amount --

ASSISTANT SECRETARY YEO: Exactly. The idea is to

give the smaller investor who is not in the position to gauge the ebb and flow of interest, not in a position to really estimate what sort of allotments might be made -- it gives him an opportunity to subscribe and not be concerned about what he is going to receive.

In other words, if he subscribes for $50,000 in 8 percent notes, he is going to get 50,000 8 percent notes.

QUESTION: What are seven-year securities presently yielding in the market?

ASSISTANT SECRETARY YEO: About 7.72, 7.73.

QUESTION: Won't this push all those up to the 8 percent level?

ASSISTANT SECRETARY YEO: Well, we are selling $3-1/2 billion in notes. The market will adjust -- it can adjust three ways -- up, down, and unchanged.

The point is this -- that I think generally the market expected a smaller issue for the purposes, for the reasons that I have mentioned. We think it is important to have a good start on our financing needs, and I think that post this financing, investors can or will perceive that a large part of the job, a significant part of the job, has been done.

Gradually, but in retrospect a large part, a significant part completed, so that we do not have a need that is conjectural in terms of how it can be met.

We described how it can be met and we have already

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done a significant part of it.

I might also say that through the April low point that additional coupon financing will be short of the seven-year area.

QUESTION: Four would be the most?

ASSISTANT SECRETARY YEO: Five; maybe a five.

I think the Wire Services might want to -- if we are clear, the Wire Services might want to --

QUESTION: Since it is so complicated, can you give us a little more than five minutes?

ASSISTANT SECRETARY YEO: Sure. About 10 of?

QUESTION: 10 of is fine.

ASSISTANT SECRETARY YEO: Is there nothing more?

Thank you.

(Whereupon, at 4:40 o'clock p.m. the press conference was concluded.)

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

14 841

For information on submitting tenders in the Washington, D. C. area: PHONE WO4-2604

FOR IMMEDIATE RELEASE February 13, 1976

TREASURY TO AUCTION $2.5 BILLION OF NOTES

The Department of the Treasury will auction $2.5 billion of 21-month notes to raise new cash. Additional amounts of the notes may be issued to Federal Reserve Banks as agents for foreign and international monetary authorities.

The notes now being offered will be Treasury Notes of Series Q-1977 dated March 3, 1976, due November 30, 1977 (CUSIP No. 912827 FJ 6), with interest payable on a semi-annual basis on November 30, 1976, May 31, 1977, and November 30, 1977. They will be issued in registered and bearer form in denominations of $5,000, $10,000, $100,000, and $1,000,000, and they will be available for issue in book-entry form.

Payment for the notes must be made on March 3, 1976. Payment may not be made through tax and loan accounts. Notes in bearer form will be delivered on March 3, 1976.

Tenders will be received up to 1:30 p.m., Eastern Standard time, Friday, February 20, 1976, at any Federal Reserve Bank or Branch and at the Bureau of the Public Debt, Washington, D. C. 20226; provided, however, that noncompetitive tenders will be considered timely received if they are mailed to any such agency under a postmark no later than Thursday, February 19. Each tender must be in the amount of $5,000 or a multiple thereof, and all tenders must state the yield desired, if a competitive tender, or the term "noncompetitive", if a noncompetitive tender. Fractions may not be used in tenders. The notation "TENDER FOR TREASURY NOTES" should be printed at the bottom of envelopes in which tenders are submitted.

Competitive tenders must be expressed in terms of annual yield in two decimal places, e.g., 7.11, and not in terms of a price. Tenders at the lowest yields, and noncompetitive tenders, will be accepted to the extent required to attain the amount offered. After a determination is made as to which tenders are accepted, a coupon yield will be determined to the nearest 1/8 of 1 percent necessary to make the average accepted price approximately 100.000. 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 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. Tenders at a yield that will produce a price less than 99.751 will not be accepted.

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 $500,000 or less will be accepted in full at the average price of accepted competitive tenders, which price will be approximately 100.000.

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(OVER)

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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 the 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 commercial and other banks 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, Federal Reserve Banks, and Government accounts. Tenders from others must be accompanied by payment of 5 percent of the face amount of notes applied for. However, bidders who submit checks in payment on tenders submitted directly to a Federal Reserve Bank or the Treasury may find it necessary to submit full payment for the notes with their tenders in order to meet the time limits pertaining to checks as hereinafter set forth. Allotment notices will not be sent to bidders who submit noncompetitive tenders.

Payment for accepted tenders must be completed on or before Wednesday, March 3, 1976, at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt in cash, in other funds immediately available to the Treasury by March 3, 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) Thursday, February 26, 1976, 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) Tuesday, February 24, 1976, 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. Where full payment is not completed on time, the allotment will be canceled and the deposit with the tender up to 5 percent of the amount of notes allotted will be subject to forfeiture to the United States.

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

FOR IMMEDIATE RELEASE February 20, 1976 843

RESULTS OF AUCTION OF 21-MONTH TREASURY NOTES

The Treasury has accepted $2.5 billion of the $4.8 billion of tenders received from the public for the 21-month notes, Series Q-1977, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	6.57%	1/
Highest yield	6.64%	
Average yield	6.62%	

The interest rate on the notes will be 6-5/8%. At the 6-5/8% rate, the above yields result in the following prices:

Low-yield price	100.039
High-yield price	99.925
Average-yield price	99.957

The $2.5 billion of accepted tenders includes 6 % of the amount of notes bid for at the highest yield and $0.4 billion of noncompetitive tenders accepted at the average yield.

In addition, $110 million of tenders were accepted at the average-yield price from foreign and international monetary authorities.

1/ Excepting 1 tender of $90,000.

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The Department of the TREASURY NEWS

THE DEPARTMENT OF THE TREASURY 1789

For information on submitting tenders in the Washington, D. C. area: PHONE WO4-2604

FOR RELEASE AT 4:00 P.M. February 27, 1976 844

TREASURY TO AUCTION $2.0 BILLION OF NOTES

The Department of the Treasury will auction $2.0 billion of 4-year notes to raise new cash. Additional amounts of the notes may be issued to Federal Reserve Banks as agents of foreign and international monetary authorities.

The notes now being offered will be Treasury Notes of Series C-1980 dated March 17, 1976, due March 31, 1980 (CUSIP No. 912827 FK 3), with interest payable on September 30, 1976, and thereafter on March 31 and September 30. They will be issued in registered and bearer form in denominations of $1,000, $5,000, $10,000, $100,000, and $1,000,000, and they will be available for issue in book-entry form.

Payment for the notes must be made on March 17, 1976. Payment may not be made through tax and loan accounts.

Tenders will be received up to 1:30 p.m., Eastern Standard time, Friday, March 5, 1976, at any Federal Reserve Bank or Branch and at the Bureau of the Public Debt, Washington, D. C. 20226; provided, however, that noncompetitive tenders will be considered timely received if they are mailed to any such agency under a postmark no later than Thursday, March 4. Each tender must be in the amount of $1,000 or a multiple thereof, and all tenders must state the yield desired, if a competitive tender, or the term "noncompetitive", if a noncompetitive tender. Fractions may not be used in tenders. The notation "TENDER FOR TREASURY NOTES" should be printed at the bottom of envelopes in which tenders are submitted.

Competitive tenders must be expressed in terms of annual yield in two decimal places, e.g., 7.11, and not in terms of a price. Tenders at the lowest yields, and noncompetitive tenders, will be accepted to the extent required to attain the amount offered. After a determination is made as to which tenders are accepted, a coupon yield will be determined to the nearest 1/8 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 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. Tenders at a yield that will produce a price less than 99.001 will not be accepted.

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 $500,000 or less will be accepted in full at the average price of accepted competitive tenders, which price will be 100.000 or less.

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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 the 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 commercial and other banks 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, Federal Reserve Banks, and Government accounts. Tenders from others must be accompanied by payment of 5 percent of the face amount of notes applied for. However, bidders who submit checks in payment on tenders submitted directly to a Federal Reserve Bank or the Treasury may find it necessary to submit full payment for the notes with their tenders in order to meet the time limits pertaining to checks as hereinafter set forth. Allotment notices will not be sent to bidders who submit noncompetitive tenders.

Payment for accepted tenders must be completed on or before Wednesday, March 17, 1976, at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt in cash, in other funds immediately available to the Treasury by March 17, 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) Thursday, March 11, 1976, 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) Tuesday, March 9, 1976, 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. Where full payment is not completed on time, the allotment will be canceled and the deposit with the tender up to 5 percent of the amount of notes allotted will be subject to forfeiture to the United States.

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INTEREST ON THE PUBLIC DEBT
UNDER ALTERNATIVE HYPOTHESES
(Millions of Dollars)

Fiscal Year	Total Budget Outlays	Interest on the Public Debt: Actual	Interest on the Public Debt: Assuming No Bonds	Interest on the Public Debt: Assuming Hypothetical Bonds 1/
1966	134,652	12,014	12,014	12,014
1967	158,254	13,391	13,391	13,392
1968	178,833	14,573	14,573	14,571
1969	184,548	16,588	16,588	16,561
1970	196,588	19,304	19,304	19,243
1971	211,425	20,959	20,959	20,837
1972	231,876	21,849	21,837	21,789
1973	246,526	24,167	24,131	24,143
1974	268,392	29,319	29,270	29,304
1975	324,601	32,665	32,559	32,578
1976	373,535e	37,700e	37,530	37,584
TOTAL	2,509,230	242,529	242,155	242,016

Office of the Secretary of the Treasury
Office of Debt Analysis

February 27, 1976

1/ Assumed bond sales are equal to 10% of actual notes issued in each quarterly financing in which no bonds were actually sold.
e - Estimated; Note: Figures may not add to totals due to rounding.

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QUARTERLY FINANCINGS, UNDER ALTERNATIVE HYPOTHESES
(Billions of Dollars)

Calendar Year Quarter		Gross Offerings to Private Investors			Calendar Year Quarter		Gross Offerings to Private Investor		
		Actual	With Assumed Bonds 1/	Assuming No Bonds			Actual	With Assumed Bonds 1/	Assuming No Bonds
1966:	1	$ 7.4	$ 7.4	$ 7.4	1971:	1	$11.0	$10.4	$11.0
	2	1.5	1.5	1.5		2	4.2	3.5	4.2
	3	4.2	4.2	4.2		3	5.5	5.3	5.5
	4	3.5	3.5	3.5		4	8.6	7.5	8.6
		$16.6	$16.6	$16.6			$29.3	$26.7	$29.3
1967:	1	$ 4.0	$ 4.0	$ 4.0	1972:	1	$ 4.0	$ 3.4	$ 4.0
	2	4.7	4.7	4.7		2	1.8	1.1	1.8
	3	4.0	3.7	4.0		3	8.2	7.7	8.2
	4	4.9	4.8	4.9		4	2.9	2.9	2.9
		$17.6	$17.2	$17.6			$17.0	$15.2	$17.0
1968:	1	$ 8.1	$ 7.9	$ 8.1	1973:	1	$ 3.5	$ 3.0	$ 3.8
	2	6.1	5.9	6.1		2	2.5	1.2	2.9
	3	5.5	5.3	5.5		3	2.3	2.1	2.3
	4	3.7	3.1	3.7		4	3.8	3.8	3.8
		$23.4	$22.2	$23.4			$12.2	$10.2	$12.8
1969:	1	$ 3.5	$ 3.1	$ 3.5	1974:	1	$ 4.1	$ 3.6	$ 4.1
	2	4.3	3.8	4.3		2	4.2	3.6	4.0
	3	2.8	2.4	2.8		3	4.6	3.9	4.6
	4	5.8	5.8	5.8		4	4.9	3.9	4.9
		$16.3	$15.0	$16.3			$17.9	$15.0	$17.7
1970:	1	$ 4.9	$ 4.9	$ 4.9	1975:	1	$ 5.8	$ 5.3	$ 5.8
	2	7.2	6.0	7.2		2	5.1	4.8	5.1
	3	8.0	7.5	8.0		3	5.9	5.0	5.9
	4	7.4	6.7	7.4		4	3.5	3.4	3.7
		$27.5	$25.2	$27.5			$20.3	$18.5	$20.5
					1976:	1	$ 9.5	$ 9.1	$10.0

Office of the Secretary of the Treasury
Office of Debt Analysis

March 1, 1976

Details may not add to totals because of rounding.

1/ Assumed bond sales are equal to 10% of actual notes issued in each quarterly financing in which no bonds were actually sold.

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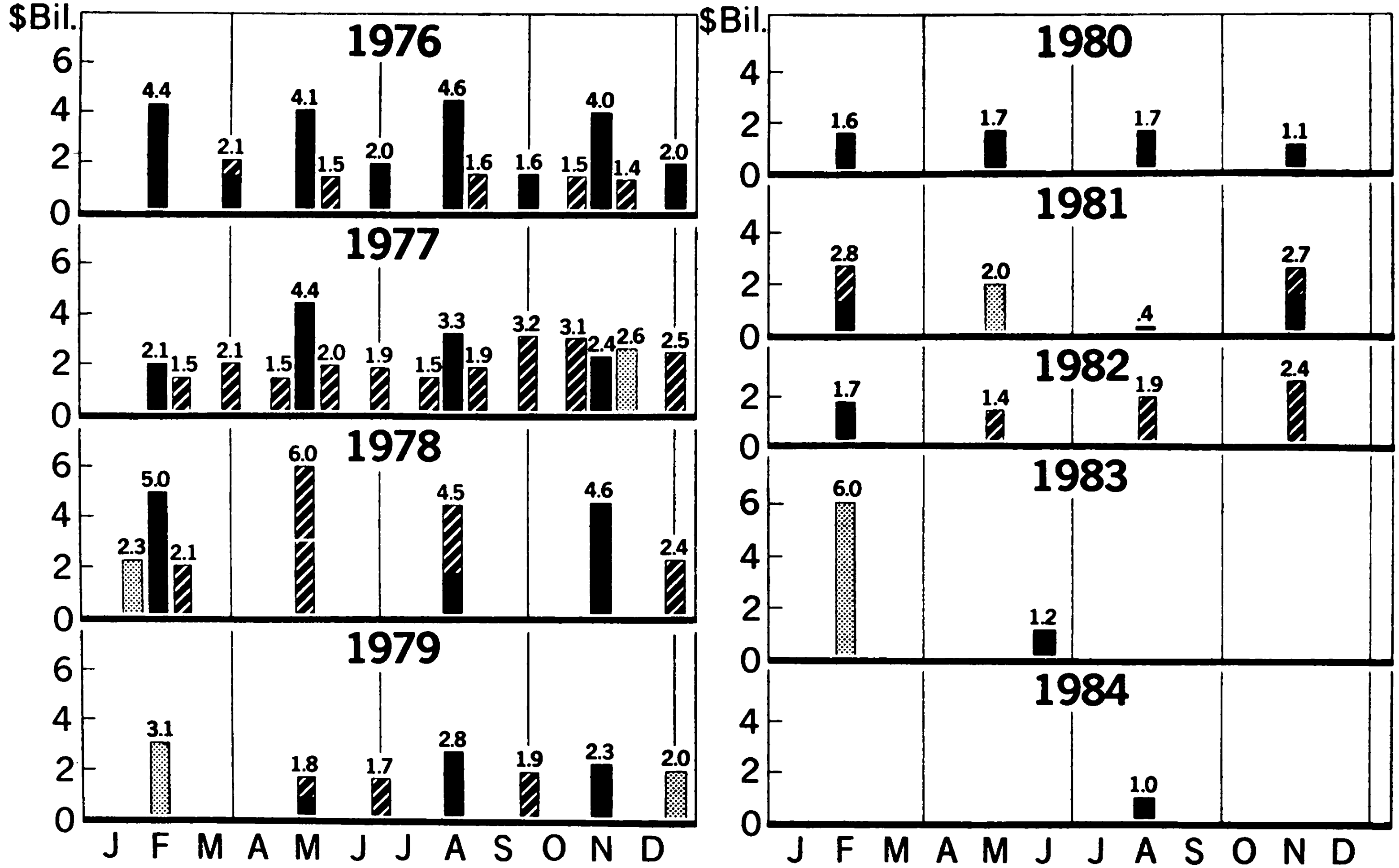
TREASURY MARKETABLE MATURITIES

Privately Held, Excluding Bills and Exchange Notes



New issues calendar year 1975.

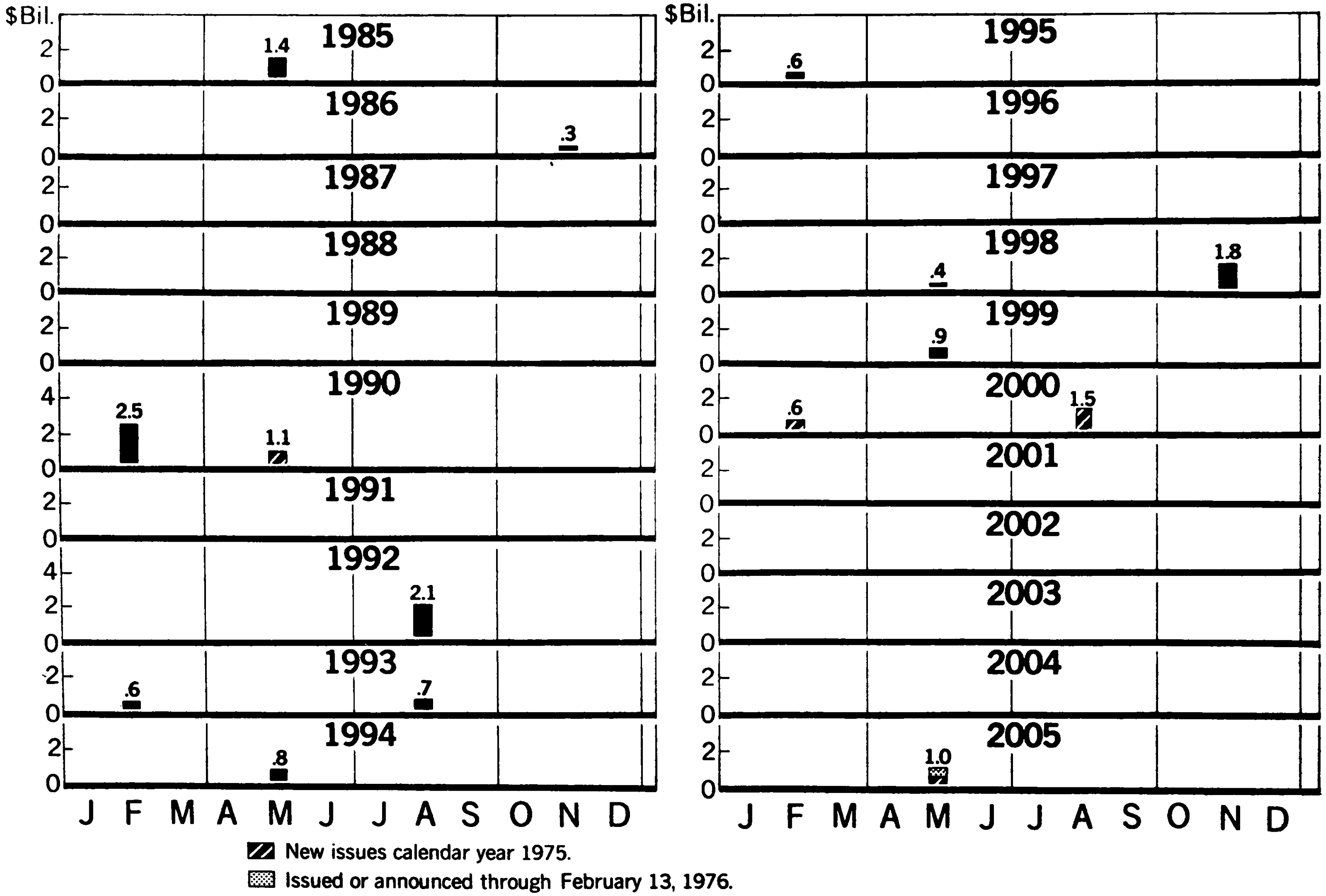
Issued or announced through February 13, 1976.

Office of the Secretary of the Treasury
Office of Debt Analysis

February 24, 1976-1

TREASURY MARKETABLE MATURITIES

Privately Held, Excluding Bills and Exchange Notes



Office of the Secretary of the Treasury
Office of Debt Analysis

February 24, 1976-4

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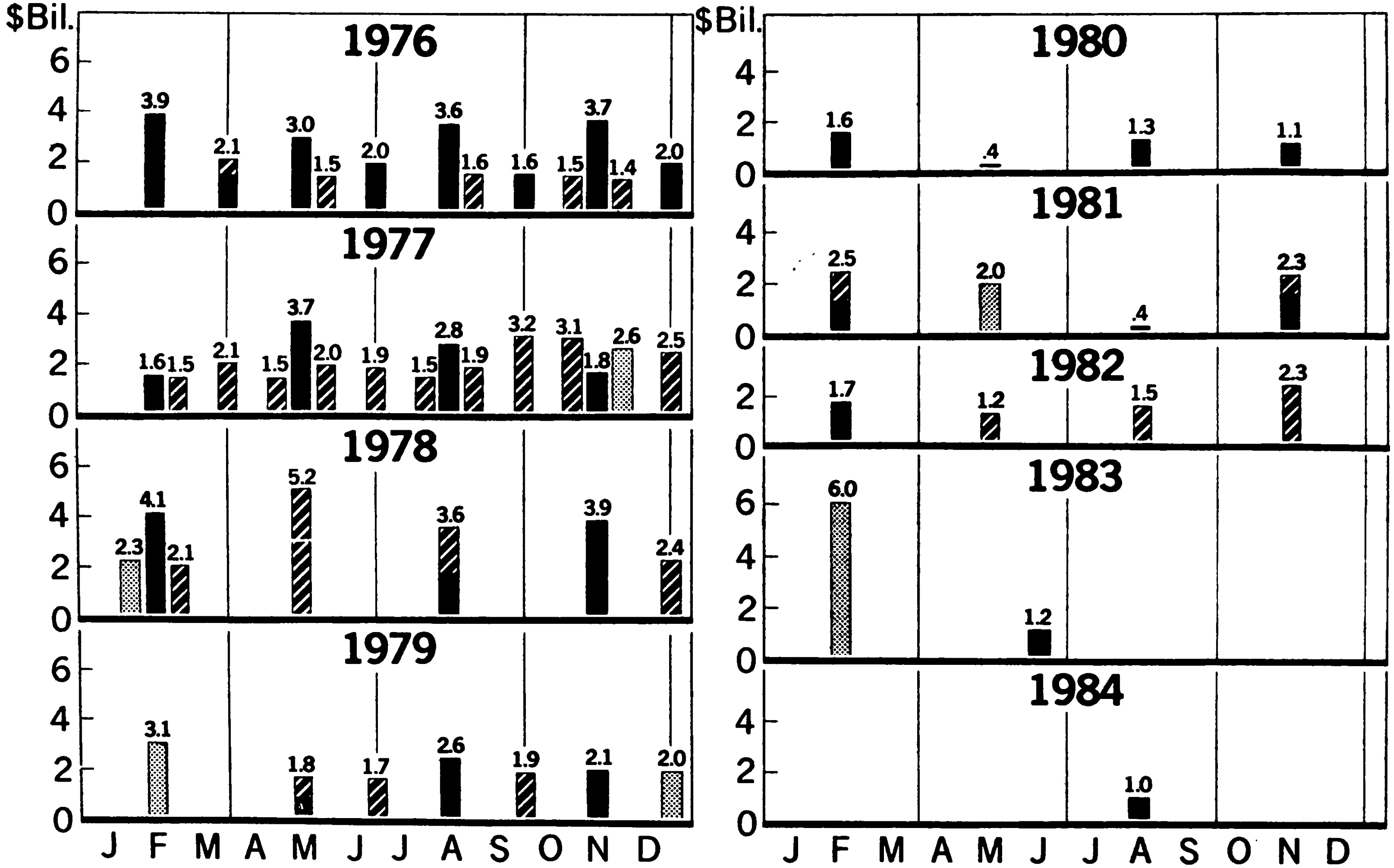
HYPOTHETICAL TREASURY MARKETABLE MATURITY STRUCTURE WITH ASSUMED BOND ISSUES [1]

Privately Held, Excluding Bills and Exchange Notes



New issues calendar year 1975.

Issued or announced through February 13, 1976.

Office of the Secretary of the Treasury
Office of Debt Analysis

1/Assumes sales of 20 year bonds equal to 10% of actual notes issued in each quarterly financing in which no bonds were actually sold.

February 24, 1976-2

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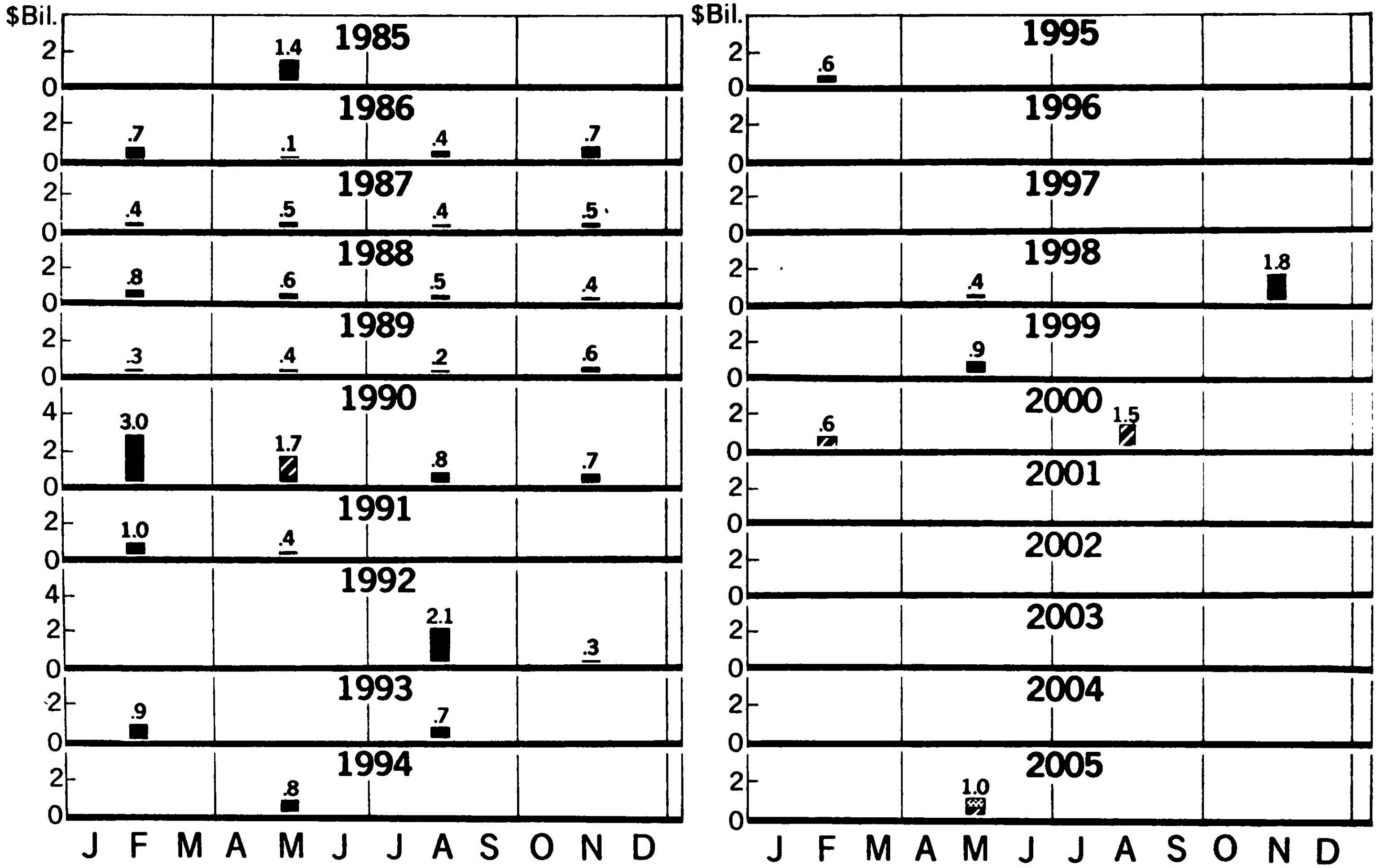
HYPOTHETICAL TREASURY MARKETABLE MATURITY STRUCTURE WITH ASSUMED BOND ISSUES 1/

Privately Held, Excluding Bills and Exchange Notes



New issues calendar year 1975.

Issued or announced through February 13, 1976.

1/ Assumes sales of 20 year bonds equal to 10% of actual notes issued in each quarterly financing in which no bonds were actually sold.

Office of the Secretary of the Treasury
Office of Debt Analysis

February 24, 1976-5

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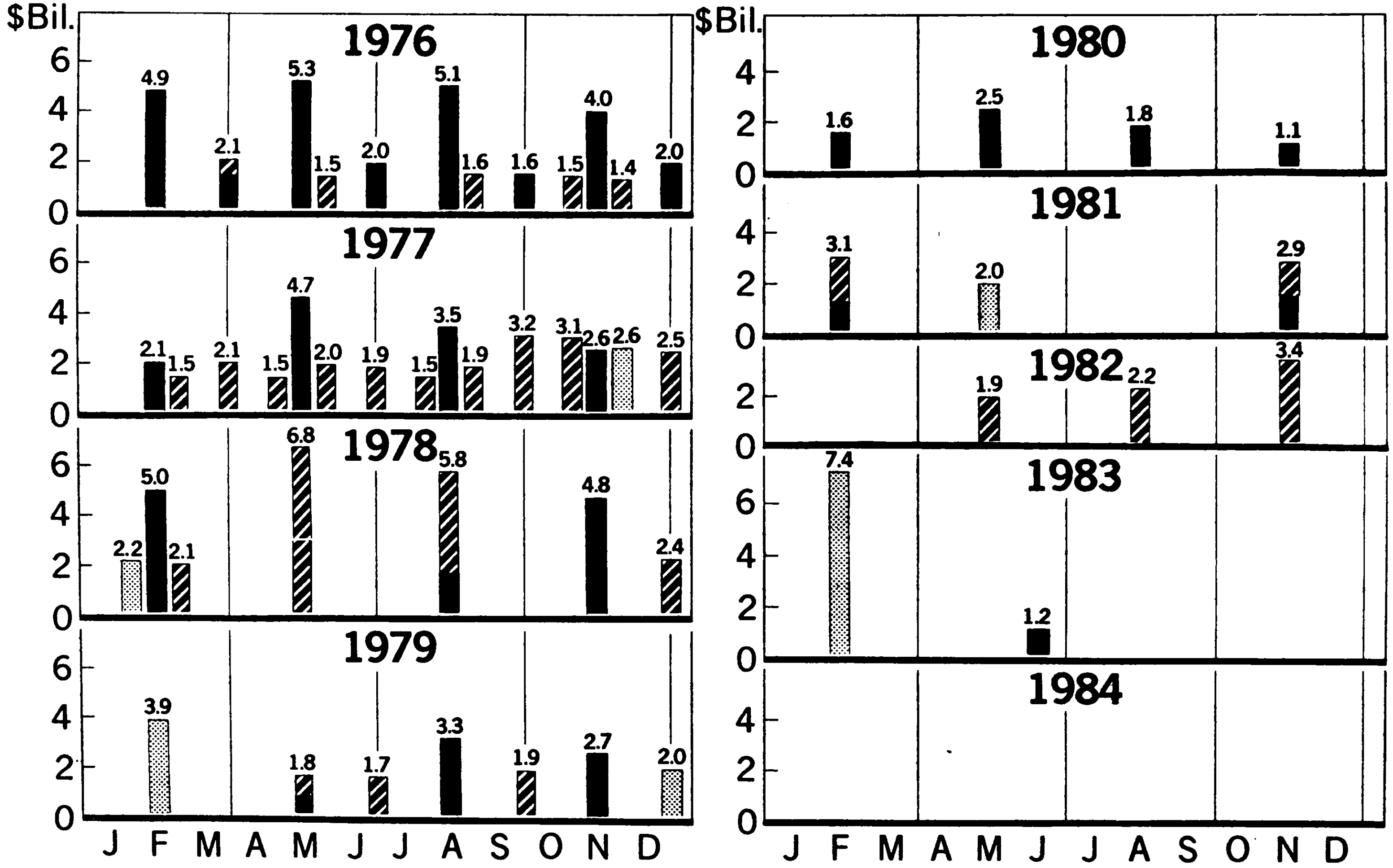
HYPOTHETICAL TREASURY MARKETABLE MATURITY STRUCTURE, ASSUMES NO AUTHORITY TO ISSUE BONDS

Privately Held, Excluding Bills and Exchange Notes



Office of the Secretary of the Treasury
Office of Debt Analysis

February 24, 1976-3

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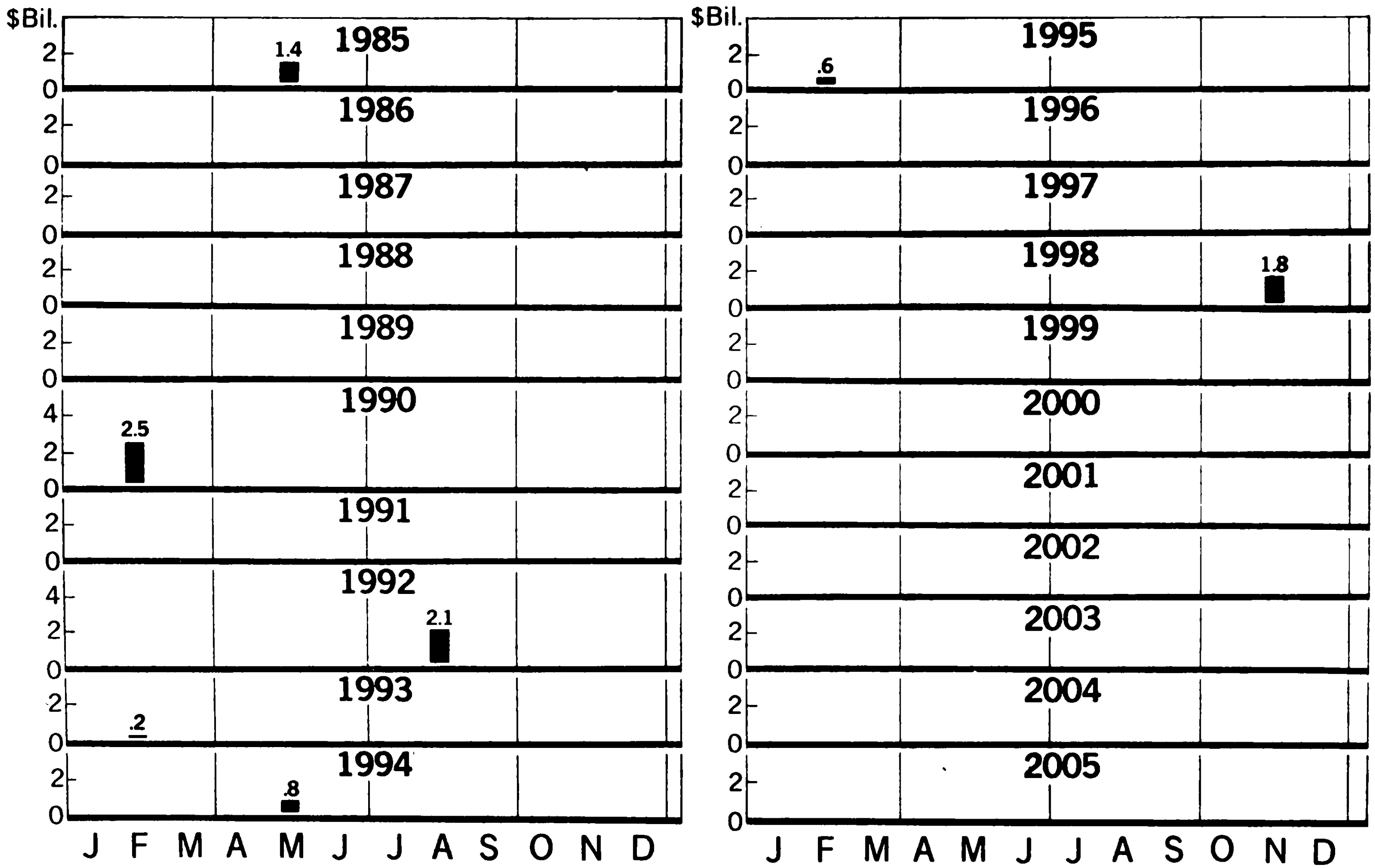
HYPOTHETICAL TREASURY MARKETABLE MATURITY STRUCTURE, ASSUMES NO AUTHORITY TO ISSUE BONDS

Privately Held, Excluding Bills and Exchange Notes



Office of the Secretary of the Treasury
Office of Debt Analysis

February 24, 1976-6

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EFFECT OF STARK BILL ON SERIES E BOND REDEMPTION VALUES

Period (Years and months after issue)	Current schedule Redemption values and yields for $25 bond				Stark bill minimum Redemption values and yields for $25 bond			
	Redemption value during each period	Approximate investment yield (annual percentage rate) 1/	2/	3/	Redemption value during each period	Approximate investment yield (annual percentage rate) 1/	2/	3/
0-0 to 0-1	--	--	--	6.00%	--	--	--	6.00%
0-1 to 0-2	--	--	--	6.10	--	--	--	6.10
0-2 to 0-3	$18.75	0.00%	0.00%	6.21	$18.82	2.25%	3.86%	6.13
0-3 to 0-4	18.75	0.00	0.00	6.32	18.88	2.78	3.84	6.17
0-4 to 0-5	18.75	0.00	0.00	6.44	18.94	3.05	3.83	6.21
0-5 to 0-6	18.75	0.00	23.47	6.56	19.00	3.20	3.46	6.26
0-6 to 0-7	19.10	3.73	0.00	6.25	19.07	3.41	3.81	6.29
0-7 to 0-8	19.10	3.20	0.00	6.37	19.13	3.47	3.79	6.34
0-8 to 0-9	19.10	2.79	0.00	6.50	19.19	3.51	4.42	6.39
0-9 to 0-10	19.10	2.48	0.00	6.63	19.26	3.61	3.77	6.43
0-10 to 0-11	19.10	2.23	0.00	6.76	19.32	3.63	3.76	6.48
0-11 to 1-0	19.10	2.03	34.26	6.90	19.38	3.64	4.37	6.54
1-0 to 1-1	19.61	4.54	0.00	6.37	19.45	3.70	3.73	6.58
1-1 to 1-2	19.61	4.18	0.00	6.51	19.51	3.70	4.34	6.64
1-2 to 1-3	19.61	3.88	0.00	6.65	19.58	3.75	3.71	6.69
1-3 to 1-4	19.61	3.62	0.00	6.80	19.64	3.74	4.32	6.76
1-4 to 1-5	19.61	3.39	0.00	6.96	19.71	3.78	3.68	6.81
1-5 to 1-6	19.61	3.19	31.92	7.12	19.77	3.77	4.29	6.89
1-6 to 1-7	20.10	4.69	0.00	6.57	19.84	3.80	3.66	6.95
1-7 to 1-8	20.10	4.44	0.00	6.73	19.90	3.80	4.26	7.03
1-8 to 1-9	20.10	4.22	0.00	6.90	19.97	3.82	3.63	7.10
1-9 to 1-10	20.10	4.01	0.00	7.08	20.03	3.81	4.23	7.19
1-10 to 1-11	20.10	3.83	0.00	7.27	20.10	3.83	4.22	7.27
1-11 to 2-0	20.10	3.66	31.77	7.47	20.17	3.85	3.60	7.35
2-0 to 2-1	20.60	4.76	0.00	6.83	20.23	3.83	4.19	7.46
2-1 to 2-2	20.60	4.57	0.00	7.03	20.30	3.85	4.17	7.55
2-2 to 2-3	20.60	4.39	0.00	7.24	20.37	3.86	4.16	7.65
2-3 to 2-4	20.60	4.23	0.00	7.47	20.44	3.87	3.55	7.76
2-4 to 2-5	20.60	4.07	0.00	7.70	20.50	3.86	4.13	7.89
2-5 to 2-6	20.60	3.93	33.59	7.96	20.57	3.87	4.12	8.01
2-6 to 2-7	21.14	4.86		7.15	20.64	3.88		8.15

Estimated annual cost of Stark bill minimum = $22.0 million

Office of the Secretary of the Treasury
Office of Debt Analysis

March 3, 1976

1/ From issue date to beginning of each period.
2/ From beginning of each period to beginning of next period.
3/ From beginning of each period to maturity.

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SERIES E U.S. SAVINGS BONDS
REDEMPTION VALUES AND YIELDS

BONDS BEARING ISSUE DATES BEGINNING DECEMBER 1, 1973

Issue price / Denomination	$18.75 25.00	$37.50 50.00	$56.25 75.00	$75.00 100.00	$150.00 200.00	$375.00 500.00	$750.00 1000.00	$7500 10000	Approximate investment yield (annual percentage rate)		
Period (years and months after issue)	(1) Redemption values during each half-year period (values increase on first day of period)								(2) From issue date to beginning of each ½-yr. period	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to maturity
									Percent	Percent	Percent
0-0 to 0-6	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$7500	----	3.73	6.00
0-6 to 1-0	19.10	38.20	57.30	76.40	152.80	382.00	764.00	7640	3.73	5.34	6.25
1-0 to 1-6	19.61	39.22	58.83	78.44	156.88	392.20	784.40	7844	4.54	5.00	6.37
1-6 to 2-0	20.10	40.20	60.30	80.40	160.80	402.00	804.00	8040	4.69	4.98	6.57
2-0 to 2-6	20.60	41.20	61.80	82.40	164.80	412.00	824.00	8240	4.76	5.24	6.83
2-6 to 3-0	21.14	42.28	63.42	84.56	169.12	422.80	845.60	8456	4.86	5.39	7.15
3-0 to 3-6	21.71	43.42	65.13	86.84	173.68	434.20	868.40	8684	4.95	5.53	7.59
3-6 to 4-0	22.31	44.62	66.93	89.24	178.48	446.20	892.40	8924	5.03	5.92	8.29
4-0 to 4-6	22.97	45.94	68.91	91.88	183.76	459.40	918.80	9138	5.14	6.09	9.48
4-6 to 5-0	23.67	47.34	71.01	94.68	189.36	473.40	946.80	9468	5.25	12.93	12.93
5-0 1/	25.20	50.40	75.60	100.80	201.60	504.00	1008.00	10080	6.00	----	----

1/ Maturity value reached at 5 years and 0 months after issue.

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MARCH 4, 1976

STATEMENT OF JOHN A. BUSHNELL
ACTING ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE SUBCOMMITTEE ON LEGISLATION AND NATIONAL SECURITY
OF THE HOUSE GOVERNMENT OPERATIONS COMMITTEE

Mr. Chairman, I am pleased to be here today to explain how seriously Treasury, other U.S. government agencies and the borrower governments consider the prompt, on-time payment of foreign debts owed the United States government. Delinquencies in the payment of debts by foreign obligors is taken very seriously by Treasury, and we have taken a number of steps during the past two years to insure that debts are paid on schedule. As I shall explain later, payment on only a small portion of the debt owed to the United States is in arrears and for the great bulk of these arrears there are special circumstances which limit our ability to remedy the situation.

This is the first time I have testified on this important subject. Therefore, I think it would be appropriate to review past Congressional and Executive action on this matter.

WS-696

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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For Immediate Release March 4, 1976

STUDY GROUP MAJORITY FINDS NO SIGNIFICANT RELATIONSHIP BETWEEN CHANGES IN INTEREST RATES AND EXCHANGE RATES

There was general agreement among more than 70 economic researchers participating in a Treasury Department workshop here on foreign exchange markets that there is no simple relationship between changes in interest rates and changes in exchange rates.

Sponsored by the U.S. Treasury's Office of the Assistant Secretary for International Affairs, the workship, held last week, brought together economic researchers from government, the universities, and financial and research institutions.

The presentation and discussion of papers was organized around four themes: Explanation of the behavior of foreign exchange markets; testing for the efficiency of foreign exchange markets; the effects of exchange-rate flexibility on resource allocation; and international economic interdependence and issues of coordination of macroeconomic policies under flexible exchange rates.

Empirical evidence showed that, contrary to the hypotheses of some observers, exchange rates frequently fall at the same time interest rates rise. Whether interest rates and exchange rates are positively or negatively related depends upon the precise causes of changes in interest rates, the findings indicated.

Most of the studies emphasized the important role that expectations play in the determination of exchange rates. Several participants argued that the variability observed in exchange rates under the current floating system has mainly reflected the unusual degree of uncertainty and variability in underlying economic conditions in this period.

It was generally agreed that markets appear to have adjusted to the new situation of generalized flexibility and are now functioning relatively efficiently. There was considerable disagreement, however, as to the technical efficiency of exchange markets in the period immediately following the decision to float in 1973. Several studies presented evidence of destabilizing speculation and market inefficiency in this earlier period.

The papers on international economic interdependence generally challenged the notion that we have entered a new era of economic synchronization among the industrial countries. In the view of these researchers, an important degree of interdependence does in fact exist but there is little evidence to support the argument that this interdependence has recently tended to increase rapidly.

It was argued that the high degree of synchronization of economic activity among the industrial countries in the recent past was due to common external shocks rather than increased macroeconomic interdependence.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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MARCH 4, 1976

FOR RELEASE ON DELIVERY

STATEMENT OF JOHN A. BUSHNELL
ACTING ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE SUBCOMMITTEE ON LEGISLATION AND NATIONAL SECURITY
OF THE HOUSE GOVERNMENT OPERATIONS COMMITTEE

Mr. Chairman, I am pleased to be here today to explain how seriously Treasury, other U.S. government agencies and the borrower governments consider the prompt, on-time payment of foreign debts owed the United States government. Delinquencies in the payment of debts by foreign obligors is taken very seriously by Treasury, and we have taken a number of steps during the past two years to insure that debts are paid on schedule. As I shall explain later, payment on only a small portion of the debt owed to the United States is in arrears and for the great bulk of these arrears there are special circumstances which limit our ability to remedy the situation.

This is the first time I have testified on this important subject. Therefore, I think it would be appropriate to review past Congressional and Executive action on this matter.

1. Congressional and Executive Actions and Treasury Responsibilities.

As you are aware, the Foreign Operations and Government Information Subcommittee of the House Committee on Government Operations began holding hearings on delinquent debts owed the United States Government in 1970. In an effort to improve the government's performance in collection of debts, and in response to timely and useful suggestions from the Subcommittee, the Executive Branch has developed a complete reporting system on foreign debts owed the U.S. Government, and has instituted procedures for the periodic review of outstanding delinquencies.

Under section 634(f) of the Foreign Assistance Act, as amended, Treasury is responsible for compilation of data on foreign debt owed to the U.S. Government and arrearages on such debts. We receive from all U.S. Government Agencies semi-annual statements of long-term foreign debt owed (those with original maturities of over one year), short-term debts (maturities of 90 days to one year), and accounts receivable (maturities of less than 90 days).

Information is also compiled on debts in each category which are due and unpaid 90 days or more. This information is used in taking appropriate steps to insure prompt collection, as well as in assisting the Congress in its work.

Treasury also oversees the review of individual debt problems through its chairmanship of the National Advisory

Council on International Monetary and Financial Policies (NAC). The NAC in its consideration of new loans to foreign countries reviews the status of those countries' debts to the U.S. The NAC has adopted a formal procedure for the deferral or disapproval of loans to countries with delinquent debts.

In all of its activities in the debt collection area, Treasury works closely with the Department of State and the agencies to which the debts are owed. The responsibility for collection lies initially with the creditor agency. In cases where the creditor agency's efforts are unsuccessful, the Department of State is asked to provide its assistance.

The Treasury Department is also responsible for compiling an annual report on the external debt situation of the less developed countries and debt rescheduling. This report, which is required by Section 634(g) of the Foreign Assistance Act of 1961, as amended, is comprehensive in nature, containing detailed information on the external debt of developing countries, including debt servicing problems of major debtor countries and the steps which debtor and creditor countries have taken in dealing with these problems. Copies of the second annual report, dated January 30, 1976, have been provided to members of this subcommittee. I shall comment on this report later in my statement.

Treasury also chairs a NAC working group which is developing an early warning system to identify in advance those countries which may incur debt servicing difficulties. Another Treasury-chaired NAC working group, which works closely with the debt early warning group, examines in detail the debt servicing problems of countries which may incur debt servicing difficulties.

2. Foreign Debts Owed to the USG.

All foreign debts owed the United States Government arise from Congressionally mandated programs undertaken in this century. Foreign debt owed the United States falls into two broad categories: debts contracted for the most part after World War II and debts relating to our activities during and immediately after World War I. Since collections on some debts, particularly those under lend-lease, during the Second World War, were deferred until the war had ended, I would prefer, for convenience sake, to refer to these as post-World War II debts.

The total principal outstanding on these post-World War II debts was $35.2 billion on June 30, 1975. Of this total, $34.0 billion was on long-term credit, $93.8 million short-term credits, and $527.9 million accounts receivable. The vast majority of this debt is a result of U.S. Government foreign aid and export credit programs undertaken during the last 30 years. Some $15 billion was contracted under the Foreign Assistance Act, and predecessor legislation, and the Foreign Military Sales Act, $5 billion under Public Law 480, and about $9 billion under the Export-Import Bank Act. Another $1.6 billion arose from activities related to World War II, primarily lend-lease and surplus property disposal.

Given the aid and export support objectives of these loans, it is not surprising that most of them, nearly 85 percent by value are owed by non-oil exporting developing countries. The largest individual debtors are: India $3.7 billion, Pakistan $2.4 billion, Brazil $2.1 billion, Israel $1.8 billion, Turkey $1.6 billion, Indonesia $1.3 billion and Korea $1.3 billion.

In the vast majority of instances, debts due to the United States have been paid on time. During the 18 months December 31, 1973, to June 30, 1975, the United States collected some $3.1 billion in principal and interest due on long-term credits, and the equivalent of about $700 million in principal and interest on foreign currency loans. During this period of time, long-term arrearages declined by about $130 million. While a portion of this reduction in arrearages reflects debt rescheduling agreements, the amount of money actually collected on foreign debts far exceeded new arrearages incurred. Foreign debt arrearages constitute a very small portion of total debts falling due to and being collected by agencies of the United States.

Let me turn now to a discussion of post-World War II debt delinquencies and describe our efforts to deal with these delinquencies.

As I indicated earlier, Treasury compiles information from the U.S. government agencies on all debts which are overdue and unpaid 90 days or more. As of June 30, 1975, the latest date for which complete data are available, the total principal and interest delinquent was $636 million. This compares with $753 million on December 31, 1973. On the whole, I believe our performance in reducing debt arrearages has been good. With continued effort, I would expect this underlying favorable trend to continue.

However, there are certain cases which are extremely difficult to resolve through normal collection procedures. Table 1, which is attached to my statement, classifies arrearages according to the nature of the problem underlying the arrearage. For example, those arrearages which fall under the heading "Extraordinary Political Arrearages" account for nearly 60 percent of total arrearages as of June 30, 1975. Special problems, particularly problems of a political nature, impede our ability to collect these debts. Mr. Boeker of the State Department will be addressing the nature of the political problems underlying these arrearages with respect to China and Cuba.

By far the largest arrearage in this group, $199 million, relates to military logistical support provided by the United States to other nations during the Korean conflict. While the United States has reached formal agreement with most countries for payment for such assistance, no such agreements have been reached with six developing countries: Colombia, Ethiopia, Greece, The Philippines, Thailand and Turkey. The policy to be followed in seeking disposition of these matters is under intensive review within the Administration. Mr. Boeker will provide background information on this problem. Without going into the details, I would like to note that the tenth report of the Moorhead Subcommittee (December 1973) concluded that:

> "It is improbable that as less developed nations they (the six nations) ever implied a willingness or ability to pay. There is no reason for continuing to carry these claims as debts on U.S. Treasury records."

The second category, "major arrearages", includes Egypt, Iran, and Pakistan. Together, these arrearages totaled $108 million as of June 30, 1975.

Secretary Simon raised the matter of debt arrearages when he visited Egypt in July 1974. At that time, Egyptian arrearages totaled nearly $60 million, a large portion of which was on local currency loans. Since that time, we were pleased to see that these arrearages were virtually eliminated. Unfortunately, new arrearages have occurred which total $13 million as of June 30, 1975. Subsequently, this amount was reduced by nearly $5 million at year end 1975.

Secretary Simon is visiting Egypt later this week to discuss a number of economic and financial issues. He will raise the question of the remaining debt arrearages with appropriate Egyptian officials. Given the excellent cooperation which Egyptian officials have demonstrated in the past, we are confident that this arrearage can be cleared up in the near future.

The Pakistan arrearage relates to a debt rescheduling agreement which the U.S. and Pakistan are signing this morning. This agreement, which will be submitted to Congress for appropriate review, will implement a June 28, 1974, understanding reached between Pakistan and members of the World Bank Aid to Pakistan Consortium. When the debt agreement is implemented, the amounts, which are now carried as arrearages, will be rescheduled, and Pakistan will be current on its obligations to the United States.

For the past four years, the United States has been in regular communication with Iran in an effort to collect arrearages of $35 million on several lend-lease and surplus property agreements signed in the period 1945-1948. This arrearage is receiving priority attention and some payment has been received. Mr. Boeker will discuss the matter in detail.

The remaining category of other long-term, short-term, and accounts receivable arrearages total just over $155 million as of June 30, 1975. This compares to $310 million for December 31, 1973. During this period, arrearages on long-term debts owed by foreign public sector entities declined about $125 million, while those arrearages from private sector entities fell about $35 million. Many of these arrearages reflect technical and administrative problems, rather than hard-core delinquencies.

3. Efforts to Improve Collection of Delinquent Debts

During the past year several steps have been taken to improve the debt collection procedures of agencies of the government. At a meeting of the National Advisory Council on International Monetary and Financial Policies (NAC) which I chaired on August 7, 1975, agencies reviewed measures they were taking to improve their debt collection procedures. At that time, Eximbank, whose defaults amount to less than 1 percent of Exim's portfolio, reported that the Bank was in the process of establishing a computerized program for automatically billing debtors 45 days prior to due date of payment. This program is in the process of being implemented, and when fully implemented -- the end of FY 1976 -- it will help to limit the level of delinquent accounts on Exim transactions.

The Department of Defense established a Task Force to develop standardized procedures for all the Armed Services on Foreign Military Sales program transactions to include uniform billing, cash collection, and delivery reporting. Mr. Welsch will comment on how these measures should help to control delinquent accounts on DOD transactions.

In addition to these technical improvements, Treasury and State have intensified their efforts to reduce the level of delinquencies. Treasury stepped up its efforts in the weekly staff meetings of the National Advisory Council to call attention of creditor agencies to delinquent debts of particular countries and to seek their increased cooperation in collecting these delinquencies. While the results have obviously not eliminated all debt delinquencies, there are several instances where our consideration of loans to these countries was deferred pending a satisfactory response from the debtor country. In most cases prompt payment or at least a schedule for early payment to bring payments up to date have resulted.

4. World War I Debt.

The other part of our debt is World War I debt. The question of the delinquent principal and accrued interest on World War I debt owed to this government by our European Allies, and related debts owed by Germany, is extremely complex and has remained unresolved for over 40 years.

United States Allies during World War I borrowed $12 billion to purchase war material. After taking into account interest charges of $14.6 billion, an amount which exceeds principal, and repayments of $2.8 billion, the outstanding debt totaled approximately $24 billion as of June 30, 1975.

These debts present special problems. Most debtor countries fulfilled their commitments under the debt agreements until the Depression. Aside from a few countries, however, the debtor governments have made no payments since the Depression of 1933-34. The principal debtor governments (except the Soviet Union which repudiated all foreign debts in January 1918) have never denied the validity of the debts. Despite their clear legal validity, the debts are, as a practical matter, inextricably bound up with the entire question of German War Reparations and the intra-European debts generated during the First World War. Many European nations are net creditors on World War I indebtedness, with Germany owing them more than they in turn owe. These nations have since the early 1930's steadfastly maintained that they would only resume payments on their war debts to the United States on the condition that the issue of Germany's World War I reparations was satisfactorily settled.

Resolution of the problem of government claims against Germany arising from World War I was deferred "until a final general settlement of this matter" by the 1953 London Agreement on German external debts, to which the United

States is a party. This agreement was ratified by the United States Senate and has the status of a treaty.

While the United States has never recognized any legal connection between World War I obligations owed to this country and reparation claims on Germany, there is a linkage in reality. A National Advisory Council working group has this complex matter under study but thus far has not found any feasible way to resolve this problem.

5. LDC Debt, Debt Rescheduling and U.S. Policy.

The question of increased LDC balance of payments deficits and the concomitant rise in LDC external debt is attracting considerable attention in international fora, such as the United Nations Committee on Trade and Development (UNCTAD) and the Organization for Economic Cooperation and Development (OECD). The magnitude of these balance of payments deficits and the pattern of past and projected financing is analyzed in considerable detail in the second annual "Report on Developing Countries' External Debt and Debt Relief Provided by the United States" which was sent to Congress on January 30, 1976.

The sharp jump in oil prices and a combination of other factors such as higher prices for food and fertilizer in 1974 and the worldwide recession of 1974/75 impaired significantly the economic prospects for many of the non-oil LDC's. However, the report concludes that most LDC's will be able to manage the financing of their current account deficits in 1976, even though many countries will continue to borrow beyond normal levels. If there are LDC debt problems in calendar year 1976, it is expected that these problems will be associated with individual countries -- perhaps three or four -- rather than with the LDC's as a whole.

The Report sets forth in unequivocable terms the U.S. position on U.S. participation in a generalized debt rescheduling or debt moratorium as advocated by some countries. The U.S. opposes a generalized debt rescheduling or moratorium as these are not considered to be appropriate instruments to alleviate the balance of payments financing difficulties of these LDC's. Moreover, proposals which have been advanced along these lines would be inequitable providing only minor assistance to the poorest countries and windfall benefits to others.

U.S. policy on debt rescheduling is to evaluate the merits of debt reorganization on a case-by-case basis, predicated on the principle of basic adherence to scheduled terms of credit payment. Within this framework, the U.S. objective is to encourage countries to undertake appropriate corrective policies in order to minimize the incidence of debt rescheduling.

In summary, Mr. Chairman, let me repeat that most debts by foreign governments to the U.S. are being repaid on time. In the fiscal years 1974 and 1975, we have collected over $5.6 billion in principal and interest on government long-term credits. Collections on short-term credits are also substantial. During the same two years, we have reduced the total of delinquent debt. About 60 percent of total debt arrearages on post-World War II debt and almost all arrearages on World War I debt are subject to special political or other factors, which make prompt payment unlikely at this time.

Mr. Chairman, I will be happy to answer any questions which you or members of the committee may have.

TABLE 1

ARREARAGES OF 90 DAYS OR MORE ON FOREIGN CREDITS AND LOANS OF U.S. GOVERNMENT AGENCIES*

	(in $ millions) 12-31-73	6-30-75
I. EXTRAORDINARY POLITICAL ARREARAGES		
A. LONG-TERM, of which:		
1. China	76.5	79.6
2. Cuba	58.3	64.9
Sub-total	134.8	144.5
B. SHORT-TERM and ACCOUNTS RECEIVABLE, of which:		
1. China	16.6	16.6
2. Vietnam and Cambodia	3.4	8.6
3. Unresolved Korean War Logistical Support	199.8	199.8
Sub-total	219.8	225.0
TOTAL POLITICAL	354.6	369.5
(Percent of overall total)	47%	58%
II. MAJOR ARREARAGES - PUBLIC LONG-TERM		
1. Egypt	49.0	13.3
2. Iran (payments initiated,1974)	35.3	35.7
3. Pakistan (rescheduling agreed)	4.0	59.5
TOTAL MAJOR ARREARAGES	88.3	108.5
(Percent of overall total)	12%	17%
III. OTHER ARREARAGES		
A. PUBLIC		
1. Long-term	161.3	34.6
2. Short-term and accounts receivable, of which:	81.5	93.4
FMS	33.2	57.9
Logistical support	8.4	10.8
Lend-lease	4.9	5.0
Eximbank	19.1	3.8
Other	15.9	15.6
Sub-Total	242.8	127.7
B. PRIVATE		
1. Long-term	57.4	20.8
2. Short-term and accounts receivable, of which:	9.9	9.5
Eximbank	8.5	8.9
Other	1.4	0.6
Sub-Total	67.3	30.3
TOTAL OTHER ARREARAGES	310.1	158.0
(Percent of overall total)	41.%	25%
IV. OVERALL TOTAL - Groups I, II, III	753.0	636.0

*Excludes World War I Debt.

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FOR IMMEDIATE RELEASE March 5, 1976

RESULTS OF AUCTION OF 4-YEAR TREASURY NOTES

The Treasury has accepted $2.0 billion of the $5.4 billion of tenders received from the public for the 4-year notes, Series C-1980, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	7.50% 1/
Highest yield	7.55%
Average yield	7.54%

The interest rate on the notes will be 7-1/2%. At the 7-1/2% rate, the above yields result in the following prices:

Low-yield price	99.990
High-yield price	99.818
Average-yield price	99.853

The $2.0 billion of accepted tenders includes 34% of the amount of notes bid for at the highest yield and $0.7 billion of noncompetitive tenders accepted at the average yield.

In addition, $15 million of tenders were accepted at the average-yield price from foreign and international monetary authorities.

1/ Excepting 9 tenders totaling $891,000.

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RESULT

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Today

4-yr. note 7-1/2%

2/20/76

21-mo. note 6-5/8%

2/5/76

3-yr. note 7%

1/13/76

5-yr, 4-mo. note 7-3/8%

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FOR IMMEDIATE RELEASE March 5, 1976

MEMORANDUM TO THE PRESS

Attached for your information is the Joint Communique on the Second Session of the U.S. - Saudi Arabian Joint Commission on Economic Cooperation, as issued by Secretary of the Treasury William E. Simon and Saudi Arabian Minister of Finance and National Economy Aba al-Khail in Riyadh, Saudi Arabia on February 29, 1976.

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JOINT COMMUNIQUE ON THE SECOND
SESSION OF THE U.S. - SAUDI ARABIAN
JOINT COMMISSION ON ECONOMIC COOPERATION

RIYADH, SAUDI ARABIA

FEBRUARY 29, 1976

The U.S. Saudi Arabian Joint Commission on Economic Cooperation concluded its second formal session today with major attention given to the ways in which the Joint Commission could be helpful in the realization of Saudi Arabia's economic and social development.

The Joint Commission assessed the progress achieved since the last commission meeting and concluded agreements and understandings on a number of technical cooperation programs including electrical services, science and technology, and vocational training.

The U.S. Saudi Arabian Joint Commission on Economic Cooperation was established in accordance with the joint statement issued by Crown Prince Fahd and Secretary of State Kissinger on June 8, 1974. The Joint Commission meeting, held in Riyadh, February 29, 1976, was chaired by Minister Muhammad al-Ali Aba Al-Khail, Minister of Finance and National Economy. Secretary of the Treasury William E. Simon, Chairman of the U.S. side of the Commission, led the American delegation. Prince Muhummad Al-Faisel, Governor of the Saline Water Conversion Corporation, attended the session, as did other high Saudi officials from the Ministries of Finance and National Economy, Labor and Social Affairs, Agriculture and Water, Planning, Industry and Electricity, Commerce, Education, and Higher Education.

The American Delegation included William Seidman, Special Assistant to the President for Economic Affairs; Gerald L. Parsky, Treasury Assistant Secretary for International Affairs and U.S. Coordinator of the Joint Commission; Charge' D' Affaires Hume A. Horan and visiting American officials from the U.S. Departments of Treasury, State, Agriculture, Commerce, Health, Education and Welfare, Interior,

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and Labor, and the National Science Foundation.

In reviewing the atmosphere within which economic relations between the two countries have been progressing, the Saudi side reiterated the Saudi Government's position concerning the League of Arab States' boycott of Israel, it reaffirmed that this boycott is a non-violent economic measure which is a product of the absence of a just and lasting peace in the Middle East; that it is not based on any form of discrimination relating to race, color, religion, national origin, sex or age; and that ever since it was started in the late 1940's, this boycott was not -- and is not today -- intended against the United States. The Saudi side further expressed its hope that the existing and potential economic cooperation between the two countries will not be disrupted by any misinterpretation of the Arab boycott of Israel. The American side was pleased with the reaffirmation of this policy of not discriminating on the basis of race, color, religion, sex and national origin. The American side further noted that President Ford's statement of November 20, 1975 with respect to discrimination and the subsequent executive actions were not directed against any particular country. Both sides agreed to make these policies more widely understood and further agreed that any action based on misinterpretation of this policy could hinder cooperation between both countries.

Secretary Simon and his colleagues also had meetings outside the Commission framework with Minister of Finance and National Economy Aba Al-Khail and Governor of the Saudi Arabian Monetary Agency Abd Al-Aziz Al-Quraishi; Minister of Industry and Electricity Ghazi Al-Gosaibi; Minister of Commerce Soliman Solaim; Minister of Petroleum and Mineral Resources Zaki Yamani; Minister of Foreign Affairs Prince Saud Ibn Faisel; and representatives of various Saudi Arabian Chambers of Commerce. These meetings provided an opportunity for the United States to reaffirm its commitment to cooperate closely with Saudi Arabia in the realization of its economic and social development plan goals. The United States also reaffirmed its intention to continue its efforts looking toward a just and durable peace in the Middle East and noted the constructive support it has received from the Kingdom in these efforts.

The members of the Commission exchanged views on the development of U.S.-Saudi Arabian economic cooperation since the last meeting, noting that the administrative and financial mechanisms relating to projects were now in place and will permit more rapid project implementation. Specifically, a trust account has been established in the U.S. Treasury Department, in accordance with the February 13, 1976,Technical Cooperation Agreement (TCA) to fund joint commission technical cooperation programs on a reimbursable basis. On the administrative side, the commission noted that the U.S. representation to the Joint Economic Cooperation Commission office is fully staffed and collaborating on a daily basis with its Saudi Arabian counterpart to develop and implement projects.

A large number of other possibilities for technical and financial cooperation between our two countries were also explored. The U.S. and Saudi Arabia expressed both a desire to have the U.S. play a major role in the development of key sectors of the Saudi economy and both also expressed a wish to investigate methods of increasing mutual trade and private business activity.

Industrialization and Trade

Saudi Development Plan

The Saudi delegation reaffirmed its interest in U.S. private sector participation in the realization of the goals of its five-year development plan. The U.S. delegation pointed out that it has undertaken a number of initiatives in support of further active participation by private U.S. firms and institutions in the Saudi economic development programs.

Following the promulgation of the plan in Saudi Arabia, the U.S. coordinator for the Joint Commission, Treasury Assistant Secretary Gerald Parsky, held a press conference in Washington, D.C. devoted to the plan. A Treasury-produced condensation of the plan has been distributed to date to more than 5,000 U.S. business firms. The complete text of the 663-page summary of the Saudi development plan is also being made available to the American public at a nominal cost through the U.S. Department of Commerce.

To further increase business cooperation between the two countries in Saudi Arabia's industrial effort, the United States has invited leading Saudi officials and private businessmen to visit the United States to meet with U.S. business firms and groups, especially in the electrical field.

The Saudi Arabian government outlined its anticipated needs for imported grain, rice and flour, and the American delegation stated that the United States is committed to satisfy the requirements of its historical customers such as Saudi Arabia.

Electricity

Procurement of Electrical Equipment

An agreement was signed between the United States and the Saudi Arabain Governments on November 23, 1975, providing for the procurement of nearly 200 million riyals ($60 million) worth of electrical equipment through the Joint Economic Commission.

The U.S. General Services Administration is responsible for the actual procurement. It is expected that the first items delivered under this procurement will arrive in Saudi Arabia by early summer this year. The equipment is to be part of a stockpile both for projects now being planned and to meet any unexpected power emergencies.

Electrical Planning Project

In December, 1975, the Saudi Arabian Government formally asked the U.S. Government through the Joint Economic Commission, for assistance in upgrading the Kingdom's electrical systems and planning for the future. A project agreement signed today provides that the U.S. Treasury, on behalf of the Saudi Arabian Government, will contract with U.S. to:

--Prepare a comprehensive 25-year electrification plan to include the conduct of a national power survey; and

--Offer advisory assistance to improve the capacity of existing systems to meet Saudi Arabia's rapidly changing demands for power.

Statistics and Data Processing

The commission received a report on the status of the project agreement on statistics and data processing which was signed on September 27, 1975. Under the agreement, the U.S. Bureau of Census and its National Computer Center is assisting the Ministry of Finance and National Economy in achieving and effective statistics and data processing capability.

The team leader and two senior specialists are now in Riyadh. The remaining specialists will arrive by June, 1976.

Standards System

The Saudi Arabian Government also agreed to consider a U.S. National Bureau of Standards (NBS) proposal for technical cooperation in further developing the capabilities of the Saudi Arabian Standards Organization (SASO), particularly in the area of food and building materials standards, and program informational services. The Saudi request for collaborating follows reports on food and building materials standards and on general requirements for the creation of industrial standards which were prepared by the American Food and Drug Administration and NBS technicians who visited Saudi Arabia in the spring of 1975.

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Communications

The United States has agreed to send a three-man team to provide some short and long-term collaboration with the Ministry of Information with regard to the development of systems for broadcast equipment maintenance, a communications and documentation library, and radio and TV for the entire Kingdom. The United States also agreed to collaborate with the Ministry in the development of a National Information Center.

Agriculture and Water Resources

The most significant development in this field since the Commission's first meeting in February, 1975, was the signing of a project agreement on November 23, 1975, under which the U.S. will provide 34 agriculture and water specialists to the Saudi Arabian Ministry of Agriculture and Water for collaboration in implementing that ministry's development plans.

The work of the team leader and senior specialist who have arrived in Riyadh has resulted in (a) agreements on short-term study projects in fruit and vegetable packaging and in park development in the Kingdom; and (B) discussions of long-term projects to develop the Wadi Dawasir area in accordance with the recommendations of a previous U.S. study, and to evaluate the water and agricultural resources of the Arabian Shield.

The Commission reviewed the progress of the six-man U.S. team that is in the process of doing a comparative assessment of alternatives for the future water supply for Riyadh.

Manpower and Education

Vocational Training

A project agreement was finalized which looks to further developing the Manpower Training and Development Program under the Saudi Ministry of Labor and Social Affairs. This project will involve a wide range of advisory services to be provided by 20 U.S. Labor Department specialists. The project will also provide labor market analyses, the development and implementation of capital-intensive training methodologies, and the purchase and installation of vocational training equipment.

In a related development, the Saudi and U.S. representatives also finalized a memorandum of agreement which will supplement this project agreement. The memorandum provides that the U.S. Department of Labor will be responsible for making arrangements, on a reimbursable basis, for architectural and engineering services and for the construction of vocational training facilities in the Kingdom on a turnkey basis.

Education and Higher Education

As a result of discussions held during the first Joint Commission Meeting, a team of U.S. educators traveled to Saudi Arabia to undertake an evaluation of the higher education system and to provide recommendations.

A team of U. S. educational specialists has been proposed to work, on a long-term basis, with the supreme council of universities to develop implementation strategies to further improve the higher education system. Part of this strategy will involve the development of a community college system in the Kingdom. A proposal for U.S. collaboration in this endeavor is under active consideration. The American side agreed to provide Saudi Arabia with evaluative reports respecting the community college system in the United States.

Science and Technology

The United States and Saudi Arabia today signed a project agreement under which the U.S. National Science Foundation will provide technical assistance to the Saudi Arabian National Center for Science and Technology. The agreement calls for extensive cooperation between the two countries designed to develop the Kingdom's scientific resources in a manner that is responsive to its economic and social goals.

Work on the project will begin immediately with priority being given to developing an analysis of the Kingdom's scientific resources and undertaking a variety of scientific projects between Saudi Arabian and American counterparts.

The Commission also exchanged views on the current status of a number of possible technical cooperation projects in the fields of housing, ports, desalination, and communications.

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Overall Assessment

The Commission considered the results of its second session as very useful and noted that the understandings and project agreements entered into are positive and constru-tive contributions toward strengthening U.S. Saudi bilateral economic and trade relationships as intended by his Royal Highness and Crown Prince Fahd and Secretary of State Kissinger in establishing the Commission. The Commission commended all participating departments and agencies on both sides for their efforts to date and directed them to continue exploring possible new areas of cooperation in the economic field.

The co-chairman agreed to hold the next Joint Commission meeting in Washington at the end of this year or early 1977.

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ederal financing bank NEWS
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Press inquiries: 202-964-2615

FOR IMMEDIATE RELEASE   March 8, 1976   884

SUMMARY OF LENDING ACTIVITY

February 16, - February 29, 1976

Federal Financing Bank lending activity for the period February 16 through February February 29, 1976 was announced by Roland H. Cook, Secretary:

The Federal Financing Bank made the following loans to utility companies guaranteed by the Rural Electrification Administration:

Date	Borrower	Amount (000's)	Maturity	Interest Rate
2/20	South Mississippi Electric Power Association	$4,210	2/27/78	6.827%
2/20	Central Louisiana Telephone Co.	300	12/31/10	8.184%
2/23	United Power Association	3,500	12/31/10	8.167%
2/25	Southern Illinois Power Coop.	2,700	2/25/78	6.787
2/25	Associated Electric Coop.	3,000	12/31/10	8.051%

On February 17, the Bank purchased $4,000,000 of notes from the Department of Health, Education, and Welfare. The Department had previously acquired the notes which were issued by various public agencies under the Medical Facilities Loan Program. The notes purchased by the Federal Financing Bank are guaranteed by the Department of Health, Education, and Welfare and mature on July 1, 2000. The interest rate is 8.164%.

The National Railroad Passenger Corporation (Amtrak) made the following drawings against Note No. 6, a $130 million renewable line of credit with the Bank:

Date	Amount	Maturity	Interest Rate
2/17	$10,000,000	3/30/76	5.138%
2/25	15,000,000	3/30/76	5.127%
2/27	2,000,000	3/30/76	5.205%

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On February 27, Amtrak borrowed $5 million against Note No. 4, a $120 million line of credit. The note matures March 31, 1976. The interest rate is 5.205%.

On February 27, the Bank advanced $1,056,927.72 under a November 25, 1975 agreement with Amtrak and others to finance 26 GE electric locomotives. The agreement provides for serial repayments with a final maturity date of July 15, 1989. The interest rate is 8.125%. Amtrak borrowings from the FFB are guaranteed by the Department of Transportation.

The Federal Financing Bank made the following advances to borrowers guaranteed by the Department of Defense under the Foreign Military Sales Act:

Date	Borrower	Amount	Maturity	Interest Rate
2/17	Government of China	$ 4,000,000.00	7/1/83	7.563%
2/18	Government of Israel	200,000,000.00	12/31/85	7.719%
2/23	Government of Argentina	1,064,893.05	4/30/83	7.552%
2/23	Government of Peru	6,800,000.00	12/31/82	7.503%
2/25	Government of Israel	15,312,942.94	6/10/85	7.616%
2/26	Government of Philippines	3,000,000.00	12/31/81	7.315%
2/26	Government of Philippines	3,960,000.00	12/31/81	7.315%
2/27	Government of Korea	11,557,267.34	6/30/83	7.455%

On February 17, the Federal Financing Bank paid $180,567,009.64 to the Secretary of the Treasury for New York City Note #5. The face amount of the note is $180 million and bears interest at a rate of 6.26%. The note matures June 30, 1976. The effective rate of return to the FFB is 5.385%. The Secretary of the Treasury made the loan to New York City under the New York City Seasonal Financing Act of 1975.

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On February 18, the Bank purchased a $1,220,000 debenture from the Northwestern Growth Fund, Inc., a small business investment company in Minneapolis, Minnesota. The debenture matures February 1, 1986 and bears interest at a rate of 7.965%. SBIC debentures are guaranteed by the Small Business Administration.

The US Railway Association made the following drawings against Note No. 3, a $296 million line of credit with the Bank:

Date	Amount	Maturity	Interest Rate
2/18	$3,500,000	2/23/76	5.138%
2/20	4,000,000	2/23/76	5.116%

On February 23, USRA amended Note No. 3 to extend the maturity to April 1, 1976, to allow USRA the option to renew the note for additional periods provided that the final maturity is no later than June 30, 1976, and to raise the maximum amount of the note to $296.5 million. On the same day, USRA signed Note No. 5, a $91 million line of credit maturing on April 1, 1976. To pay the FFB the $265,618,382.83 in principal and interest owed on February 23, 1976 under Note No. 3, USRA borrowed $261,496,565.80 against the amended Note No. 3 and $4,121,817.03 against Note No. 5. The interest rate on both borrowings is 5.041%.

On February 27, USRA made the following borrowings:

Note	Amount	Maturity	Interest Rate
No. 3	$20,500,000	April 1, 1976	5.138%
No. 5	1,000,000	April 1, 1976	5.138%

USRA borrowings from the FFB are guaranteed by the Department of Transportation.

On February 27, the Tennessee Valley Authority borrowed $175 million at an interest rate of 5.138%. The note matures on May 28, 1976. On the same day, the Bank purchased a $300 million Power Bond at an interest rate of 8.175%. The bond matures February 28, 2001. TVA used the proceeds of these loans to repay $480 million of notes maturing with the Bank.

On February 25, the FFB purchased $5,610,000 of Series J, Participation Certificates from the General Services Administration at an interest rate of 8.20%. The PC's mature on July 31, 2003. Proceeds from the loan will be used to complete 17 public building projects initially financed by the GSA sale of Series H and I PC's in the market before the FFB began operations.

On February 27, the General Services Administration and the FFB amended the Public Buildings Purchase Contract and Financing Commitment dated June 26, 1976. The amendment added two projects to the original contract, increased FFB's commitment to GSA from $190 million to $279 million, and changed the final maturity date of the loan to July 31, 2003. GSA makes monthly drawings against this commitment to finance the construction of public buildings.

Federal Financing Bank loans outstanding on February 29, 1976 totalled $20.2 billion.

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FOR IMMEDIATE RELEASE

March 8, 1976

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2.7 billion of 13-week Treasury bills and for $3.4 billion of 26-week Treasury bills, both series to be issued on March 11, 1976, were opened at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	13-week bills maturing June 10, 1976			26-week bills maturing September 9, 1976		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	98.725	5.044%	5.18%	[illegible]	[illegible]	[illegible]
Low	98.718	5.072%	5.21%	[illegible]	[illegible]	[illegible]
Average	98.721	5.060%	5.20%	[illegible]	[illegible]	[illegible]

	13-wk		26-wk
Last week	5.258		5.724
To-day	5.060		5.487
Low since	4.870	2/23/76	5.204

Tenders at the low price for the 13-week bill [illegible]
Tenders at the low price for the 26-week bill [illegible]

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RES[illegible]

District	Received	Accepted	Rec[illegible]	
Boston	$ 85,610,000	$ 30,510,000	$ [illegible]	[illegible]
New York	4,295,840,000	2,151,655,000	4,3[illegible]	[illegible]
Philadelphia	38,525,000	30,010,000	[illegible]	[illegible]
Cleveland	75,925,000	40,590,000	[illegible]	[illegible]
Richmond	25,235,000	24,955,000	[illegible]	[illegible]
Atlanta	44,685,000	28,990,000	[illegible]	[illegible]
Chicago	191,140,000	50,180,000	3[illegible]	[illegible]
St. Louis	74,370,000	35,370,000	[illegible]	[illegible]
Minneapolis	28,180,000	7,180,000	[illegible]	[illegible]
Kansas City	56,690,000	48,690,000	[illegible]	[illegible]
Dallas	39,600,000	19,600,000	[illegible]	[illegible]
San Francisco	511,100,000	232,580,000	496,540,000	183,340,000
TOTALS	$5,466,900,000	$2,700,310,000 a/	$5,778,910,000	$3,403,915,000 b/

a/ Includes $486,880,000 noncompetitive tenders from the public.
b/ Includes $227,960,000 noncompetitive tenders from the public.
1/ Equivalent coupon-issue yield.

ıe Department of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 964-2041

FOR IMMEDIATE RELEASE March 9, 1976 889

OFFICE OF INTERNATIONAL TAX AFFAIRS
ESTABLISHED WITHIN TREASURY'S OFFICE
OF TAX POLICY

Establishment of a new Office of International Tax Affairs within the Office of Tax Policy was announced today by Assistant Secretary for Tax Policy, Charles M. Walker.

The purpose of the new office is to provide a focal point within the Office of Tax Policy from the handling of international tax matters, including tax treaties. Personnel for the new OITA office consist of lawyers in the existing Office of International Tax Counsel, and international economists in the existing Office of Tax Analysis.

The OITA will have as its Director, Mr. Robert J. Patrick, Jr. (International Tax Counsel), and as Deputy Directors, Mr. David S. Foster (Deputy International Tax Counsel) and Mr. Gary Hufbauer (Assistant Director for International Taxation, Office of Tax Analysis). Serving under Mr. Patrick and his deputies will be their existing staffs of lawyers and economists. It is anticipated that working teams combining both lawyers and economists will be drawn together to engage in tax treaty negotiations as the need arises.

Upon announcing the new office, Assistant Secretary Walker noted that by means of this new staffing arrangement, the Office of Tax Policy emphasizes the necessity and desirability of formalizing handling of international and foreign tax matters.

In light of the expanding number of new and renegotiated treaties and participation in the increased activities of the Committee on Fiscal Affairs of the Organization for Economic Cooperation and Development (OECD) for which the office is responsible, Mr. Walker said the new office will improve efficiency at Treasury and provide better service for the public.

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The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

FOR RELEASE AT 4:00 P.M. March 9, 1976

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TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $5,600,000,000 , or thereabouts, to be issued March 18, 1976, as follows:

91-day bills (to maturity date) in the amount of $2,500,000,000, or thereabouts, representing an additional amount of bills dated December 18, 1975, and to mature June 17, 1976 (CUSIP No. 912793 ZM1), originally issued in the amount of $3,099,235,000, the additional and original bills to be freely interchangeable.

182-day bills, for $3,100,000,000, or thereabouts, to be dated March 18, 1976, and to mature September 16, 1976 (CUSIP No. 912793A9 7).

The bills will be issued for cash and in exchange for Treasury bills maturing March 18, 1976, outstanding in the amount of $5,622,225,000, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,772,115,000. 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 non-competitive 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 Standard time, Monday, March 15, 1976. 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

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(OVER)

securities and report daily to the Federal Reserve Bank of New York their positi 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 March 18, 1976, in cash or other immediately available funds or in a like face amount of Treasury bills maturing March 18, 1976. 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.

Department of the TREASURY NEWS
GTON, D.C. 20220 TELEPHONE 964-2041

March 10, 1976 892

Joint Statement
of the U.S.-Israel
Joint Committee for
Investment and Trade

Jerusalem
March 3, 1976

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U.S.-ISRAEL JOINT COMMITTEE FOR INVESTMENT AND TRADE

JERUSALEM
March 3, 1976

JOINT STATEMENT

The United States-Israel Joint Committee for Investment and Trade met in Jerusalem on March 1st and 2nd for its second regular meeting. The meeting was chaired jointly by Minister of Finance Yehoshua Rabinowitz and Secretary William Simon. Other senior officials of the two governments also participated. (A list of senior participants is attached.) During the meeting, the Committee reviewed the implementation of the Statement of May 13, 1975, and discussed ways and means to expand economic cooperation between the U.S. and Israel.

During the meeting, the Israeli members of the Joint Committee briefed the U.S. delegation on the current economic situation in Israel, the measures taken to curb inflation, reduce consumption, increase exports and slow the drain of foreign exchange reserves, as well as recently-enacted tax reforms. Proposals announced by the Government of Israel to encourage investment and increase productivity were also reviewed. The U.S. members reviewed current economic developments in the U.S. and the Administration's economic policy.

The Committee received a report on the implementation of the Joint Statement of May 13, 1975, and expressed its satisfaction with the achievements and the work performed by the Joint Steering Group, which coordinated the activities and prepared the material that 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 approved a program for further cooperation, intended to expand economic and financial ties between the two countries, and, in particular, to support the economic development of Israel through an increase in investment and trade flows between the two countries. The Committee expressed its desire that this program will contribute, as direct aid does, to a just and lasting peace in the Middle East. The strengthening and stabilizing of the economy of Israel will also aid in decreasing Israel's dependence on direct aid, although such assistance may still be needed in the near future.

To facilitate and expand economic cooperation between the two countries, the Co-chairmen signed an agreement for the establishment of the Binational U.S.-Israel Industrial Research and Development Foundation. The Committee noted with satisfaction that the U.S.-Israel Treaty to Avoid Double Taxation was now before the Senate.

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The Committee noted with satisfaction that the U.S.-Israel Industrial Research and Development Council held its first plenary meeting in Israel on December 7-12, 1975, and that the U.S. section of the Israel-U.S. Business Council will have its first meeting in Washington on March 17 at the Chamber of Commerce of the United States. Plans are now underway to hold the Business Council's first plenary session in Israel.

Principles and programs agreed upon are:

I. Economic Cooperation

The Committee indicated that an important objective of the cooperative efforts between the two countries is to assist Israel in increasing its production and improving its efficiency, so as to enable Israel's economy to progress. The Committee believes that such progress can be achieved by continued reliance upon free economic markets, by promotion of a free, cooperative and open order of world trade and investment and accordingly by continued resistance to the application of restrictive trade practices in international commerce. Members of the Committee also agreed on the importance of ensuring against discrimination in international economic relations on the basis of race, religion or national origin. The U.S. members reaffirmed the U.S. policy of opposition to restrictive trade practices or boycotts fostered or imposed against countries friendly to the U.S.

II. Encouragement of Investment

The Committee noted the incentives to be introduced in Israel to encourage investment and the additional opportunities for foreign investment resulting from the agreement between Israel and the European Economic Community. The Committee welcomed these steps which would enhance the climate in Israel for foreign investment.

The Committee encouraged U.S. and Israeli business to seek out joint business opportunities as part of their interest in achieving a stronger world economy, peace and international cooperation. It was agreed that the Israel-U.S. Joint Business Council could make a major contribution in this area.

Within the general framework of activities to facilitate investment in Israel, the U.S. expressed its willingness to:

1. organize this year a mission of high-level U.S. business executives to Israel, under the sponsorship of the Overseas Private Investment Corporation (OPIC). In this connection, OPIC will continue and renew its efforts to identify potential U.S. partners for ventures in Israel.
2. provide appropriate assistance to Israeli industrialists visiting the U.S. to seek out ties with U.S. firms.

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3. continue to publicize investment opportunities offered in Israel and assist U.S. businessmen in exploring these opportunities and helping to develop additional ones. Such investment could be a source to Israel for technology to improve industrial efficiency and increase production. This could improve the climate for further investment.

4. cooperate closely with the Business Council in its efforts to promote investment opportunities in Israel and expand and strengthen the ties between the business communities of the two countries.

In carrying out these activities, the USG will bring to the attention of the U.S. private sector the fact that the rapid industrial development of Israel creates opportunities that can benefit U.S. business as well as the economy of Israel.

III. Trade Development

1. The Committee noted the special effort made by the Government of Israel to increase exports and expressed its satisfaction that trade between Israel and the U.S. has expanded since its last meeting. The Committee agreed that a further expansion of bilateral trade is an important objective of both countries and a major task to be undertaken under the guidance of the Committee. The U.S. agreed to:

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(a) disseminate information to trade and business on opportunities in Israel;

(b) organize trade missions to Israel under the auspices of the Department of Commerce for exploration of business opportunities. In this respect it was noted that missions dealing with electronic data processing and building and construction are presently being organized;

(c) provide appropriate assistance to Israeli businessmen who visit the U.S. seeking to expand mutual trade;

(d) assist Israel by working with trade and business organizations in the U.S. and to encourage their members to visit Israel and explore the various opportunities offered.

2. The Committee noted with satisfaction that since its last meeting and as a result of discussions held between the two countries, Israel has been declared eligible to receive tariff preferences under GSP, which should enhance the opportunity for increased exports from Israel to the U.S.

3. The Committee reviewed the progress achieved in implementing a program to enable Israeli producers to sell their products to DOD suppliers and noted the importance of this effort to Israel. To this end:

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(a) Israeli members indicated their intention to appoint a special representative of the GOI to help Israeli suppliers explore business opportunities with DOD and its primary suppliers.

(b) It was agreed that potential Israeli suppliers will visit the United States in the near future to bring to the attention of DOD Military Department procurement offices and their primary suppliers the range of products that Israeli producers can offer. DOD will facilitate their visits by providing them with appropriate assistance and guidance.

(c) DOD has in the past assisted and will continue to assist Israeli producers in making contacts with DOD purchasing offices and suppliers in order to help Israeli producers ascertain the purchasing requirements of the DOD purchasing offices and suppliers, with the aim of facilitating the special efforts of Israel to expand its exports.

Both sides expressed the hope that these measures will help maximize the opportunities for the sale of Israeli products to DOD and its suppliers.

IV. Supply and Storage of Raw Materials

The U.S. noted that in accordance with the Joint Statement of May 13, 1975, the Government of Israel has

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submitted to it plans for its grain and raw material purchases in the United States. The U.S. members reaffirm that in the event that it becomes necessary for the USG to impose short-supply export controls, these purchase plans will enable the U.S. 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.

V. Scientific Cooperation

The Committee noted the Resolution of the Board of Governors of the U.S.-Israel Binational Science Foundation (BSF) passed on February 18, 1976, which states as follows: "The BSF has been allocating grants since mid-1974. Although most of the research projects supported by the Foundation have not yet reached completion, it can be stated that the projects supported by the Foundation are in areas of interest to both the U.S. and Israeli Governments. These projects were selected on the basis of high scientific and/or technological merit and of potential benefit to both countries. The BSF plays a vital role in encouraging and fostering scientific cooperation between both countries. The aim of the Foundation is to support research which will develop cooperative arrangements such as single programs carried out in each country with full coordination and exchange of scientists.

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To a greater extent than in former years, highly rated research proposals worthwhile supporting because of their potential benefit to both countries cannot be activated due to lack of funds. The Board wishes to recommend to both governments that they examine the possibility of increasing the funds available to the BSF to support its activities."

The Committee agreed to follow closely the activities of the Foundation and to determine as soon as possible whether additional funds may be desirable to increase its utilization for the benefit of both nations.

VI. Future Work

The Committee noted the usefulness of its periodic meetings and of the exchange of information on the economic developments in both countries, and decided to continue them on a regular basis. In the period between the meetings, regular exchanges of information should continue within the Steering Group and through visits of senior officials of each country to the other and meetings with counterparts. Until the next meeting of the Joint Committee, it was agreed that a study should be undertaken under the coordination of the Steering Group of further areas of cooperation as well

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as the advisability of providing appropriate formal arrangements for the joint cooperation activities, which is on the agenda for the Steering Group.

Chairman of the United States Delegation	Chairman of the Israeli Delegation
William E. Simon Secretary of the Treasury	Yehoshua Rabinowitz Minister of Finance

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SENIOR PARTICIPANTS

US-ISRAEL JOINT COMMITTEE FOR INVESTMENT AND TRADE

MARCH 1-2, 1976

JERUSALEM

Israel

H.E. Yehoshua Rabinowitz, Minister of Finance - Co-Chairman

Arnon Gafni, Director-General, Ministry of Finance

Dr. Moshe Mandelbaum, Director-General, Ministry of Trade and Industry

Avraham Agmon, Special Advisor to the Minister of Finance, Ministry of Finance

Haim Stoessel, Accountant General, Ministry of Finance

Moshe Neudorfer, Director, State Revenue Administration

Sar Shalom Shiran, Head, Budget Department, Ministry of Finance

Dov Kantorowitz, Controller of Foreign Exchange, Ministry of Finance

Gen. (Res.) Moshe Goren, Director, Israel Investment Authority

Prof. Yitzhak Yaacov, Chief Scientist, Ministry of Trade and Industry

Ze'ev Sher, Economic Minister, Embassy of Israel, Washington

Gad Elron, Head, Economic Division, Ministry of Foreign Affairs

United States

William E. Simon, Secretary of the Treasury - Co-Chairman

The Honorable Malcolm Toon, Ambassador

L. William Seidman, Assistant to the President for Economic Affairs

Gerald L. Parsky, Assistant Secretary for International Affairs, Department of the Treasury

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Travis E. Reed, Assistant Secretary for Domestic and International Business, Department of Commerce

Joel W. Biller, Deputy Assistant Secretary for Commercial Affairs and Business Activities, Department of State

Roger E. Shields, Deputy Assistant Secretary for International Economic Affairs, Department of Defense

Charles W. Hostler, Deputy Assistant Secretary for International Commerce, Department of Commerce

David Gregg, Executive Vice President, Overseas Private Investment Corporation (OPIC)

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR RELEASE ON DELIVERY
MARCH 10, 1976, 12:00 Noon

REMARKS BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
DISTINGUISHED LECTURE SERIES
MAINZ, FEDERAL REPUBLIC OF GERMANY
MARCH 10, 1976

Economic Policy in a Changing World Economy

As America celebrates its bicentennial this year, it is interesting to note that Mainz had already been a famous university city for three hundred years when the United States declared its independence in 1776. The proud traditions of both America and Mainz certainly deserve recognition but my comments this evening will concentrate on the challenges of the future, particularly the need for continued creativity and efficiency in our economic systems which must provide the foundation for stable societies.

The United States and the Federal Republic of Germany have experienced remarkable economic development. The severe recession of 1974-1975 has ended and both nations are once again expanding real output. But despite the impressive record of economic gains and the current progress of the cyclical recovery, many people remain pessimistic about current events and the future. There is a national tendency for public opinion to swing from euphoric optimism to abject pessimism while missing the middle-ground of moderate judgments and realistic expectations. If we are to overcome this widespread skepticism, government policies in the future must be increasingly based on realism. Over the years government leaders have tended to make exaggerated claims about the potential benefits of new policies to gain current political favor. When government officials promise more than can be delivered, general disillusionment and resentment eventually develop. Decisions about the allocation of national resources and distributions of the output of goods and services are the most basic of all economic issues and greater realism is required in determining national priorities.

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Longer-term planning horizons and economic policies that would give increased attention to longer-term goals which extend beyond the solution of current problems are needed. Government policies are too often simply individual responses to special interest pressures rather than a carefully integrated set of goals for the future.

Stability

The repetition of excessive fiscal and monetary stimulus followed by extreme restraint has caused a volatile pattern of economic development. The difficulty of predicting economic activity and the lagged impact of frequent policy adjustments have frustrated the fine-tuning efforts of government planners and exaggerated the extremes of economic booms and recessions.

To achieve the desired improvement in economic decisions based on realism, longer-term perspectives and stability, the United States has established the following goals:

- Sustain responsible fiscal and monetary policies which will contribute to domestic and economic progress;
- Continue the liberalization of world trade and investment based on the principles of open and competitive markets;
- Assist developing nations to grow toward economic self-sufficiency; and
- Maximize the benefits from the world's resources.

These basic objectives are shared by many other nations, including the Federal Republic of Germany. This is a union based on a realistic recognition that we share mutual national interests in promoting economic development and stability. A strong American domestic economy is vital to your interests. Similarly, your impressive economic development is important to us. Nevertheless, each country has specific national interests and this desirable diversity will occasionally cause disagreements about the technical details and procedures of international trade and finance. While it would be naive to expect consensus on every policy issue, serious discord need not occur. As long as we approach these specific problems with a cooperative attitude based on mutual respect and the underlying strength provided by healthy domestic economies we will find workable solutions. Also meaningful alliances do not require that all differences be eliminated but it does mean that our independent policies be directed toward the mutual goals of: (1) sustaining responsible fiscal and monetary policies within our domestic economies as the necessary foundation of real strength; and (2) continuing progress toward a more open and efficient international economic environment.

I. DOMESTIC ECONOMIC POLICIES

It is increasingly recognized that the pace of domestic economic activity, including employment and inflation, is directly affected by international economic developments. Although issues of national concern continue to dominate economic policies, advanced nations have a definite responsibility to manage their domestic monetary and fiscal affairs with regard to international obligations. The most significant contribution the United States can make to international economic progress is to strive to keep the pattern of growth in our domestic economy more balanced so that it does not disrupt the world economy. Unfortunately, U.S. economic policies have not provided the desired stability over the past decade. One result has been alternating booms and recessions. Another result involved the loss of price stability which characterized the American economy for almost 200 years.

Fortunately, the recession of 1974-75 apparently ended by April 1975 and a relatively strong cyclical recovery has occurred since then which has improved employment conditions in general and specifically reduced the unemployment rate without causing an acceleration of price increases as inflation has remained in the six percent zone for several months. Looking ahead, our GNP forecast indicates that 1976 will be a good year with real output gains of more than six percent. Personal consumption expenditures will provide a solid base for continued growth, and business spending for plant and equipment should improve as the year progresses, which will provide the necessary thrust to sustain the recovery beyond 1976. Of particular interest to other nations is our expectation that U.S. imports will increase in 1976 following a four percent decline in 1975. This acceleration of imports by the United States will contribute to the general recovery in other nations. This basic turnaround in the U.S. economy and relatively strong recovery over the past year is the direct result of three fundamental adjustments: (1) the unwanted accumulation of inventories was eliminated and new orders stimulated industrial output gains; (2) the "real incomes" of consumers were restored by reducing the double-digit level of inflation and initiating tax reductions and rebates to increase personal disposable incomes; and (3) employment conditions improved rapidly enough to reduce unemployment and strengthen consumer confidence.

The near-term prospects for economic growth in the United States are encouraging. However, there are still several important policy issues which must be resolved to successfully sustain the recovery well beyond 1976. This policy debate will undoubtedly continue during the coming months and the ultimate decisions will likely determine the course of the U.S. economy for many years to come.

The basic issue concerns the proper amount of stimulus needed to achieve the interdependent goals of sustaining the economic recovery and reducing unemployment without creating a new surge of inflation which would lead to another sequence of boom and recession. This same issue confronts other industrial nations as they attempt to achieve stable economic recoveries during the coming months. In the United States, the administration has proposed a set of policies which we believe will lead to output gains well above the long-term sustainable pace of the U.S. economy in order to reduce the unacceptable level of unemployment. Critics contend that this goal is inadequate and that added stimulus is necessary to sustain the current recovery and reduce unemployment. Those who argue for increased stimulus apparently believe that the government can directly accelerate the pace of the entire economy by adjusting its policies and that such stimulus can be effectively eliminated when the private sector recovers. They represent the remnants of the fine tuning school who believed, at least until recently, that fiscal stimulus was amenable to precise adjustments. Incredible as it seems, in the context of the unfortunate events of 1970-1974 there are still some who believe in this concept.

Then there are some who have not believed that the American economy would recover or that if it did it would be an extremely lethargic, almost imperceptible advance. Fortunately, the record to date reveals a vigorous though nonetheless orderly cyclical revival.

There is a third group, small but still vocal. For them it is an issue of the public sector vs. the private sector; government direction vs. the market economy. In short, the debate is between those who believe in the basic superiority of the private enterprise system, when it is allowed to function properly without overbearing government interference, and those who believe that the government must fill a permanent and increasing role if the economy is to progress.

My own conclusion is that, within recognized limits, the market system is the most efficient and creative approach since it is more flexible in responding to changing economic conditions. This does not mean that the government does not have an important role in economic affairs. Nor does it mean that the existing institutional arrangements will always exist. The market system will continue to evolve and this flexibility will enable it to remain creative and productive.

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It should also be emphasized that the Administration believes that its recommendations will lead to a more sustainable durable recovery as opposed to the disappointing results of the past decade when cyclical booms and recessions have dominated the economy. Considerable stimulus has already been injected into the U.S. economy. The Federal budget has increased 40 percent from $268 billion in fiscal year 1974 to approximately $374 billion in fiscal year 1976 and a large additional stimulus would create risks of once again overheating the U.S. economy and that businessmen and consumers would react negatively to the prospects of accelerating inflation if that deeply ingrained in our society, it should also be recognized that more stable economic policies are required to avoid the unnecessary distortions of the past decade. Increased government spending programs have proven to be a cumbersome tool for short term economic stabilization purposes. Moreover, experience has shown that programs initiated in a period of economic slack tend to become a permanent part of the budget. It is extremely difficult to reduce or eliminate even the obviously ineffective or obsolete programs and to scale down existing programs for countercyclical purposes has been for all practical purposes, impossible. This is particularly true when the sizeable outlays of the many state and local governments are added to the total.

This implies that we must avoid abrupt and excessive changes in government expenditures. No matter how well intentioned, such sharp swings in spending tend to accentuate rather than stabilize the business cycle and serve to increase the uncertainty of developing policies to meet future needs. In turn, this uncertainty is felt in the consumer markets.

II. INTERNATIONAL ECONOMIC POLICY

As we strive to improve the domestic economy, it is equally important to recognize the significance of international monetary, trade and investment relations.

International Monetary Issues

The patterns of exports and imports, the location of production facilities and international capital flows are directly influenced by currency exchange rates. Under the Bretton Woods system created in 1944 exchange rate stability was expected to be based on a comprehensive set of rules which would specify a fixed rate for each national currency. However, that system could not adapt to extreme variations in domestic economic policies, sharply differing rates of inflation, wide variance in interest rates and the resultant large capital flows which became characteristic of this period. Disruptive currenc~~y devaluat~~ions occurred, typically under crisis

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conditions. The familiar postwar monetary system based on fixed exchange rates finally collapsed in 1971 and multilateral exchange rate adjustments were agreed to at the Smithsonian meetings at year-end, but the dollar had to be devalued again in February 1973 and a period of floating exchange rates was initiated in March 1973. Since then a series of reform efforts, under the direction of the International Monetary Fund (IMF), has moved steadily ahead leading up to the interim committee agreements in Jamaica last January.

In participating in the reform efforts since 1973 the United States has emphasized the following basic goals:

1. The monetary system should be flexible.

2. Each nation should retain authority to select its own preferred solutions to economic disequilibrium, including changes in fiscal and monetary policies.

3. Competitive currency devaluations should be prevented.

4. The new system should provide a meaningful surveillance authority to enforce the rules adopted.

5. The basic goal of international monetary reform is to restore stability to the system.

At meetings two months ago in Jamaica, the world's finance ministers agreed on a series of far-reaching structural reforms in the international monetary system. That agreement represented the first general revision of our international monetary arrangements since the basic framework for the post-war economic system was created at the 1944 Bretton Woods.

We live in a different world from that which existed at the time of Bretton Woods. The Jamaica compact reflects fundamental shifts in thinking from the ideas which underlay the Bretton Woods system. It is widely acknowledged that the change in thinking -- which focuses attention on underlying economic factors -- calls for a new and different attitude with respect to exchange rates, gold, and other aspects of the monetary system. It is perhaps less generally noted that it calls also for a new perspective on the question of international liquidity.

The new monetary system agreed to at Jamaica differs fundamentally from the Bretton Woods system in the provisions setting forth exchange rate rules, and in the provisions on gold -- two of the basic components of the Bretton Woods system. Both changes stem from a common idea. The view that monetary stability cannot be imposed on a heterogeneous world by imposing a rigid monetary system -- that monetary stability can be achieved only by developing underlying conditions of stability in the major economies. That is to say the new reforms recognize that lasting stability cannot be superimposed on the world economy by forcing countries into the mold of a rigid system, but must develop and grow through the maintenance of proper policies in the national economies making up the system.

First, consider the reform dealing with exchange rates. The Bretton Woods system recognized as legitimate only one exchange rate regime -- par values. It assumed that exchange stability could be achieved by requiring adherence to a more or less fixed structure of exchange rates. On the one hand, the threat of reserve loss or the eventual share of a forced devaluation was the leverage to influence domestic policies in deficit countries. For surplus countries, it was imagined that they would act, in terms of policies, to maintain the symmetry of the system. These assumptions proved wrong. Countries did not respond as expected. The assumptions of the framers of Bretton Woods proved mistaken in another respect. They had assumed a world in which relative price stability and equilibrium would be the norm -- disequilibrium and inflation abnormal. In the first half of this decade exactly the opposite has been the case and the tensions resulting from pervasive inflaton resulted in overriding distortions which could not be accomodated within the par value system.

A final note about their assumptions and the realities of today. As a logical corollary of their views, they tended to assume minimal capital flows. Surely they would be surprised at the circumstances of today when billions of dollars can move across the exchanges in a matter of a few days.

The exchange rate arrangements agreed upon at Jamaica take a different approach, and have a different focus. The new provisions focus on underlying economic and financial conditions and acknowledge that exchange stability can prevail only if nations achieve stability in those underlying economic conditions.

A second important step involves the continued phasing out of gold from the international monetary system and an increased reserve asset and unit of account role for the SDR

The official price of gold will be terminated, and gold will no longer be used by the IMF for official transactions. One-sixth of the IMF's gold stock will be sold with the proceeds of the sale, including any profit resulting from the transaction price being above the official price, to be used by the new trust fund for assisting developing nations experiencing balance-of-payments difficulties. It is anticipated that the trust fund will handle the sale through periodic auctions, spread out over four years. Another one-sixth of the IMF's gold holdings will be sold to member governments in proportion to their quota subscriptions. In addition, members of the group of ten have agreed among themselves that (1) they will not engage in efforts to peg the price of gold; (2) that the total stock of gold held by the IMF and group of ten countries will not increase; and (3) that G-10 countries will respect the conditions on gold trading agreed to by central banks.

The third action agreed to will increase the current quotas for members of the IMF by approximately one-third from 29 billion-SDRs to 39 billion SDRs ($35 to $47 billion). The quotas for OPEC (Organization of Petroleum Exporting Countries) members will rise even more so that their total share of IMF voting power will jump from 5 to 10 percent. Other developing nations will maintain their existing proportionate shares and the relative voting position of industrial nations will decline. For example, the U.S. quota will rise from $8 to $10 billion but our relative share of total voting rights will decline from 22.1 to 21.5 percent.

The increase in IMF quotas and amendments to the articles will require formal ratification by member governments once the Executive Board clears up the remaining details. This ratification process is expected to take eighteen to twenty-four months. The United States strongly supports the agreements and anticipates a rapid response from Congress.

Another important development associated with the exchange rate agreements involves the creation of an improved consultation process to monitor currency fluctuations. The arrangements will evolve over time but it is a fact that finance ministers and their deputies and central banks have been in frequent contact to review underlying economic and financial conditions and circumstances in the exchange markets. The United States does not envision this continuous consultation process as a means of creating specific targets for exchange rate relationships involving the dollar nor will central bank intervention be used except when necessary to correct disorderly market conditions.

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The attention which all nations are now committed to giving to underlying economic conditions augurs well for the future management of our economic affairs and the control of inflation. If each nation individually can manage its affairs soundly and responsibly, and if all nations cooperate in the same vein, we will have made a great stride toward the stability in our economic affairs that we all desire. The Jamaica agreements represent an important benchmark that will enable the broad reform measures to move ahead. The United States supports these agreements as a basis for reducing instability in exchange rates.

International Trade Issues

One of the most significant postwar economic developments has been the rapid expansion of trade among market economies from a level of $55 billion in 1950 to over $800 billion in 1975. The United States strongly supports the growth of a free and open world trading and investment order. The case for free trade is based on the general concept of comparative advantage. Trade barriers typically reduce or eliminate the exchange of goods that would benefit all countries. Similarly, trade restrictions which insulate domestic producers from foreign competition reduce the pressures for controlling price increases and for stimulating creative product development. Although foreign trade has historically comprised a relatively small share of total economic activity in the United States we have remained the world's largest exporter and importer. However, during the 1960's the historical U.S. merchandise trade surplus slowly eroded because of the overvalued dollar, disadvantageous cost developments and the effective export promotion efforts of other nations. By 1971 a small trade deficit was reported and the shortfall increased in 1972. A small trade surplus was reported in 1973, following our adjustment of currency exchange rates, but record inventory accumulations and the sharp increase in the cost of oil imports resulted in a swing back to deficit in 1974. In 1975 the United States recorded a record trade surplus in excess of $11 billion as exports increased 9.5 percent and imports declined 4.1 percent. During the coming year we expect the current trade surplus to diminish as the pace of economic recovery in the United States increases and the demand for imports increases more rapidly than the continued growth of our exports.

Looking into the future the European community represents a major economic power which operates a common external tariff and an expanding network of preferential trading arrangements with other countries in Europe, Africa and Asia. Fortunately, most of the abrasive problems that have developed in trading relations have been worked out through extended periods of negotiations. However, examples of protectionist agricultural policies, administrative barriers and

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discriminatory public procurement practices persist and the expansion of preferential trading arrangements is a serious concern. Since trade issues directly affect the number and quality of jobs in each country such actions quickly become the basis for domestic protectionist pressures. The benefits of free trade are general for the entire population but the costs of economic disruptions caused by import competition are very specific and affect individual workers and companies. The continuation of the great benefits from free trade can never be taken for granted, particularly during periods of economic recession when individual nations struggle to avoid current account deficits and further loss of domestic output and jobs.

The United States has strongly supported the new round of Gatt negotiations which officially began in 1973. Within the general framework of creating a more open world trading system the United States has the following goals:

1. Reducing, harmonizing or eliminating tariffs on a broad scale.

2. Reducing or harmonizing nontariff barriers. These measures have proliferated in recent years and have often reduced or nullified the benefits of tariff cuts or have completely prevented trading. Because nontariff barriers are difficult to identify and quantify they have become a major negotiating problem. Guidelines for controlling export restraints, limiting the use of subsidies, product and safety standards, public procurement, administrative restrictions and quantitative quotas must be improved.

3. Strengthening the enforcement of international trade rules to minimize conflicts among trading nations.

4. Providing for the special trade needs of developing nations.

5. Preserving equitable access to supplies at reasonable prices. In dealing with commodity issues, the United States continues to believe that a case-by-case approach is essential and that restrictive agreements and pricing formulas are not useful for most commodities.

The United States has been encouraged by the relatively successful OECD trade pledge to avoid discriminatory trading practices during the difficult period of growing current account deficits for most industrial nations resulting from the serious international disruptions caused by the quadrupling of oil prices and the effects of the widespread economic recession. We also support the use of prior consultations within the OECD as a means of avoiding trade measures which violate the terms and spirit of the agreement. Similarly, we have supported the long negotiations attempting to develop limitations on official export credit subsidies. These issues demonstrate the difficulty of preserving an open trading system during periods of unusual economic strain and domestic pressures to protect markets and jobs.

The major thrust of U.S. trade policies was summarized in the important trade legislation finally approved in January 1975 following several years of internal debate. That benchmark legislation was a necessary prerequisite for U.S. participation in the current multilateral trade negotiations and provides the U.S. Government with the necessary flexibility for conducting its trade policies. Basic provisions include:

1. Authority to negotiate for more open access to markets and supplies with emphasis on equity and reciprocity;
2. Increased flexibility in providing excape clause relief and adjustment assistance for American industries, workers and individual firms suffering injury from import competitions.
3. Provisions for diversifying the types of actions the United States can take in responding to unfair international trade practices;
4. Authority to expand normal commercial relationships with the nonmarket economies; and,
5. Authority to fulfill the pledge to establish a plan of generalized tariff preferences for certain trade with developing nations.

We believe that the trade reform legislation is a further step in promoting a more liberal trade policy. However, some critics have described it as being potentially a restrictive measure and there have been expressions of concern in Europe about the possible growth of protectionist sentiment in the United States. This is frankly a puzzling viewpoint which is not supported by actual developments. The Treasury Department is required by law to investigate all formal complaints of alleged "dumping" of foreign products in the U.S. markets and institute countervailing duty investigations when there is a complaint of a bounty or grant on a particular commodity. However, there has been no evidence of any overt effort to tighten the existing restrictions, nor is there any indication of any growing protectionist movement. To the contrary, the protectionist pressures appear to be moderating as the major swing in trade continues. The increase in investigations is due to the fact that all pending cases received over the past few years must be completed in a very short time frame under the Trade Act limit. Major changes are occurring in comparative unit labor costs, energy costs and other competitive factors to improve significantly the outlook for U.S. exporters. We will continue to strive for the elimination of barriers to trade and the expectations and

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successful conclusion of the multi-lateral trade negotiations.

International Investment Issues

Member nations of the Atlantic community have fortunately avoided the widespread adoption of capital controls despite the distortions created by economic recession and oil price changes. Foreign direct investment and short-term credit to finance trade have played an important role in the economic development of the entire region during the postwar period. Unfortunately, short-term capital flows can also be disruptive if they are contrary to domestic stabilization goals or create significant balance-of-payments problems. Most short-term capital flows are temporary and self-reversing. However, it is occasionally necessary to neutralize these flows. For example, a basic role of the IMF is to provide official financing to assist members in overcoming short-term payments deficits. Other examples can be given in which individual countries have adjusted their fiscal and monetary policies. A third approach is to limit capital movements directly. The United States, for balance-of-payments purposes, instituted three such programs in the 1960's. The interest equalization tax was applied to securities sold in U.S. capital markets by developed countries (except new Canadian issues) and long-term bank loans beginning in 1963. In 1965 the Federal Reserve voluntary credit restraint program created voluntary guidelines for capital flows from banks and other financial institutions. At the same time voluntary restraints on direct investment were established. This program became mandatory in 1968, but unfortunately, such programs also create serious distortions in the efficient allocation of resources. The relaxation of capital controls began in 1969 and they were finally revoked in January 1974. Since then the United States has avoided controls and our financial markets have been open to foreign borrowers.

The U.S. Government has reaffirmed its intention to avoid restrictions on foreign investments in America. There have always been specific requirements that foreign investors conform to U.S. laws, and certain types of investments -- such as ownership of communication companies, nuclear energy facilities, mineral resources on federal properties, certain transportation companies and a few others -- are prohibited but in general, foreign investors receive the same treatment as domestic investors. During the period of concern about the possibility that OPEC funds would flow into American to buy up basic industries, various bills were submitted in the Congress to restrict foreign investment. The Administration strongly opposed such actions, and no additional barriers were created. The OPEC nations have given no evidence of any effort to buy up American firms or disrupt the U.S. economy. At the same time, the inflow of investments from Europe continue at a somewhat moderate pace. On the one hand, as of the end of 1974, the total book value of U.S. foreign direct investments totaled $119 billion. Of the total amount $45 billion, or 38 percent, was committed to Western Europe. From the opposite viewpoint, foreign direct investment in the United States was $22 billion, of which $14 billion, or 64 percent, was by European investors.

The near-term economic outlook is favorable and the longer-term problems can be overcome if responsible policies are sustained. But our responsibilities are not completed by merely identifying desirable goals. It remains as true today as ever that the economic performance of each nation will depend upon the effectiveness of its domestic fiscal and monetary policies and how well it adjusts to the competitive environment created by the increasing integration of the world's economic system. The United States and the Federal Republic of Germany share mutual goals in seeking stable economic progress. The disruptive experiences of the past, when cooperation failed, provide strong incentives for cooperating in the future to achieve an open and competitive international monetary, trade and investment system. The specific day-to-day reform efforts will often be slow and occasionally abrasive. However, these temporary frustrations will not cause us to lower our goals but to use more realism and determination in achieving them.

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ADDRESS BY THE HONORABLE DAVID R. MACDONALD
ASSISTANT SECRETARY OF THE TREASURY
(ENFORCEMENT, OPERATIONS, AND TARIFF AFFAIRS)
BEFORE
THE INTERNATIONAL TRADE CLUB OF CHICAGO
CHICAGO, ILLINOIS
MARCH 11, 1976
12:15 P.M.

"Annual Report on International Unfair Trade Practices"

As one of the trustees over the administration of a portion of U.S. internationl trade policy, I would like to submit to you, as fellow shareholders in the Common Weal, an annual report concerning international unfair trade proceedings which have been or are now being processed by the Federal Government. As you know, there are four major laws designed to protect United States industry from foreign exporters who engage in unfair trade practices: the Countervailing Duty Law; the Antidumping Act (which we administer at Treasury); Section 301 of the Trade Act of 1974, relating to "unreasonable" and "unjustifiable" practices; and Section 337 of the Tariff Act of 1930, prohibiting unfair practices in import trade.

The efforts of this Administration have been directed at effecting the most favorable atmosphere for international trade, while at the same time acting expeditiously to provide relief for trade distorting practices which can be harmful to domestic industry and labor.

Furthermore, we operate on the premises that:

(1) There is no inconsistency between free trade and fair trade.

(2) Meaningful remedies must be provided for injury caused by unfair trade practices, and the failure

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to provide such remedies actually is harmful to broader efforts to expand and liberalize trade generally.

(3) If voluntary discontinuance by governments of an unfair trade practice can be attained, it is preferable to achieve our ends in this manner, than to impose unilaterally the remedies available under existing legislation.

With these principles in mind, I would like to report the following for Calendar 1975:

A. Antidumping -- The sale of products into the United States at discriminatorily low prices, causing injury.

(1) The Trade Act of 1974 amended the Antidumping Law (19 U.S.C. 160) to bring it into accord with pre-existing Treasury practice and time schedules. It did not materially change Treasury's method of operation.

(2) In 1975, 25 cases were initiated (compared with ten cases initiated in 1974, and twenty in 1973).
13 preliminary decisions
12 final decisions on complaints of sales at less than fair value, eight affirmative, four negative.
Of the seven cases referred to the International Trade Commission in 1975 for injury determination, the Commission found injury in two cases and no injury in five cases.

(3) Of the cases initiated in 1975, probably most significant from a trade standpoint are the allegations that automobiles from eight countries have been dumped. These cases involve total imports of $7.5 billion.

(4) There is one new procedure initiated by reason of the enactment of the Trade Act of 1974 which deserves comment. This is a provision allowing the referral of an antidumping petition to the International Trade Commission for an initial determination whether there is "no reasonable

indication that industry is being injured, or likely to be injured." The idea is to terminate early those cases in which there is no likelihood of injury. Pursuant to this provision, three referrals were made to the International Trade Commission by Treasury and all were returned to the Treasury for investigation, the ITC being unable to determine that there was no probability of injury.

(5) My only observation regarding 1975's increase in antidumping activity is that antidumping petitions appear to be a lagging economic indicator. That is to say, an increase in dumping petitions begins to occur about six months after a downturn in the economy later decreasing during recovery. So far in 1976, we have received no new dumping petitions I can therefore affirm that we are definitely past the bottom of the recession!

B. Countervailing Duty Law -- The assessment of additional duties equal to bounties or grants bestowed upon exports from foreign governments or associations.

(1) The Trade Act of 1974 did impose substantial practical changes in the administration of the Countervailing Duty Law. First, it placed time limits on the processing of petitions for relief -- six months for a preliminary determination whether a bounty or grant exists, and twelve months for a final determination and assessment of the duty. It also empowered the Secretary of the Treasury to waive the assessment of countervailing duties if three conditions are met:

(a) Adequate steps are taken to eliminate or substantially reduce the adverse effect of the bounty or grant.

(b) There is a reasonable prospect of success of MTN negotiation.

(c) To countervail would likely seriously jeopardize this chance of success.

(2) In 1975, Treasury initiated 38 cases under the Countervailing Duty Law, including 30 which were pending from prior years. This set a record for these cases, since the total number of cases processed from the enactment of the Act in 1897 to 1974 is approximately 65.

(3) Of the 38 investigations --

(a) Thirteen were terminated at the request of the petitioners.

(b) Twenty-five preliminary determinations were issued.

(c) In addition, twenty final determinations were issued, of which ten were affirmative, and ten negative.

(4) These numbers, however, do not tell the entire story. Of the ten negative determinations, several were decided in the negative only after the foreign country in question discontinued the bounties or grants due to the threat of countervailing duties. Of the ten positive decisions, four resulted in countervailing duties with no waiver. Six waivers were granted, but of the six waivers, four were granted only after substantial reductions in the subsidies occurred. For example, on EC cheese, all subsidies on cheese for further processing or manufacture were removed and substantial percentage reductions were made on the export of table cheeses. In the case of canned hams from the EC, a 20 percent reduction was effected before the waiver was granted, and further reductions will be required in the event that the hog/corn ratio drops below 15 to 1.

(5) I should add that in the vast majority of cases, the domestic industry and interested members of Congress are consulted prior to the issuance of any waivers.

C. Section 301 of the Trade Act of 1974 -- "Unreasonable and unjustifiable" trade practices of foreign countries.

(1) Of five complaints received under this new section, one case, involving discriminatory treatment of non-Guatemalan shipping companies, has been determined to be an unjustifiable trade practice. An appropriate remedy is still under study. A second case, involving a quota placed by Canada on eggs exported from the United States, has been resolved with a largely increased quota for U.S. eggs.

D. Section 337 Cases -- Unfair competition in import trade.

(1) Seventeen cases are under consideration by the International Trade Commission, the agency with primary jurisdiction. The bulk of these cases relate to patent infringement, in which the complainant intends to exclude the infringing product, but some cases involving tying arrangements and exclusive dealing arrangements are pending before the International Trade Commission.

Trade Policy Regarding Subsidies and Countervailing Duties -- Tokyo Round of Multilateral Trade Negotiations

In addition to the administration of existing unfair trade legislation, the Administration is working in the GATT to harmonize each country's practices in order to avoid trade confrontations and yet protect American interests from harmful and unjustifiable practices. The principal effort is taking place in the subsidies area.

The first meeting of the Subsidies/Countervailing Group of the GATT Tokyo Round negotiations took place last November; the next meeting is scheduled for April 5. The United States has submitted a position paper regarding a proposed Subsidy Code which would be binding upon subscribing countries.

Under the U.S. position paper, all subsidization which tends to promote exports would be prohibited, whether or not it causes injury to a domestic industry and whether or not the exports are destined for the United States or a third country. Those subsidies, on the other hand, which apply equally to domestic and foreign sales, such as regional aid programs, would only be prohibited if injury resulted to an American industry. Finally, certain practices which technically may be regarded as subsidies, such as export financing arrangements and trade fairs would be allowable, with appropriate limitations, without regard to injury.

The basic trade-off envisaged by the U.S. position paper would be that certain subsidized exports to the U.S. would be subjected to an injury test or would be allowable, while other subsidized exports to third countries as to which the United States can presently do very little would be effectively prohibited without an injury test. Up to this point, much of the discussion in Geneva has revolved around the fact that the United States applies its countervailing duties on the basis of foreign subsidies only, without being required to find injury to domestic industry. Although the GATT requires an injury determination before countervailing duties can be imposed, the United States is not subject to this requirement by reason of a "grandfather clause", which allows U.S. legislation antedating our accession to the GATT to stand. This is not, however, as much a derogation from the GATT requirement as may appear at first blush, since the Treasury Department will not initiate a countervailing duty investigation unless it has received a petition on behalf of an aggrieved industry. Our experience has been that when an industry is willing to go to the expense of acquiring information to file a complaint, it certainly feels it has been injured. In any case, it is our position that the GATT should be revised to eliminate the injury test in cases of an export-tilted subsidy. We analyze the export-tilted subsidy as nothing more than a unilateral negativing by one country of the legitimate tariff rate of the country to which the exported goods are shipped.

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Conclusion and General Observations

Finally, I should point out that the job of our Special Trade Representatives in the Tokyo Round of negotiations is many times more difficult than it has been in the past. In prior negotiations, tariff reductions were the primary objective. These are quantifiable and measurable impediments which lend themselves to negotiated reductions. The present Round of negotiations, on the other hand, is designed primarily to eliminate non-tariff trade barriers. Oftentimes these trade barriers are found in the domestic practices of the negotiating country; they are not easily measured or compared; and they are the subject of sensitive "country interests." To dismantle as many of these barriers as possible is the ambition of the Tokyo Round.

At Rambouillet, the President gave new impetus to the Geneva negotiations by urging that the bulk of the agreements in many areas be completed by the end of 1977. This does not mean, of course, that our negotiators will be inclined to reach an agreement merely for agreement's sake. That mentality, as every businessman knows, causes disastrous results. If no arrangement advantageous to the United States and to the harmony of mutually beneficial trade can be made in the multilateral trade negotiations, no agreement will be made at all.

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FOR RELEASE ON DELIVERY

STATEMENT BY THE HONORABLE GEORGE H. DIXON
DEPUTY SECRETARY OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
HOUSE COMMITTEE ON BANKING, CURRENCY AND HOUSING
THURSDAY, MARCH 11, 1976, 10:00 a.m.

Mr. Chairman and Members of this Committee:

I appreciate this opportunity to testify on behalf of the Treasury Department and the Administration.

As you know, for six years, beginning with the appointment of the Hunt Commission, this Administration has sought, as a principal legislative objective, the enactment of comprehensive financial reform--the Financial Institutions Act. Now this Committee has the opportunity to take an important step toward enactment of the most far-reaching financial legislation in 40 years, legislation that will serve the general public interest and provide benefits for growing numbers of users of financial services. This Administration continues to be a strong advocate of financial reform. We want to work with you to achieve it.

The philosophy underlying the FIA is quite direct: if we increase competition among financial institutions, we will enhance the quality and reduce the cost of financial services to consumers, and at the same time strengthen the institutions themselves. Such legislation will be of particular benefit to thrift institutions since it should help them avoid the cyclical episodes of disintermediation which have impinged so heavily on their ability to finance housing. We are convinced that the time to act on this legislation has come.

The Hunt Commission's recommendations regarding financial structure reform were first reflected in Administration legislation introduced in 1973. Hearings were held by Senator McIntyre's Subcommittee in both 1973 and 1974 and the bill was reported by the full Senate Banking Committee in December 1974. Throughtout this period and into early 1975, the Treasury Department, on behalf of the Administration, carefully surveyed the views of the affected institutions and those of interested members of the public, including representatives of consumer groups.

Then in March 1975, the bill was reintroduced with some important improvements that had resulted from this careful review process. And, finally, on December 11, with a significant amendment allowing the payment of interest on demand deposits, the Financial Institutions Act of 1975, including the first six titles of the Administration's bill, but excluding Title VII, which incorporated the Mortgage Interest Tax Credit, passed the Senate by a vote of 79-14.

Your own study, Financial Institutions in the Nation's Economy, also took up the issues presented by the Financial Institutions Act and made them the subject of extensive hearings and discussion. The basic elements of fundamental financial reform, therefore, have become well established and are now ripe for enactment.

A principal and important thrust of FIA is to increase competition. In the past the institutional structure of the private financial institutions that make up our unique system has kept them from being fully competitive. The government, both through legislation and regulation, has been a party to this circumstance. By encouraging greater competition, the bill will provide new opportunities for savers to receive a competitive rate of return on their savings while, at the same time, provide home buyers with greater assurance that the availability of funds for home mortgages will not be disrupted during periods of high interest rates and competition for investment funds.

The FIA is designed to increase the strength of our financial institutions, particularly the thrift institutions, by permitting them, and equipping them, to respond more readily to economic change, whether long-run evolutionary change or short-run changes in the immediate economic environment. The consumer will be the clear beneficiary.

Specifically, the FIA will enable savings and loan associations and mutual savings banks to offer checking accounts and negotiable order of withdrawal accounts to both business and individuals (Section 202(c)). It will allow them to diversify a portion of their assets into consumer loans, unsecured construction loans, commercial paper, and certain high-grade private debt securities (Section 301). Credit unions also will be allowed to offer checking account services and mortgage loans to members, make a wider range of loans at more varied interest rates, and establish a limited liquidity facility (Title V).

To improve the overall availability of mortgage credit, and to provide greater stability in the availability of mortgage credit, commercial banks, savings and loan associations, and other lenders will be given a tax credit incentive to enlarge their mortgage lending. The tax credit incentive will be on a graduated scale, ranging from 1.5 percent to 3.83 percent, depending upon the proportion of assets invested in residential mortgages. (Title VI)

In addition, to benefit the saver, the FIA provides for the elimination of Regulation Q 5-1/2 years after the effective date of the Act (Section 103).

The Administration seeks financial institutional reform which is both balanced and competitively fair. Debates on the meaning of fairness, and the reasonableness of new proposals are part of the give and take that must always accompany the creation of a new order of things. Such debates can be endless. The aims of the FIA have been to strengthen the Nation's system of financial institutions, promote competition, increase the availability of consumer financial services, and to treat institutional groups even handedly.

We believe, Mr. Chairman, that FIA is a useful legislative road map. Against this background, three principal aspects of your Financial Reform Act cause us concern.

First, we believe all institutions should be permitted to accept demand deposits or other third-party payment accounts.

Demand deposits represent a source of funds which at their core should be stable in volume and cost and relatively immune to disintermediation. The ability to offer such accounts will materially assist thrift institutions in competing on both a price and service basis with commercial banks. We are at a loss to understand the FRA proposal to grant these powers to savings and loan associations and credit unions only if the laws of individual States are also changed to permit such accounts. The "McFaddenizing" of deposit powers would be counterproductive in terms of the overall direction of financial reform. The merits are all in the direction of making these powers universal.

As you may know, we have also accepted the provision in the FIA which would permit the payment of interest on demand accounts. This is clearly in the interests of consumers.

Second, we are strongly opposed to the provisions of FRA which would require a 1/4 percent differential for thrift institutions and banks which maintain a specified percentage of housing-related and liquidity assets. We doubt that to use the differential as an incentive to provide funds for housing will succeed. Thrift institutions, by desire, experience, and tradition, will continue to invest the bulk of their resources in housing as they do now. Commercial banks, on the other hand, will think long and hard before opting to qualify by increasing their mortgage lending. I would estimate that few commercial banks would do so. The trade-offs between higher interest costs for deposits and the consequences of an altered asset mix for sound balance sheet and earnings management will be difficult to analyze.

I hardly need remind the Committee that Regulation Q has not protected our financial institutions from disintermediation and has almost certainly contributed to the scarcity of mortgage credit in high interest rate periods. It has done this largely at the expense of savers who, in the end, are the key to the availability of funds for housing and for all others forms of investment. Traditionally, the objective of the differential has been to allow thrift institutions to pay a higher rate of return on deposits as an offset to their inability to offer the same range of consumer services as banks. Once these services have become substantially equal for both deposits and loans, we believe that the regulatory agencies in the interest of competition should have discretion to and should in fact eliminate the differential. To eliminate the differential is in part, therefore, a matter of achieving competitive equity.

Thus, we propose again that Regulation Q be eliminated within five and one-half years and that regulators be entrusted to accomplish this and to adjust or to eliminate the differential in the interest of consumers, the availability of mortgage credit, and of fair competition.

Third, we oppose the proposal to use the Federal Home Loan Bank System and the Treasury Department to finance the mortgage market. We believe that it would lead to an unnecessary extension of a direct federal role in the mortgage market. It would tend to raise the cost of all Treasury borrowing during tight-money periods, and would encourage disintermediation. Thus, it would be self-defeating. It would tend to "crowd out" other borrowers with legitimate, desirable needs. It would largely duplicate programs of FNMA, GNMA and existing FHLBB advances. It would be difficult, perhaps impossible to administer equitably.

We continue to believe that to improve the overall availability of mortgage credit, and to provide greater stability to that credit, commercial banks, savings and loan associations and other lenders should be given a tax credit incentive to enlarge their mortgage lending. You will recall that the mortgage interest tax credit (MITC), included in the FIA would be a graduated scale, ranging from 1.5% to 3.83%, depending upon the proportion of assets invested in residential mortgages. The MITC would be a permanent incentive for greater mortgage lending. It would tend to provide a maximum tax credit during periods of tight money, and in that way act as an automatic stabilizer for the flow of mortgage credit.

I am sure it is clear that we believe the FIA to be extremely important legislation which provides a clear statement of national policy on basic, substantive financial reform. It is a plan designed to build a financial institutional system which will be better able to serve us all. It is time for its enactment.

Mr. Chairman, we will provide you as promptly as possible with written comments regarding other provisions of the FRA in the general area of institutional reform.

Now I would like to turn to the question of regulatory agency reorganization.

Our financial institutions, and particularly our commercial banking system, are emerging from the nation's deepest recession in the post-World War II period with a demonstrated ability to withstand substantial economic adversity. Comments about problem loans, insider loans, disclosure of confidential examination reports, and other matters may have diverted our attention from this fundamental point. Regulators, along with the bankers they regulate, can share credit for this powerful evidence of the strength of our financial institutions.

It can hardly surprise us that problem loans have surfaced. What is more important and exceedingly reassuring is that the industry has faced unanticipated problems but has been able to increase its capital base and show remarkable earnings vitality even when earnings have been affected by deductions for unusually large loan loss provisions. Let us recall, too, that the regulatory role has traditionally been to protect depositors and maintain public confidence in the banking system as a whole. By this measure the record is good. Over the years, losses to depositors have been nominal and in the case of recent bank failures such losses have been non-existent. Public confidence in the banking system remains strong.

My point is simply that the walls are not tumbling down. It is not necessary to rush hastily into a reorganization of the regulatory system. There is time to approach the issue thoughtfully, deliberately, carefully and dispassionately.

We believe the present regulatory arrangments have generally worked well and that they should be largely preserved. We would, however, like to see the agencies strengthened by prompt enactment of the additional enforcement powers they have requested from the Congress. These would permit more expeditious handling of problem bank and bank holding company situations,permit acquisition of a problem bank by an out-of-state bank holding company, strengthen penalties for violation of cease and desist orders, permit easier removal of officers and directors of banking institutions, place limits on loan to insider, and permit divestiture of a bank holding company subsidiary. We endorse these proposals wholeheartedly.

Strengthened enforcement powers, along with continued improvement and refinement of the techniques of bank examination and regulatory supervision, including the use of computers and financial models, offer the greatest return in terms of modern, dynamic and effective supervisory practices. We believe that each of the three supervisory agencies with jurisdiction over commercial banks have made major strides in recent years in improving their methods and practices. The on-going changes in the Comptroller's Office have, perhaps, been the most dramatic, but each of the agencies can present a comparable list of improvements. As against a "competition in laxity," there is today a competition in regulatory excellence. It would be unfortunate if the energies of the supervisory agencies were diverted to organizational matters at the expense of their primary work at a time of major institutional change.

By contrast, there is no evidence that a single regulatory agency will insure either greater efficiency or better supervision. There is virtue in diversity. We think that consolidation might well restrict the ability of the banking industry to undertake healthy and constructive innovation in the provision of consumer services. Moreover, the uncertainty created by regulatory reorganization might well impair the willingness of banking institutions to engage in innovation.

We believe it would be wrong to separate the responsibility for the exercise of monetary policy by the Nation's central bank from a responsibility for regulation and examination. There is an inextricable link between monetary policy and bank supervision. The banking system is the primary vehicle through which the Federal Reserve implements monetary policy. A continuing, day-to-day contact with banks throughout the country through the regulatory process gives the Federal Reserve both an appreciation of and an ability to influence banking developments. Thus, for example, the level and mix of loan commitments and the adequacy of contingency planning are matters that are within the purview of bank regulators, but have a critical impact on the ability of the Federal Reserve to execute monetary policy. A build-up in loan commitments may be an important consideration in determining what actions are needed to control monetary and credit expansion. The adequacy of contingency planning by banks, the measures they would take to meet unforseen adversities, also is of critical interest to the Federal Reserve, since a lack of such planning may weaken the System's ability to fulfill monetary policy goals.

We cannot stress too strongly the need for the Federal Reserve to have at its elbow every tool that offers to prospect of assisting in the determination of monetary policy; for wisdom in that policy is essential for our fight against inflation, and to our domestic and international economic well-being.

Based on the GAO study, with which you are familiar, there is also some question as to whether there would be any significant cost savings from consolidation. The analysis suggests that there is little or no overlap in a majority of regulatory operations. Even where there is some duplication, however, it could not be known for a considerable time if any savings could be achieved.

The Financial Reform Act would concentrate regulatory and supervisory control of over eighty percent of the banking assets in a single agency. Such concentration might inadvertently weaken or impair the dual banking system.

In our judgment, Mr. Chairman, now is not the time to reorganize or consolidate our regulatory agencies.

There are serious questions which need careful study and deliberation in an atmosphere free of the heat and emotion of the moment. We need to deal with fundamental problems. What is the role of the regulator? Is it only to protect depositors and the public against the consequences of an institutional failure? Is it to serve as a kind of super-management? Should it be to shape and guide the evolution of the industry? When basic powers have been equalized, should we have separate regulators for banks and savings and loans association and for credit unions? What is the future of the dual banking system? Can we avoid the rigidity which seems to be the inevitable result of the creation of a single regulatory agency? Can we afford to give up the laboratory for experiment which is provided by the present organization of the supervisory agencies? What is the most appropriate relationship between the conduct of monetary policy and the administration of bank examinations and supervision?

None of these are easy questions. Mr. Chairman, we stand ready to participate with you in a careful study of these and other issues which could provide a basis for the further development of our regulatory system.

In the meantime there is much that can and should be done. The proposals to strengthen the enforcement powers of the agencies should be enacted. The regulators must continue and intensify the improvements in supervision and examination which are already underway.

Most importantly, this Committee and this Congress have a great opportunity to make a permanent contribution to the health of our financial institutions so that they may better serve the consumer. We look forward to working with you to accomplish these objectives in the immediate future.

It has been a pleasure to appear before you this morning. I would be pleased to respond to any questions that you might have.

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The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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MEMORANDUM FOR THE PRESS: March 11, 1976

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10 MAJOR ECONOMIC INFORMATION GAPS

By William E. Simon
Secretary of the Treasury
Chairman, Economic Policy Board

Inadequate and misleading information is one of the ultimate enemies of sound public policy formulation. Unless the air is cleared of the fog of myth, ignorance and misconception that surrounds many aspects of the U.S. economy, America's search for vigorous and durable growth with a minimum of inflation and unemployment will continue to be severely handicapped.

What are some of the economic myths that have gained popular currency? Following are 10 of the most common. The facts countering these myths are offered as a contribution toward stimulating the clearer perception and greater understanding that must accompany sound policy-making.

Myth #1: Budget deficits do no real harm -- it is "only money the people owe to themselves."

Budget deficits have been recorded in 16 of the past 17 years, with that for the current year (fiscal 1976) projected at $76 billion, a record high. Such budget deficits are a major source of distortion and instability and harm the economy in these ways:

-- Fiscal flexibility of the Federal Government is limited by the growth of interest payments on the mounting Federal debt which rose in the past 10 years from about $320 billion to $570

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billion. The annual interest payment on this debt now amounts to an estimated $38 billion, or nearly a tenth of all budgeted expenditures for fiscal year 1976. Interest payments are a prime example of "uncontrollable" outlays and, to the extent they increase and put pressure on the total budget, they may displace spending for other programs or bar tax decreases.

-- Deficits interfere with the orderly application of monetary policies in two ways. One is when the deficit levels rise and fall by large amounts, causing substantial swings in the debt-financing activities of the Treasury Department. The second is by inducing a larger increase in the money supply than might otherwise take place. Both effects result from the need for the Federal Reserve System to accommodate Treasury financing activities so as to minimize their impact on the orderly operation of our financial markets.

-- Deficits place Treasury in a position of competing with private investors for the available supply of savings. As interest rates rise in line with the expanded demand, the nation then experiences the phenomenon known as "crowding out." Those crowded out -- unable to borrow -- may include prospective homeowners or businessmen needing funds to invest in modernized plant and expanded job opportunities.

-- Finally, deficits aggravate inflation in several ways:

*Through the induced increase in the money supply.

*Through the direct impact of higher interest rates on production and living costs.

*Through the reduced capital investment induced as people are "crowded out" by large deficits -- which increases production bottlenecks and leads to less efficient production at higher costs.

*Through the pressures that higher spending puts on the aggregate demand for goods and services, which helps push up prices.

*And deficits, continuing year-in and year-out, fuel those inflationary expectations which subtly and insidiously erode people's confidence in their government, their society and the future and which must be wrung out of the economy if we are ever to control inflation itself.

Myth #2: Defense outlays account for the sharp rise in the Federal budget.

Not so. For over a decade, the portion of the Federal budget earmarked for defense has declined substantially and the nondefense portion has risen correspondingly.

In actual dollar amounts, defense outlays increased from $45.9 billion in fiscal 1960 to an estimated $92.8 billion in fiscal 1976.

However, prices have risen 127 per cent in this period so that current defense outlays, though doubled, have dropped more than 10 per cent in real defense purchasing power. In other words, two defense dollars today buy less than what one dollar bought in 1960.

As a share of the Federal budget, defense outlays declined from about 50% in fiscal 1960 to 25% in fiscal 1976. Defense outlays have also constituted a declining share of our Gross National Product, falling from 9.3% of GNP in fiscal 1960 to 5.8% this year.

Significantly, a rising share of the defense budget has not been going for weapons, planes and ships but for payroll, pensions and related personnel costs. Such costs rose from 43% in fiscal 1964 to 55% in fiscal 1974 and are expected to fall only slightly, to about 52%, this current year.

Federal nondefense spending simultaneously has risen steadily from approximately 50% of the budget in fiscal 1960 to a current 75%. The greatest single increase in nondefense outlays has been in the income security categories -- social security, unemployment insurance and other government payments to individuals.

Myth #3: The growth of government is no greater than the growth of our expanding economy.

Growth in government spending has far exceeded the rate of expansion of the economy. Over the past 20 years, annual Federal spending has risen by about 430% while our Gross National Product -- the total output of goods and services -- has risen by only 288%.

The Federal budget, which averaged 18.3% of GNP in 1956-60, rose slowly to 19.1% in 1961-65 and to 20.3% in 1966-74. Then in fiscal 1975, Federal spending increased by nearly 21% while GNP increased by about 6%, and the proportion of Federal spending to GNP rose sharply to 22.5%. In the current fiscal year, Federal spending is expected to increase by another 15% and GNP by roughly 10%, with the proportion of Federal spending to GNP rising to 23.5%.

Total government (Federal, state and local) shows similar growth. Over-all government spending averaged 35% of GNP during the calendar year 1975 -- up from 27% in 1960 and 21.3% in 1950 (and 12% in 1930). The Office of Management and Budget has concluded that, if present and projected government spending trends are allowed to continue, the ratio of total government spending to GNP might reach a range of 55% to 60% by the end of this century.

This would necessarily involve a major transfer of decision-making from the private sector, which we look to for innovation, job creation, productivity gains and rising living standards. Individual freedoms and personal spending decisions would be increasingly restricted as larger portions of paychecks go to support an ever-expanding government. More power for a ballooning bureaucracy would mean increased regulation and a far less efficient economy, plus a smothering of incentives for businesses and individuals alike, whose freely made decisions in the marketplace have brought America an unmatched prosperity.

Myth #4: Bureaucratic growth is overstated -- government employment is actually growing less than the over-all work force.

This is true only for Federal employees. Actually, government employment is booming but the big growth is at the state and local levels rather than in Washington.

Over the past 10 years the number of public employees has risen at more than double the growth rate of the private sector. In 1965, government at all levels employed about 10 million people, in contrast to 61 million workers in the private sector. In 1975 public employment had grown almost 50% to 14 1/2 million while workers in the private sector had risen to 71 million, an increase of less than 20%.

Employment in state and local government, which stood at nearly 8 million in 1965, by 1975 had swollen to more than 12 million. Federal civilian employment, on the other hand, rose by less than 400,000 during the past decade -- from nearly 2.4 million to about 2.7 million.

Another measure of change in this area: In 1950 only 1 in 10 workers was a government employee; by 1975 this ratio had shifted to 1 in 6.

Part of the boom in state-local employment has been fueled by Federal aid programs. State and local government spending more than tripled from $74.5 billion in 1965 to $229 billion by 1975. Meanwhile, Federal grants-in-aid to state and local governments nearly quintupled from $11.1 billion in 1965 to $54 billion in 1975, or from 15% of their total expenditures to 23.5% of the total.

Myth #5: We could balance the budget if the wealthy would pay their fair share of taxes.

The great majority of wealthy taxpayers do pay their share of taxes, and the Administration has been recommending legislation since 1973 that would close loopholes against those few who, because of various exclusions, deductions and shelters, pay little or no Federal income tax.

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Present rates on all taxable income -- dividends, interest and other capital income, as well as wages and salaries -- range from 14 per cent to as high as 70 per cent. Those below the poverty line, of course, pay no personal income tax. A recent Brookings Institute study showed that Federal personal income taxes as a proportion of total income actually ranged from about 1 per cent for lower-income families to 17-18 per cent for families with incomes over $100,000 (many of the latter, of course, receive little return, aside from social security in direct government pay-out benefits).

There is no way that increasing the taxes on the wealthy alone could balance the budget. The Federal deficit for fiscal 1976 is projected at $76 billion. This is almost equal to the total income to be reported in calendar 1975 on tax returns with adjusted gross incomes of $50,000 and over. Under present rates, these taxpayers will pay around $21 billion in personal income taxes. Even if they paid a 100 per cent average tax rate, it would not make up for the deficit.

The fact is that the tax burden is heavy on everybody. Federal tax receipts of $298 billion for the current fiscal year represent a contribution of $4,150 from each American household. These receipts are double the tax take in 1968 and four times the tax take in 1956. It is also worth noting that a Conference Board study last spring showed that total taxes -- Federal, state and local -- have been among the most rapidly rising items in the typical family budget; while the cost of living climbed about 40 percent since 1969, total taxes increased 65 percent.

More important, the Federal tax structure in particular is riddled with complexities that create not only confusion but a loss of public faith in the basic fairness of the tax system. That is why I have proposed fundamental reform based on fairness and simplicity that would wipe the slate clean of the hodgepodge of tax preferences, deductions, credits and exclusions and impose instead a single progressive tax on all individuals. This would assure that everybody pays their fair share and would give the American people a tax system they can both understand and trust.

Myth #6: Government loan guarantees "don't cost the taxpayer a penny."

Government loan guarantees have been enacted by Congress for more than 100 special programs. Loan guarantees currently outstanding total more than $200 billion, up from $91 billion in 1965. They have been increasing by about $15 billion annually in recent years, from $184 billion at the end of fiscal 1974 to $199 billion in 1975 and to an estimated $215 billion by June 1976.

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Government loan guarantees involve substantial costs to taxpayers and the economy, varying according to the nature of the programs and the different types of subsidies provided by Congress for these programs. For example...

--Default costs. All guaranteed loans involve government assumption of credit risks and thus pose huge potential costs to the federal taxpayer in the event of default.

--Principal subsidies. In some cases the Federal Government enters into loan guarantee arrangements with the expectation of paying part or all of the principal amount of the loan, so that the guaranteed loan amounts to an outright grant of taxpayer funds. For example, experience indicates that the $14 billion of guaranteed public housing loans outstanding will probably have to be repaid by the Federal taxpayer.

--Interest subsidies. Many guaranteed loans provide for direct interest subsidies -- such as loans for students, rural community facilities and subsidized private housing. The federal budget shows estimated expenditures of $1.5 billion for interest subsidies on guaranteed loan commitments in fiscal year 1975.

--Administrative costs. Some loan guarantee programs involve fees charged by federal agencies to cover administrative expenses for the programs. However, other programs incorporate no such fees, or the fees are not adequate to cover such costs.

--Market impact. Finally, there are incalculable costs to the taxpayer and the economy resulting from the impact on financial markets and on the allocation of credit of government loan-guarantee loan-insurance and other credit-assistance programs. The financing of these programs, which is done largely outside the federal budget, when combined with the financing of the budget deficit, currently consumes about half of the total new credit generated by our economy and about three-fourths of the new credit available to finance securities issued in the long-term capital markets. Non-subsidized borrowers suffer in terms of the availability of credit or the interest rate demanded, or both.

During the decade from fiscal 1967 through fiscal 1976, Federal budget deficits are totaling $230 billion while net borrowings for Federal programs not included in the budget, including loan guarantees, total another $165 billion. The Federal Government has thus sopped up nearly $400 billion -- more than a third of a trillion dollars -- out of the pool of savings available for public and private financing needs in this single decade.

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Myth #7: Government regulation should be tightened to ensure that business operates more in the public interest.

While government regulation originally was aimed at preventing business abuses, regulation in all too many cases has now come to constitute an abuse in itself, often preventing business from operating efficiently and in the public interest.

Federal regulatory agencies now exercise direct control over transportation, power generation, communications and the securities market -- industries that account for 10% of everything made and sold. Business in general has also come under more and more central dictation in the areas of environmental protection, consumer requirements, hiring practices, job safety and operations reporting. Worse, the economic burden represented by these multiplying regulations amount to tens of billions of dollars a year -- a cost borne by the American consumer in every item purchased.

One major corporation recently disclosed a study it made which showed that government regulation is costing this one business $1.3 billion this year. This is more than the firm paid out in dividends in 8 of the past 10 years, and was nearly as much as it spent last year to modernize and expand plant and equipment and provide new jobs.

Just the paperwork burden of government regulation is staggering. Individuals and business firms spend over 130 million man-hours a year filling out over 5,000 government forms. Even more costly is the paperwork burden within government itself. The Commission on Federal Paperwork estimates that Federal spending to process forms totals an incredible $15 billion a year. In fact, just the cost for forms themselves runs to a billion dollars annually, and one department -- Agriculture -- maintains nearly a million cubic feet of records and spends $150 million yearly on reporting systems. And when government and businesses are so burdened, it is not just they who pay the penalty. Everyone pays -- the taxpayer and consumer alike.

While most government restrictions were no doubt prompted by desirable objectives, the pendulum now seems clearly to have swung too far toward too much government interference in the marketplace. Further tampering with the competitive enterprise system through controls, regulations, quotas, subsidies and handouts can only make the economy less responsive and less efficient -- reducing the size of the economic pie for everyone instead of prompting its expansion to afford everyone a bigger slice.

Myth #8: Profits are excessive and help fuel inflation.

While opinion polls show that the public thinks companies average 33% out of each dollar in after-tax profits, the reality is less than 5%. And what profit is earned (after government takes its tax cut) is returned to shareholders, which directly or indirectly

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include almost everyone, or is plowed back into modernized plant and equipment. This generates higher productivity which helps to curb inflation.

Thus, in a competitive-enterprise system, the profit incentive is a major factor which exerts downward pressure on the rate of inflation. As long as new companies are able to enter markets and existing companies are able to expand, businesses will generally strive to maximize their efficiency in production, distribution and marketing.

This continual quest for more efficient ways to do business and earn more money results in more investment, which creates more jobs and increases productivity; this is the only way that Americans as a whole can realize gains in real income and real standards of living.

In recent years, profits have been lagging badly. For the five-year period 1970-74, after-tax profits of manufacturing corporations averaged 4.4 cents per dollar of sales, down from an average of 5 cents per dollar of sales during the previous decade.

From 1965 to 1974, profits of non-financial corporations rose from $38.2 billion to $64.5 billion, an apparent large increase. However, when allowance is made for inflation, and when factors such as depreciation of plant and equipment are put on a more accurate basis to reflect replacement rather than original costs, 1974 profits were only $18.1 billion -- not a gain but a decline of over 50 per cent. And when dividend payments are subtracted from these adjusted profits, the resulting retained earnings become wholly inadequate to finance the capital expenditures needed to expand and modernize productive plant and equipment.

America's capital investment needs over the next decade are estimated at from $4 trillion to $4.5 trillion -- three times that of the past decade. Without adequate profits to stimulate adequate investment, we could not hope to increase productivity, and the end result would be higher inflation, higher unemployment and a host of other problems.

Myth #9: The way to really stop inflation is to impose wage and price controls.

This is one of the more insidious of all economic myths, and it can only be concluded that most advocates of controls have short memories, little knowledge of history, and limited approaches to economic analysis.

The fact is that controls have not worked since they were first tried in the days of ancient Greece. They don't stop inflation; they ultimately stimulate it. And they deal only with the results of inflation, not the causes -- like taking aspirin for a fever rather than the hard medicine needed to clear up the infection.

World War II is often cited as a control "success story." What is seldom mentioned, however, is that when controls were phased out after the war, wholesale prices, bottled up for several years, exploded 30 per cent in only 12 months.

When controls were imposed in 1971-74, they temporarily suppressed some prices and wages, but at the expense of severe distortions. This was because profits were squeezed down by controls in many basic industries like steel and paper, causing expansion plans to be cut back, aggravating shortages and finally increasing rather than lessening the pressure on prices -- one major factor that pushed us into double-digit inflaction in 1974 and triggered the recession.

Controls are counter-productive because they frustrate natural market forces. For example, when demand for a product rises in relation to supply, the price also rises. Profits of existing suppliers go up temporarily. More important, profit opportunities are increased for new producers as well; the vying for customers between old and new competitors increases the supply and the price tends to go down again. Conversely, a freeze on prices, wages and/or profits dampens the incentive to produce and shrivels up supplies over a period of time. Imbalances in demand and supply for the product are then reflected in such things as rationing, black markets, curtailment of expansion, flow of capital and goods out of the United States to countries where profit opportunities are better, and many other results contrary to the objectives that the price controllers are attempting to achieve.

In short, controls distort investment decisions and the allocation of resources, distort markets and exports, and keep natural forces from reacting to remedy economic defects. And controls offer a cruel choice: whether to lift them eventually and cause grave problems of inflation, unemployment or both, or keep the lid on and ultimately stifle the individual enterprise system. That is a choice we should never have to make; it can be avoided by avoiding controls themselves.

Myth #10: <u>Inflation isn't all that bad -- most people can boost their incomes fast enough to keep ahead of price increases</u>.

This may be true for many -- for the wealthy, the powerful, the privileged and the propertied. However, this only underscores the fact that inflation hits hardest at those who can least afford it -- the poor, the unemployed, the disabled, the dependent, the elderly and those retired on fixed incomes. For example. . .

*At 1974's inflation rate of 12%, a person retiring on a $500 monthly income would see his purchasing power cut two-thirds in 10 years -- to only $161. Even at the 1975 inflation rate of 7% his monthly check's value would be cut nearly in half in 10 years -- to $25

*Or take the housewife at the supermarket paying out $10 for a bag of groceries: At the 1974 inflation rate, prices of those groceries would more than triple in 10 years -- to $31.06. Even at a 7% inflation rate, the same bag of groceries would nearly double in cost in 10 years -- to $19.67.

*Or look at how monthly mortgage payments rise as inflation pushes up interest rates along with prices. A home-buyer used to be able to take out a conventional 30-year mortgage loan of $35,000 at a 6% interest rate and pay a monthly principal and interest payment of $209.84. Yet that same loan at 10% -- a not-uncommon rate today -- costs the home-buyer $307.15 or almost $100 a month more.

*Finally, imagine you're a businessman looking ahead 10 years to when you will have to replace a machine costing $1 million today. It's like that bag of groceries all over again. At a 7% annual inflation rate, you would have to scrape up nearly twice as much in 10 years ($1,967,151). And at a 12% rate, you would have to come up with three times as much ($3,105,848).

Inflation is thus seen as the hand-maiden of public disenchantment with our society and the cutting edge of government intervention. If the poor and the retired cannot protect themselves against inflation, who will they turn to for help? If utilities have trouble obtaining necessary financing to keep up with inflation, if money flows out of the thrift institutions because of inflation and the housing industry suffers, and if the airlines and railroads go to the wall, who will be called in to the rescue? The answer is government.

History is littered with the wreckage of governments that have refused to face up to the need to deal with the ravages of inflation. Continuation of heavy inflation not only threatens the livelihood of vast numbers of people and the survival of large areas of the private sector but also threatens the very personal freedoms and incentives that for over 200 years have produced unprecedented national development and the highest standards of living in human history.

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FOR IMMEDIATE RELEASE
MARCH 1976
CONTACT: PRISCILLA CRANE (202) 634-5248

SPECIAL INSTRUCTIONS ANNOUNCED TO HELP WISCONSIN RESIDENTS ANSWER RESIDENCE QUESTIONS ON INCOME TAX FORMS

Special instructions to help Wisconsin residents answer the new residence questions on 1975 Federal individual income tax returns were announced today by the Office of Revenue Sharing (ORS), U.S. Treasury Department.

The questions on residence -- designated A, B, C, and D on Forms 1040 and 1040A -- will help to provide a more accurate basis for equitable distribution of general revenue sharing funds in the future. The total of funds received by Wisconsin and other jurisdictions will depend, in part, on how accurately taxpayers complete the four residence questions.

General revenue sharing funds are returned by the Federal government to state and local general-purpose governments under the terms of Title I of the State and Local Fiscal Assistance Act of 1972 (revenue sharing law). The amount each government receives is based, in part, on population and per capita income estimates made by the Bureau of the Census, U.S. Department of Commerce.

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Every form 1040 and 1040A will include the following questions regarding principal residence:

Question A -- In what city, town, village, etc., do you live?

Question B -- Do you live within the legal limits of the city, town, etc.?

Question C -- In what county and State do you live?

Question D -- In what township do you live?

Residents of Wisconsin villages and cities should list their village or city name in both Questions A and D.

Only those who reside within the legal limits of cities and villages should mark Question B "Yes". Residents of places with names that have a marked similarity to other places names (for example, Douglas County contains a Superior City and a Superior Village) should be certain to identify the place correctly.

Residents of townships should leave Question A blank, mark Question B "No" and write their township name in Question D.

All taxpayers should provide their county and State information in Question C.

Taxpayers who need additional information to answer the residence questions should seek assistance from their local government officials or write to the Bureau of the Census, Residence Question, Washington, D. C. 20233, or call collect, (812) 948-2111 between 8 a.m. and 5 p.m. (E.S.T.) Monday through Friday.

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For information on submitting tenders in the Washington, D. C. area: PHONE WO4-2604

FOR IMMEDIATE RELEASE March 11, 1976

TREASURY TO AUCTION $3.0 BILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $3.0 billion of 2-year notes to refund $2.3 billion of notes maturing March 31, 1976, and to raise $0.7 billion of new cash. The public holds $2,143 million of the maturing notes and $ 145 million is held by Government accounts and the Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities. Additional amounts of the notes may be issued to Federal Reserve Banks as agents of foreign and international monetary authorities for new cash.

The notes now being offered will be Treasury Notes of Series K-1978 dated March 31, 1976, due March 31, 1978 (CUSIP No. 912827 FL 1) with interest payable semiannually on September 30, 1976, March 31, 1977, September 30, 1977, and March 31, 1978. The coupon rate will be determined after tenders are allotted. The notes will be issued in registered and bearer form in denominations of $5,000, $10,000, $100,000 and $1,000,000, and they will be available for issue in book-entry form to designated bidders. Payment for the notes may not be made through tax and loan accounts.

Tenders will be received up to 1:30 p.m., Eastern Standard time, Thursday, March 18, 1976, at any Federal Reserve Bank or Branch and at the Bureau of the Public Debt, Washington, D. C. 20226; provided, however, that noncompetitive tenders will be considered timely received if they are mailed to any such agency under a postmark no later than March 17. Tenders must be in the amount of $5,000 or a multiple thereof, and all tenders must state the yield desired, if a competitive tender, or the term "noncompetitive", if a noncompetitive tender. Fractions may not be used in tenders. The notation "TENDER FOR TREASURY NOTES" should be printed at the bottom of envelopes in which tenders are submitted.

Competitive tenders must be expressed in terms of annual yield in two decimal places, e.g., 7.11, and not in terms of a price. Tenders at the lowest yields, and noncompetitive tenders, will be accepted to the extent required to attain the amount offered. After a determination is made as to which tenders are accepted, a coupon yield will be determined to the nearest 1/8 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 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. Tenders at a yield that will produce a price less than 99.501 will not be accepted. Noncompetitive bidders will be required to pay the average price of accepted competitive tenders; the price will be 100.000 or less.

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 $500,000 or

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less, and all tenders from Government accounts and the Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities, will be accepted in full at the average price of accepted competitive tenders.

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 the account of customers, provided the names of the customers are set forth therein. Others will not be permitted to submit tenders except for their own account.

Tenders will be received without deposit from commercial and other banks 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, Federal Reserve Banks, and Government accounts. Tenders from others must be accompanied by payment of 5 percent of the face amount of notes applied for. However, bidders who submit checks in payment on tenders submitted directly to a Federal Reserve Bank or the Treasury may find it necessary to submit full payment with their tenders in order to meet the time limits pertaining to checks as hereinafter set forth. Allotment notices will not be sent to bidders who submit noncompetitive tenders.

Payment for accepted tenders must be completed on or before Wednesday, March 31, 1976. Payment must be in cash, 8% Treasury Notes of Series H-1976, which will be accepted at par, in other funds immediately available to the Treasury by the payment date 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) Thursday, March 25, 1976, 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) Tuesday, March 23, 1976, 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. Where full payment is not completed on time, the allotment will be canceled and the deposit with the tender up to 5 percent of the amount of notes allotted will be subject to forfeiture to the United States.

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e Department of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR IMMEDIATE RELEASE March 12, 1976

VICTOR ZONANA
APPOINTED DEPUTY TAX LEGISLATIVE COUNSEL

Secretary of the Treasury William E. Simon today announced the appointment of Victor Zonana as Deputy Tax Legislative Counsel for the Treasury Department.

On leave from New York University School of Law where he is a Professor of Law, Mr. Zonana, 35, will work closely with the Tax Legislative Counsel, Dale S. Collinson, in providing assistance and advice in matters of domestic tax policy and tax legislation to the Assistant Secretary of the Treasury for Tax Policy, Charles M. Walker. Mr. Zonana's appointment was effective February 24, 1976.

A member of the New York Bar, Mr. Zonana was an associate with the firm of Kaye, Scholer, Fierman, Hays & Handler in New York City from 1966 to 1969. In 1969, Mr. Zonana joined the full-time faculty at New York University School of Law where he has been Assistant Professor of Law (1969-72), Associate Professor of Law (1972-74) and Professor of Law. From 1973 to 1975 he was also of Counsel to the firm of Baer & Marks in New York City.

Immediately prior to joining the Treasury Department, Mr. Zonana served as a part-time Special Consultant to the Assistant Commissioner (Employee Plans and Exempt Organizations), Internal Revenue Service, Washington, D.C.

Mr. Zonana is a graduate of Hofstra College (B.S. Economics, 1961) and New York University School of Law (LL.B., 1964; LL.M. (in taxation), 1966). He is a member of the Association of the Bar of the City of New York, having served for three years as a member of its Committee on Taxation (1972-75), the New York State Bar Association Tax Section (membership on several committees), the American Bar Association, and the International Fiscal Association. He has been a speaker at numerous continuing legal education programs including the Graduate Tax Workshops at New York University School of Law, the Southern California Tax Institute, the Iowa Spring Tax Institute, the Institute of Continuing Legal Education of the University of Michigan and the Practising Law Institute.

WS-709

to Congress the Final System Plan in which it recommended the transfer of a substantial portion of the rail properties of seven of the bankrupt railroads to a new profit-oriented non-government corporation, ConRail. Also, USRA recommended in the Plan that certain related rail properties owned by other persons be transferred to ConRail. These transfers are scheduled to occur at the end of this month.

The Plan provides that, in exchange for these rail properties, the bankrupt railroads and the other transferors are to receive stock of ConRail, and in addition are to receive, from USRA, instruments referred to as Certificates of Value. These Certificates of Value in substance represent the guarantee of the Federal government that the bankrupt railroads and the other transferors will receive minimum fair value for their assets. To the extent it is determined in the future that such value has not been received, the Certificates require the government to pay the difference. The Plan also contemplates that the government, through USRA, will invest $2.1 billion in ConRail debentures and preferred stock. This amount will eventually be repaid assuming that, as projected by USRA, ConRail becomes financially self-sufficient.

The financial projections for ConRail's operations through 1985, prepared by USRA in connection with its formulation of the Plan, are premised on the assumption that, for tax purposes, ConRail's bases in the transferred rail properties will be the same as the basis of each of the transferors of such properties. This carryover of basis may prove to be quite advantageous to ConRail since the fair market value of these assets in most cases is significantly lower than their tax basis. In our view, by enacting the 1976 Act, Congress both expressly adopted and ratified the Final System Plan and implicitly approved ConRail's carryover tax basis.

Carryover of tax basis is consistent with the treatment provided by section 374 of the Internal Revenue Code in the case of certain railroad reorganizations. As a matter of policy, the transfer of assets to ConRail clearly falls within the intended scope of section 374. However, technical questions have been raised as to whether section 374 is in fact applicable to this transaction. Accordingly, it was thought advisable to adopt clarifying legislation which would assure the parties to the transaction tax treatment substantially similar to that provided by section 374 and certain related reorganization provisions.

In conformity with the tax treatment which the Internal Revenue Code provides in similar railroad reorganizations, the Bill gives rise to the following tax consequences. ConRail will have a carryover basis in the rail properties transferred to it. The bankrupt railroads and the other transferors will recognize neither gain nor loss upon the exchange of their rail properties for stock of ConRail and Certificates of Value, and will take a basis in such stock and Certificates equal to their basis in the transferred rail properties. The shareholders and creditors of the bankrupt railroads and the other transferors, to the extent they exchange stock and securities for stock of ConRail and Certificates of Value, will recognize neither gain nor loss in the exchange and will take a basis in such stock and Certificates equal to their basis in the stock and securities which they previously held.

Under current case law it is not wholly clear whether, in a bankruptcy reorganization, the net operating loss carryovers of the bankrupt corporation are retained by such corporation or pass to the transferee. In preparing its financial projections in connection with the Final System Plan, USRA did not anticipate that the net operating loss carryovers of the bankrupt railroad corporations would be transferred to it in the reorganization. The Bill thus provides that net operating loss carryovers of the bankrupt railroads will not be transferred to ConRail. The Bill does not attempt, however, to alter current law with respect to the question of whether these net operating loss carryovers will be retained by the bankrupt railroads after the reorganization transaction.

The Bill does not alter current law with respect to the taxable years to which the railroads can carry their net operating losses, except in the following limited situation. A Special Court has been established which has jurisdiction over all proceedings concerning the Final System Plan, including proceedings involving the issue of whether the bankrupt railroads and the other transferors received fair compensation for their property. The bankrupt railroads

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currently have net operating loss carryovers which, if retained by the railroads after the transfer, could be used to offset taxable income derived from Court awards received before such carryovers expire. However, as is generally the case in litigation arising in connection with bankruptcy, these Court proceedings will probably not be resolved for many years and it is probable that these net operating loss carryovers will have expired prior to the receipt of any such awards. The Bill contains a provision which permits these currently available net operating loss carryovers, if not otherwise utilized and if retained by the railroads after the transfer, to be carried forward to the year in which an award is made, and to the five suceeding years. However, these loss carryovers can be utilized only to offset taxable income which results from such awards in such years.

The Treasury Department agrees that relief in this area is appropriate. Due to the time pressures which surrounded the drafting of the Bill it was not possible to fully consider and propose a provision of more general application which might be merited by the equities of the protracted litigation situation. The Treasury Department plans to study the desirability and feasibility of enacting a more generally applicable relief provision.

With respect to the reorganization, the Bill provides for tax treatment which is substantially the same as that presently applicable to similar transactions. With respect to treatment of net operating loss carryovers, the Bill provides limited but potentially significant relief in a situation which otherwise could result in inequitable treatment of the bankrupt corporations. Accordingly, the Treasury Department supports this legislation and urges its prompt enactment.

I appreciate the opportunity to appear before your Committee and will be glad to answer any questions which you might have.

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The Department of the TREASURY NEWS
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ADDRESS BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE THE
CHICAGO ASSOCIATION OF COMMERCE AND INDUSTRY
CHICAGO, ILLINOIS MARCH 15, 1976

Thank you, Donald Erickson, members of the Association, ladies and gentlemen.

It is a special pleasure for me to be here in Chicago, especially before such a distinguished audience. I understand that your organization is the largest regional Chamber of Commerce in the country. Yet, unlike the Federal government, your size has obviously not hampered your efficiency and progress. Much of the credit for the way that Chicago has managed to combine new ideas, and new enterprises with the more than 5000 established businesses your group represents belongs to this organization.

I always welcome the chance to visit Chicago, but on this particular occasion, I have an added sense of mission. I feel that, in this busy election year, with a presidential primary facing you tomorrow, you deserve a little change of pace; you deserve to hear from at least one out-of-state speaker who isn't running for President.

So here I am, asking not for your votes, but for a few minutes of shared thoughts on some of the basic facts and basic problems facing America -- the sort of thing that sometimes gets buried in the political rhetoric of an election year. Let me begin by sidetracking a little bit.

A few days ago I returned from a two-week tour of the Middle East. That fascinating and turbulent part of the world has many dangerous problems. However, I came away from my trip with one positive impression. Today, despite old animosities and conflicts, both the Arabs and the Israelis, regardless of their political opinions, realize that the United States had developed the most dynamic and efficient economic system the world has ever known. They see the United States as the major source of strength and stability -- economically as well as politically -- in an unstable world.

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As Secretary of the Treasury, I found this encouraging because I am convinced that the way to a peaceful world political order is through a strong stable world economic order. For the Middle East, peace and prosperity can and must, go hand in hand.

As I look around this room, I realize that among you are many whose businesses were hard-hit by the recent recession and simultaneous double-digit inflation. Perhaps you might think that the leaders of the Middle-East have the wrong impression in viewing the United States as being super-strong economically. Perhaps you would think that, on the contrary, our economy is in trouble and our economic future uncertain.

I would agree certainly, our economy has undergone some trials in the last few years that have made for some unpleasant results both in unemployment and inflation. but, despite this, our country remains the world's greatest economic power -- and, believe me, the world knows it. Even today, we are proving our basic strength by the speed and the security of our recovery from the recession as compared with other industrial nations around the world.

We still have a long way to go, but we are on the road to recovery and we can all take heart from the first round of progress that was made during 1975.

-- Nineteen seventy five opened with inflation raging at 13%; we have cut that rate in half -- to about 6 percent.

-- During the spring of 1975, the unemployment rate reached 9 percent; today it is at 7.6 percent.

-- With the January increase of 800,000 in employment, nearly all of the jobs lost during the recession have now been restored.

-- During the third quarter of 1975, we registered the biggest single jump in the GNP in 25 years and the fourth quarter's pace, while slower, still indicates the recovery is maintaining its momentum.

Thus we made considerable headway in 1975, and we will make even more in 1976. But it's not good enough and this is certainly no time for complacency. The unemployment rate is still far higher than we can tolerate. And inflation is by no means completely under control. In fact, it remains the most dangerous enemy of real economic growth. And all of us -- especially those with a say in Federal spending -- must do everything we can to prevent another inflationary spiral. The ruinous inflation that crested in 1974 was the chief cause of the severe recession of 1975; if we embark once again on excessive fiscal and monetary policies resulting in double-digit inflation, I guarantee you we will have an even worse recession than before. Let us hope that it will never be said that the pain and suffering of the 1974-75 recession were in vain because the politicians in Washington refused to face the economic facts of life.

But the problem is not confined to politicians alone. It may seem strange, and it is certainly ironic, but at a time when Americans are enjoying such great abundance and such great opportunity, too many of us have lost sight of the principles and institutions that have made our way of life possible. Somewhere along the line, there has been a dangerous breakdown in communications.

Too many Americans -- especially those born into an affluent society which seemed to have no beginning or end, no cause and no effect -- have lost sight of, or have never been taught, the dynamics of prosperity in a free society.

Today, when nearly everyone takes the fruits of the free enterprise system for granted -- the abundance, the opportunity, the freedom of choice, the unprecedented opportunities for learning, travel, and general upward mobility -- not everyone understands the basic economic facts of life that create all these benefits.

Small wonder then, that when economic difficulties like the recession hit, millions of otherwise reasonable people fall for the quack nostrums of politicians who are more interested in promising than performing, and for quick-fix government spending spending that provide some short term relief but only aggravate the long-term economic ills of inflation and stagnation in the private sector.

Because of this, I believe that the time is ripe for an economic heart-to-heart talk with the American people. And I believe that organizations like the Association must do even more than they are now doing if such a national dialogue is to succeed.

What is at stake is not just the future of this or that industry. At stake is the survival of the private sector, and the individual liberties which have never long survived the collapse of a society's free enterprise system.

Unless we get the facts across today, the America of tomorrow -- of our children and grandchildren -- will be doomed to a system of economic and political bondage that is the very opposite of all that we hold dear.

The problem already exists, as I have had ample opportunity to observe, and it is getting worse, not better. It is a question of both policy and perception, for faulty perception of the economy makes faulty economic policy almost inevitable.

And I am firmly convinced that, taken together,misunderstandin and misdirection of the American economy have become the central, underlying problem of our times.

Part of it is a matter of image. Frequently, and especially to youthful idealists, those who support bigger government spending and more government domination of the private sector are perceived as concerned, socially progressive men and women who "care" -- in a nutshell, they are seen as the humane champions of the persecuted underdog.

On the other hand, those who warn that the government should not -- and cannot -- effectively solve every new problem that comes down the pike, and who advocate instead the strengthening of the free enterprise system are seen as either outdated theorists or a new generation of economic exploiters, indifferent to human suffering and only out to make a fast buck for themselves and their companies.

To make matters worse, surface appearances often tend to confirm this inaccurate impression. Advocates of big government are able to wax eloquent for hours about the ills they imagine they can cure by cranking out more currency and soaking up more credit through massive deficit spending. They have as many arguments as there are social, economic and political problems -- even though the spending they advocate, as we have seen with the great society's war on poverty, is often part of the problem rather than part of the solution.

Those of us who recognize the fallacy of the big government approach have only one argument. It's the right one, but, by dint of repetition, people are getting tired of hearing about it. For we constantly invoke the free enterprise system, too often without defining the freedoms and the opportunities that it, and it alone, provides. We chant a slogan, a label, without defining it in comprehensible, human terms.

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We can talk about the free enterprise system until we are blue in the face, but it still won't mean anything to those who do not understand what it really is and what makes it work. It's like trying to sensibly discuss the birds and the bees with someone who is unshakable in his belief that babies are delivered by the stork.

People who have never seen what happens to countries with state-controlled economies simply have no standard for comparison.

They have never witnessed the long lines of workers and housewives who have to cue up for hours outside state-owned food and department stores in order to buy a poor selection of over-priced food staples and state-manufactured clothing and merchandise.

They don't realize what a miracle of variety, economy and productive competition the average American shopping center would represent to nine-tenths of the earth's people.

They have never asked themselves why a country like the Soviet Union, with some of the largest, richest tracts of grainland in the world, but with a government-owned and run agricultural system, cannot even feed its people without turning to American farmers who own their own land, make their own decisions and feed not only our own people, but millions of others as well.

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Too often they have been taught to scoff at the very profit and property motives which make our prosperity possible.

They have never had the opportunity to compare the miraculous economic recovery of a free enterprise country like West Germany, to state-controlled East Germany.

They have never lived in countries where the seemingly idealistic dream of a non-profit, propertyless society has turned into a nightmare reality -- where the state and the state alone dictates what kind of education you will receive; whether or not you will be allowed to travel; what kind of job you can have; what you will be paid; what merchandise you can buy with your earnings; where you will live; where you will receive medical treatment; and, ultimately, where you will be buried.

They have not seen first-hand the political and social aftermath in societies where the government has destroyed free enterprise. For the personal rights of all Americans cherish -- freedom of worship, freedom of speech and freedom of association -- have never long endured once economic freedom has been destroyed. As Alexander Hamilton warned so long ago, "power over a man's substance amounts to power over his will."

Without the individual profit motive,people simply do not work as hard, produce as much, or bother to come up with as many new improvements. Whether we like it or not, it is an immutable law of human nature.

Unfortunately, like clean air, economic freedom is something most people don't really appreciate until it begins to run out -- and then it is often too late.

So we have reached the point where,although the free enterprise system works, and works better than any other economic system in effect anywhere in the world -- and although it feeds, clothes and houses more people more affluently than any other while serving as the underpinning of our free society -- it is somehow losing the semantic war to an alien philosophy of government control and economic irresponsibility that has never worked but has somehow managed to preserve an aura of idealism and altruism that attracts many young idealists.

What I am simply saving is that those of us who believe in the free enterprise system have got to do a better job of getting our story across -- expecially to young Americans.

All of these misconceptions would be unimportant if they were not so misleading -- so blatantly phoney. My experience in Washington has convinced me that almost every man and woman in a position of high public trust cares deeply about the well being of our people, especially those who are impoverished or face disadvantages because of their sex or the color of their skin.

The central question is not who cares the most, but rather how we broaden propeiity and reduce human hardship without sacrificing our freedom or destroying the most successful economic system that man has ever known.

I submit to you today that if America continues down the road toward greater governmental spending and greater governmental control over our economy and our lives -- a road that we have been moving steadily down for several decades -- then our children will be robbed of their personal and economic freedoms. And, in the meantime, all of us will be condemned to an economy riddled by chronic inflation and incurable unemployment.

That is really what is at issue underneath the semantics and the misleading labels, and of course young Americans have an even greater stake in the outcome than the rest of us.

Let's look at a few facts about government spending. For most of our history, the Federal Budget stayed somewhere below the $100 billion mark -- usually way below it.

Then, in 1962, we finally hit $100 billion -- and that was only the beginning. Seven years later, the budget broke the $200 billion barrier and then, only four years after that, we hit the $300 billion mark. And now, in our bicentennial year, we have reached the point where the Federal Government is spending $1 billion a day.

The very size of such numbers makes them almost meaningless to the average American. But there are ways of getting the message across. For example: suppose that on the day Christ was born, a man had been given $1 billion on the condition that he or his heirs spent $1,000 every day,seven days a week. How long would that $1 billion last? Adding it up, I think you'll find that today, almost 200 years later, the granchildren would still not have spent the full billion dollars.

Yet our Federal government is spending $1 billion every single day, and going into debt another $1 billion every week.

And as the Budget grows, the government comes to occupy a more and more dominant role within our society.

In 1930, government spending at all levels -- Federal, state and local -- amounted to about 12 percent of the Gross National Product. Today, because budgets have mushroomed, government accounts for a third of our entire national output, and if recent trends prevail, the government's share of the total economy could reach 60 percent before the end of this century.

For taxpayers, the burden of paying the government's bills has become so heavy that many are now in open rebellion. In the 1974 general elections, for example, voters across the country turned down some three quarters of all bond issues on the ballot. But too many get around this public opposition by voting more federal spending without increasing taxes.

The result has been a string of Federal Budget deficits that are unparalleled in our history. In 16 of the last 17 years, the budget has been in the red. And now, just when a balanced, healthy economic recovery has begun, the advocates of big spending would have us launch another round of reckless spending and runaway inflation.

It is up to us to stop them.

I wish that there was some way for television cameras to portray this story as vividly as they did the war in Vietnam or the race riots of earlier years. For,while the visual images are less dramatic, the problem is every bit as pressing and important.

But, as the great 19th century historian Thomas Carlyle once said, political economics is the "dismal science." On the surface, it seems nothing more than a pile of charts and a jumble of numbers so large as to be incomprehensible in everyday terms. To put it mildly, economics seldom makes "sexy" news stories. And yet the economy is the one thing that affects every other aspect of American life -- the food we eat, the quality of our education, our mobility, our freedom of choice in careers, services and merchandise, and our material and personal sense of pride and independence.

The smallest shock to the economy is felt in every limb of the body politic. And that is a big story, if only a graphic, gripping way of telling it could be found.

Consider the case of the Federal debt and its impact. As the debt climbs rapidly upwards, we have to pay higher and higher interest cost on it. By the end of fiscal year 1976 we will have spent $36 billion in interest payments alone.

That's more than we spent in any single year on the war in Vietnam. It's more than a third of our national defense budget. And it is money that could be better spent on needs such as public transportation, health care or any of a dozen worthy purposes.

This heavy borrowing by the government has also aggravated inflation and increased interest rates, creating strains in money and capital markets. This, in turn, affects everyone from the businessman interested in expanding his plant to create new jobs, to the young couple trying to buy their first home without paying an arm and a leg in mortgage interest.

Reckless government spending is the basic cause of inflation, and inflation was the underlying cause of the worst recession our country has experienced in a generation -- a recession we are only now beginning to recover from.

It was inflation that caused a loss of real income and the confidence of consumers, prompting the sharpest drop in consumer spending since World War II. And it was inflation that helped dry up the flow of savings into our thrift institutions, driving up interest rates and causing the housing industry to collapse.

So one of our prime concerns as we proceed with the economic recovery is to avoid another dose of the poison that brought the recession on in the first place -- rampant inflation fed by runaway federal spending.

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But spending isn't the whole problem. There is also the matter of government control and regulation for, as government spending has grown by leaps and bounds, so too has federal red tape.

Did you realize that government regulatory agencies now exercise direct control over 10 percent of everything bought and sold in the United States and indirect control over almost every other sector of the private economy?

' Did you know that it costs private industry -- and that means each one of us as consumers -- an estimated $18 billion a year just to do the paper work demanded by Federal bureaucrats?

Some of these regulations are, of course, necessary. But many of them are counter-productive, wasteful, or obsolete. And as President Ford has repeatedly stated, those regulations and regulatory bodies that no longer serve a useful purpose should be abolished, before we strangle in our own red tape.

Let me conclude with these few observations:

As we enter our third century as a nation, I believe the time has come not to reappraise our dedication to a better life for all -- that dedication is clear -- but to reappraise what we can pay for and how we can do it. The current plight of New York City, the disease that afflicts the British economy, and the overwhelming size of our own Federal deficits are all grave warnings to us. We can pay for what we now have and provide for the future only if our great capitalist economy does its job -- produces goods in a free market and makes a sufficient profit.

I am sick and tired of people apologizing for the free enterprise system. It has given this country the highest standards of living and the greatest prosperity ever known, and of most importance, has helped to give us the greatest freedom ever known to man. And it will continue to do that unless it is crushed by the juggernaut of big Government. What we need are not fewer but more capitalists in the United States -- more people with a real and direct stake in the profits generated by a productive economy. We cannot continue to have more and more of our citizens involved only in receiving benefits from the government and fewer and fewer people responsible for paying for the benefits. We must broaden the base of those who work and narrow the base of those who are able but don't want to work.

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President Ford urged that we strike a "new balance" in our national life:

-- A balance that favors greater freedom and vitality for our private enterprise system;

-- A balance that favors greater honesty and realism in dealing with the challenges of our time,

These are great goals -- goals worthy of the greatest nation on Earth. We should not begin our Bicentennial year by retreating into the past, but by going forward into the future with a common combination of patience, realistic hope, courage and common sense.

If we work together with common purpose and conviction -- with pride in ourselves and our nation -- the goals we share today can become the first achievements of our third century together.

President Ford has set a course which points us in the right direction and will permit us to get a grip on these problems, but it will take several years, not months, to bring this about. Unfortunately, the election is only a bit over seven months away. There will be calls from the opposition for "sweeping changes" and "broad new initiatives" which will really mean bigger spending, bigger deficits and ultimately bigger governmental control of the economy. We must persuade the American people that this course is wrong and that the other approach is much sounder in the long run.

The real choice is between greater government control or greater individual freedom. That is the decision before us.

Thank you.

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Contact: H.C. Shelley
Extension 2951
March 15, 1976

FOR IMMEDIATE RELEASE

TREASURY ANNOUNCED FINAL
COUNTERVAILING DUTY DETERMINATION

The Treasury Department announced today a final affirmative determination in the countervailing duty investigation of hydrogenated castor oil and 12 hydroxystearic acid from Brazil. On September 11, 1975, a "Notice of Preliminary Countervailing Duty Determination" was published in the FEDERAL REGISTER (40 F.R. 42222).

This final determination indicates that bounties or grants, within the meaning of the law, are being paid or bestowed on the manufacture, production, or exportation of the two castor oil products from Brazil. After consideration of all information submitted, a countervailing duty has been established at the rate of 11.3 percent ad valorem.

Notice of this decision will be published in the FEDERAL REGISTER of March 16, 1976.

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FOR IMMEDIATE RELEASE March 15, 1976

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2.5 billion of 13-week Treasury bills and for $3.1 billion of 26-week Treasury bills, both series to be issued on March 18, 1976, were opened at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing June 17, 1976			26-week bills maturing September 16, 1976		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	98.753	4.933%	5.06%	97.251	5.438%	5.67%
Low	98.738	4.993%	5.13%	97.234	5.471%	5.70%
Average	98.741	4.981%	5.11%	97.240	5.459%	5.69%

Tenders at the low price for the 13-week bills were allotted 80%.
Tenders at the low price for the 26-week bills were allotted 46%.

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Received	Accepted	Received	Accepted
Boston	$ 56,695,000	$ 40,295,000	$ 40,430,000	$ 12,430,000
New York	3,055,310,000	2,068,390,000	4,331,355,000	2,777,115,000
Philadelphia	24,860,000	24,860,000	31,025,000	6,025,000
Cleveland	54,785,000	54,785,000	75,225,000	15,225,000
Richmond	37,355,000	34,940,000	87,075,000	33,975,000
Atlanta	34,715,000	32,895,000	45,165,000	31,915,000
Chicago	221,885,000	85,350,000	359,770,000	89,945,000
St. Louis	63,325,000	39,325,000	45,935,000	19,435,000
Minneapolis	39,445,000	21,445,000	40,265,000	28,265,000
Kansas City	52,385,000	50,385,000	23,105,000	20,105,000
Dallas	23,675,000	19,475,000	26,380,000	18,380,000
San Francisco	259,825,000	33,325,000	266,210,000	48,890,000
TOTALS	$3,924,260,000	$2,505,470,000 a/	$5,371,940,000	$3,101,705,000 b/

a/ Includes $445,175,000 noncompetitive tenders from the public.
b/ Includes $201,165,000 noncompetitive tenders from the public.
1/ Equivalent coupon-issue yield.

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FOR IMMEDIATE RELEASE

March 15, 1976

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Tenders for $ 2.5
of 26-week Treasury bi
were opened at the Fed

RANGE OF ACCEPTED 1
COMPETITIVE BIDS: matu

	Price
High	98.75
Low	98.73
Average	98.741

Tenders at the low
Tenders at the low

TOTAL TENDERS RECEIVED

District	Received
Boston	$ 56,69
New York	3,055,31
Philadelphia	24,86
Cleveland	54,78
Richmond	37,35
Atlanta	34,71
Chicago	221,885
St. Louis	63,325
Minneapolis	39,445
Kansas City	52,385
Dallas	23,675
San Francisco	259,825
TOTALS	$3,924,260

a/ Includes $445,175,000
b/ Includes $201,165,000
1/ Equivalent coupon-iss

WS-715

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This Wk 4.981%
Last Wk 5.060%
Lowest since
2-23-76 4.870%

182

This Wk 5.459%
Last Wk 5.487%
Lowest since
2-23-76 5.204%

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March 15, 1976

Memorandum to Correspondents

Tape recordings are available of all news conferences held by Secretary Simon during his just completed trip to Europe and the Middle East. If you wish to review any of them please call Al Hattal at 964-8381.

OPTIONAL FORM NO. 10
MAY 1962 EDITION
GSA FPMR (41 CFR) 101-11.6
UNITED STATES GOVERNMENT

Memorandum

Department of the Treasury
Washington, D.C. 20220

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TO : Senior Staff Members

DATE: March 15, 1976

FROM : Bill Rhatican WR

SUBJECT: Secretary Simon's Press Conferences

We have available tapes of Secretary Simon's press conferences throughout his Middle East trip. If you are interested in listening to any of them, please contact Al Hattal on extension 8381.

Buy U.S. Savings Bonds Regularly on the Payroll Savings Plan

AMERICAN REVOLUTION BICENTENNIAL 1776-1976

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March 15, 1976

Memorandum to Correspondents

Tape recordings are available of all news conferences held by Secretary Simon during his just completed trip to Europe and the Middle East. If you wish to review any of them please call Al Hattal at 964-8381.

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FOR RELEASE ON DELIVERY

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STATEMENT BY THE HONORABLE GEORGE H. DIXON
DEPUTY SECRETARY OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SENATE BANKING COMMITTEE
TUESDAY, MARCH 16, 1976, 10:00 A.M.

Mr. Chairman and Members of the Committee:

I appreciate this opportunity to testify with regard to S.2631.

S.2631 would establish a new mixed-ownership corporation, the National Consumer Cooperative Bank, which would be authorized to make loans with maximum maturities of not more than 40 years to eligible consumer cooperatives and to guarantee loans to such organizations made by State or Federally-chartered lending institutions. Loans made by the National Consumer Cooperative Bank would not be included in the budget totals and would be exempted from any general limitations on budget outlays. The Bank would be capitalized initially principally by the Federal Government with appropriations of $1 billion being authorized for this purpose.

The bill would also create a new independent agency within the executive branch, the Cooperative Bank and

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Assistance Administration, to supervise the National Consumer Cooperative Bank and to administer a Consumer Cooperative Self-Help Development Fund, which would be established in the Treasury and for which appropriations of up to $250 million would be authorized. The Fund would be used for 30-year capital investment advances and to subsidize borrowings by eligible cooperatives.

Consumer cooperatives clearly have played a useful, although limited, role in our Nation's economy. We are, however, doubtful about the wisdom of the program contemplated by S.2631 which would add two new agencies to the already overfull catalog of Federal activities.

S.2631 is proposed as an anti-inflationary, anti-monopolistic measure. The Statement of Findings and Purpose says in this connection:

> "...the practices that commercial and industrial enterprises have developed over the years have resulted in declining competition and contributed to periods of recurring inflation and to increasing the gap between the producers' prices and the consumers' purchasing ability. The widening of this gap has been reflected in a rapidly deteriorating quality of life for some citizens below acceptable standards."

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While there is much about that statement that might be debated, I am sure this Committee understands that the root of recurring inflation and the temporary reduction in real purchasing power, which is at last being reversed, has been excessive Federal spending and deficits. This bill seems far more likely to exacerbate the conditions to which it addresses itself, than to contribute to their correction.

The Statement of Findings and Purpose also asserts that:

> "...consumer and other types of self-help cooperatives have been hampered in their formation and growth by lack of access to adequate cooperative credit facilities and lack of technical assistance."

This assertion is not supported, as a general proposition, by any evidence by which I am aware. To the best of my knowledge, ample access to credit is available to credit-worthy consumer cooperatives. If this is wrong, please correct me.

$1 billion of appropriations is authorized for the purchase of Class A stock of the Bank by the Secretary of the Treasury on behalf of the United States. The bill provides that such stock shall be redeemed by the Bank as soon as practical after June 30, 1990, and while outstanding, shall be entitled to a cumulative return, payable from income, at a rate of 2 percent per annum.

The current cost of borrowing for the Treasury Department on securities maturing in 1990, as measured by the 8-1/4% bonds of May 15, 1990, is approximately 7-7/8%. On the assumption that all of the Class A stock would be retired at the earliest possible moment, the effect of these financial arrangements would be the same as if the Treasury were to make a loan to the Bank of $500 million at the Treasury's 7-7/8% cost of money, and a grant of the other $500 million. Moreover, since retirement of the entire amount of Class A stock on June 30, 1990, would be doubtful, the part of the Federal capital investment, which would be equivalent to a grant, would be even larger. Thus, taken together with the amount authorized to be appropriated to the Self-Help Development Fund, this bill contemplates, in effect, the outright expenditure for the purposes specified by the bill in excess of $750 million.

When we consider Federal outlays, particularly of the magnitudes involved here, we must be sure that there is

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both a need for the program and that the need is so urgent that it must take precedence over other claims on the limited resources which the Federal Government can deploy to deal with the Nation's problems. Excluding loans made by the Bank from the budget totals of the Federal Government by statutory enactment will not change that fact. Moreover, beyond the fiscal consequences, such statutory exclusion would be contrary to the thrust of recent policy. We are now bringing back into the budget activities, such as the Export-Import Bank, which previously have been excluded by statute.

In view of the foregoing, Mr. Chairman, it seems to me to be unnecessary to comment in detail on the separate provisions of S.2631. I would, however, be glad to respond to any questions on the individual provisions, either now or in greater detail for the record.

There is, however, one other general point I should like to make. This has to do with the creation of a new agency. We should avoid that course if an existing agency can do the job. In this instance I see no need for the creation of the Bank or the new agency within the executive branch to supervise the Bank. With fairly minor modifications of existing law, consumer cooperatives could be made eligible for assistance by the Small Business Administration on the same basis as other small businesses. The Committee might wish to consider that as a possibility.

In summary, Mr. Chairman, we share the desire of the proponents of this legislation to broaden the ownership and control of economic organizations, to increase competition and, thereby, to reduce prices and raise the quality of goods and services in order to improve the standard of living of the American people. We doubt, however, that the bill would contribute to these objectives. Indeed, by mandating additional unnecessary Federal spending and subsidies it would be likely to have a contrary effect.

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WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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ADDRESS BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE THE
SMALL BUSINESS ASSOCIATION MULTI-AGENCY CONFERENCE
DALLAS, TEXAS
MARCH 16, 1976

For an Easterner like me, it's always a pleasure to come to Texas. I don't mind people who shoot from the hip. It's the people who shoot from the lip that bother me -- and Washington's full of them.

And, of course, it is a special pleasure for me to address such a distinguished group of private entrepeneurs at this seventh conference to be sponsored by the SBA over the past 15 months on Government Assistance to Small Business.

Much of the credit for the prosperity and bright economic outlook for this fastest growing region of our nation belongs to you. For without your hard work, self-reliance and dedication, the vitality and leadership that has made the Southwest flourish like no other area would hardly be possible.

You are continuing the great tradition of the independent small businessman -- as old as our society itself. The free men and women who tended little stores, traded along the trails and waterways, and tamed our wilderness helped plant the roots of this tradition deep in our early history.

And the freedoms they fought to preserve and protect -- freedom of speech, freedom of religion, freedom of the press, freedom of assembly and freedom to seek their fortunes -- are still very much with us today.

There are times, though, when I wonder if we tend to take our precious freedoms too much for granted. Certainly, as we look about us in other lands, we see what a rare and precious commodity freedom, economic as well as political, has become in the world today.

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I was reminded of this fact during my recent two week trip to the Middle East, the birthplace of Western Civilization and of our Judeo-Christian heritage. Israel and the Arab states still have sharp differences. But on one thing they are agreed. They both have a profound admiration for the achievements and performance of the American economy. The leaders of the Middle East believe, as I do, that the United States has developed the most dynamic and efficient economic system the world has ever known. They see the United States as the major source of strength and stability in an unstable world.

And no wonder. Despite the many new political and social burdens we have heaped upon our economy in recent years, we have made remarkable progress. Since the late 1950s:

-- We have created almost 20 million new jobs, cut the number of people below the poverty line in half, and increased real purchasing power of the American family by 40 percent, with average family income rising to more than $13,000 a year.

-- Our system has enabled farmers to harvest more than twice the grain with fewer workers than they harvested more than a generation ago, allowing us to feed not only ourselves, but many people in other countries.

-- Medical science has added ten years to our lives and today we have more time for leisure, study and self-improvement than any society in history.

Indeed, our free enterprise system, that same system which has always owed its strength and vitality to the independent small businessman, is really the mightiest engine for social progress and individual improvement ever created.

Back in the 1830s, Alexis de Toqueville, that astute observer of our young nation, wrote: "What most astonishes me is not so much the marvelous grandeur of some undertakings as the innumberable multitude of small ones."

If de Toqueville were alive today, he would be even more astonished. That innumerable multitude of small undertakings has swelled to 9.4 million private business concerns that provide jobs directly or indirectly for many millions of Americans and account for 43 percent of our GNP.

And when you look at what Government at all levels soaks up in GNP -- it accounts for over one-third -- that is quite impressive.

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And lest we forget, as I am sure you have not, small business supplies more than 20 percent of total tax receipts from business firms. Indeed, more than 90 percent of all corporations in our country are small businesses and 80 percent of all businesses employ less than 10 people.

Even the National Association of Manufacturers, long synonomous in the public mind with giant corporations, is composed predominently of small business firms.

I think it is clear then, when we talk about our private enterprise economy we are talking about all business, small, medium and large. And it is precisely because of this that our free enterprise system will be healthy only as long as small business is healthy; the American economy will grow and prosper only if small business grows and prospers.

I can assure you that President Ford and his Administration are committed not only to the survival but to the health and prosperity of small business. As the President put it last June in a talk to the National Federation of Independent Business: "You are the front-line in the very crucial struggle to preserve the private sector... America's future depends upon your enterprise...I assure each of you here today, although your business may be small, I will do my part to help each and every one of you make it big by getting government off your back."

Now, I wish I could say here today that by some magic formula we have gotten the monster of Government red tape and excessive taxation off your backs. But, the mountains of paperwork, the incredible array of complex and, at times, irrational rules and regulations you must conform to, your tax burden -- the fantastic pace of Federal spending and mounting Federal deficits which fuel inflation, drive interest rates up and make loans for business expansion hard to come by -- are not going to disappear overnight.

I can say, however, that we are making progress. And I'd like to tell you some of the things we are doing to lighten your load.

First, let me emphasize that our overriding concern in setting our economic policy goals is to preserve the free enterprise system. We must cut down the ever-encroaching power of Government over our lives if we are to broaden our prosperity and reduce human hardship without destroying basic freedom and economic health.

Inflation, I was not surprised to learn, is cited as the single most important problem facing small business today according to a recent quarterly survey conducted by the National Federation of Independent Business. No wonder. Inflation hits us all, rich and poor alike, the Mom and Pop grocery store, the corner boutique, the man in the street, and General Motors. It erodes the value of our dollars, stifles profits, drives up interest rates and puts the pinch on investment and expansion. In short, it drains the life-blood and vitality from our society.

Today, fortunately, the economic indicators tell us we are recovering from our worst period of peacetime inflation and our worst recession in more than a generation. We can all take comfort from the fact that the symptoms are receding for now. But we must never forget that the root cause of the disease remains.

I refer, of course, to the enormously bloated Federal budget and the ever-growing Federal deficit which feeds it. Today, and every day this fiscal year, the Federal Government spent $1 billion. And this week and every week this fiscal year it went into debt for another $1 billion. No wonder it has been in the red for 16 out of the last 17 years. Since 1962, when it finally hit the $100 billion mark, the budget has almost quadrupled.

The interest on the Federal debt alone by the end of Fiscal 1976 will have climbed to $36 billion. And by the end of the next fiscal year we will be paying interest of $45 billion or $125 million a day just in debt service charges.

This is more than we spent in any one year on the war in Vietnam. It is almost half of what we will be spending on national defense next year. And it is money, I'm sure you will agree, that could be better spent on improvements in health care, public transportation, rebuilding our cities, or any of a dozen public needs.

As businessmen and women you know that it spells disaster to borrow and continue to spend more than you take in for too long. You know that heavy Government borrowing has fueled inflation and increased interest rates so that strains have developed in money and capital markets. And many of you have felt these strains; as you have sought loans to expand your business and create new jobs, or to buy a home without paying an arm and a leg in mortgage interest.

If you need any further reminders, look at the consequences of more than a decade of fiscal irresponsibility in New York City. But New York is only the tip of the iceberg.

Throughout the nation we see signs that taxpayers, who have so long borne the burden of heavy Government spending, are rebelling. In the 1974 general election, for example, voters across the country turned down more than three-quarters of all bond issues on the ballot. And eight state legislatures, fed up with the rising national debt, have now adopted resolutions calling for a constitutional amendment that would require a balanced national budget. As one state representative put it: "I don't want the Government spending my grandchildren into a poorhouse."

So our major concern, as we work our way to a sound and durable recovery should be to avoid another dose of the poison which brought the recession on in the first place -- rampant inflation fed by runaway Federal spending.

I wish I could tell you today that with one fell swoop we have eliminated all the unnecessary government forms and regulations that boggle your mind and divert your precious time. I wish I could lay to rest your concerns about dealing with still another Government bureaucracy on environmental, health, safety and other regulations -- regulations which are written in the legalese jargon that only lawyers and bureaucrats can translate. Believe me, I would be delighted if I could. But I can't.

There are some important signs of progess, however. They are more than straws in the wind. And I think they signal real improvements for the small business in the future.

One of the most important is the appointment of Mitchell P. Kobelinski to the President's Economic Policy Board. As Board Chairman, I am extremely pleased that the President appointed Mitch to the Board last month. Mitch, as you know, is the new Administrator of the SBA, and has distinguished himself in Government as a member of the Board of Directors of the Export-Import Bank of the United States. He has also distinguished himself in the business and banking community in and around Chicago. His appointment marks an important first. It is the first time SBA has been represented on such a high-level government body, which, as you know, advises the President on all aspects of national and international economic policy; oversees the formulation, coordination and implementation of United States economic policy; and serves as the focal point for economic policy decision-making.

I am confident that Mitch's strong understanding of the problems of small business will help us to become more sensitive and more responsive to your needs and I expect him to be a strong, articulate spokesman for American small business the highest levels of government.

Another good sign is in my own department, where we are in the process of setting up a Small Business Advisory Committee. We plan to have the committee advise us on the whole range of economic policy issues that affect small business-- capital formation, taxes, regulatory activities, and so on.

There has long been a need for such an Advisory Body to the Treasury.

While SBA has done a great deal to help small business, it is the broad policy decsions and the overall conduct of government that have the greatest impact on small business. Now we will know your thinking on these matters.

Last month, my staff and I met with a distinguished panel of representatives of the small business community who have agreed to serve on the committee. Louis Laun, SBA's Deputy Administrator, to whom I am indebted for his valuable help in this endeavor, was also present. I told the group at the outset that I was there to listen. I also said that I do not believe in committees that are cosmetic and serve no useful purpose. This is a real move -- not just window dressing. Your voice will be heard, I promise you. At Internal Revenue, which has its own Small Business Advisory Committee, it is already being heard. At the urging of that committee, IRS has already shrunk a proposed seven page form requred by the new pension legislation -- the Employee Retirement Income Security Act -- down to 2 pages for companies with 100 employees or less and 4-1/2 pages for all other companies. And if that isn't progress, you'll be happy to hear that the infamous quarterly form 941A will no longer be required beginning in 1978. On January 2, President Ford signed legislation eliminating the need for the filing of this quarterly schedule to the Social Security Administration by all employers. This will eliminate an amount of paper 14 times the height of the Washington Monument and save the taxpayers $200 million a year, according to my friends at IRS. To paraphrase Churchill, never was so much ink wasted by so many people to achieve so little. In fact, throughout the Federal Government's departments and agencies, studies are now going on in cooperation with the President's ommission on Federal Paperwork to make government reporting requirements on businesses and individuals more fair and more efficient. And to assure action in the short-run, the Administration is working now to eliminate unnecessary paper-work requirements over which it has direct authority.

Someone once estimated that Federal employees alone shuffle enough paper in a year to fill the Astrodome fifty times. If you dyed it all green and ran it through a shredder, you'd probably have enough Astroturf to refurbish Death Valley. In a more meaningful measure, SBA estimates that small business spends $18 billion a year just to fill out government forms.

This mountain of government paper affects small and big business alike. General Motors, for example, recently estimated that it spent more than $1.3 billion in 1974 just to comply with existing government regulations or get ready for new ones. This is more than it cost to run the entire Federal Government for all of the first 75 years of our history. And that includes the Louisiana Purchase.

And it is more than a third greater than GM's net income that year and a third more than all the dividends they paid on common stock in that year.

Consider another example of the growth of government regulation and paperwork and its impact on a small business.

It is the case history of one Ed Sohmers, a typical American businessman, who honestly and conscientiously tried to comply with Federal rules and regualtions.

Mr. Sohmers' story was cited in a paper last year on "The New Wave of Government Regulation of Business" by Dr. Murray L. Wiedenbaum, a former assistant secretary for Economic Policy at Treasury.

Ed Sohmers was general manager of Marlin Toy Products, Inc., a Wisconsin company that made a toy cited as unsafe in November 1972 by the U.S. Food and Drug Administration. The toy, a plastic ball containing colored pellets, was declared unsafe, the FDA said, because if it broke open a child could swallow the pellets. No matter that Marlin had been marketing the toy since 1962 and had received no complaints.

Mr. Sohmers recalled the toy at a cost $95,000, removed the pellets and thought his problems were over.

But as he and his 85 employees were preparing for the 1973 holiday season making the toy and other products -- a new Federal Agency -- The Consumer Product Safety Commission -- took over the safety regulation of toys and other products. In the process, some of the paperwork on the Marlin plastic toy went astray. Shortly thereafter, the Commission published

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a banned products list and sure enough, the Marlin plastic toy was on the list.

Ed Sohmer's protest fell on deaf ears. The erroneous list had been distributed to thousands of toy shops and the Commission refused to recall its 250,000 copies "Just to take one or two toys off the list,"as they put it.

Predictably, the incorrect list caused order cancellations from all over the country. Marlin found itself with a $1.2 million loss and had to lay off all but ten of its 85 workers, many of whom were handicapped.

As Marlin's toy business plummeted, its paperwork problems skyrocketed:

-- Mr. Sohmers had to write more than 700 letters in an effort to obtain enabling legislation that would permit him to sue for damages.

-- He spent two weeks and $15,000 gathering documents for an appraisal company to prove the loss of business.

-- Three employees had to work two seven-day weeks pouring through documents that went back to the founding of the business in a household kitchen in 1947, in order to answer government inquiries.

-- And while all this was going on, the Justice Department, pleading a heavy workload, was able to obtain delays on the company's court action against the government.

Today, Marlin is out of the toy business.

Marlin Toys difficulties are just one example of the thousands of bureaucratic bungles that have taken their toll in both human and financial terms. In this case, government regulatory overkill took a tragic economic toll on human beings. Many of Marlin's discharged employees, especially the handicapped, could not find other jobs.

Let me give you another example of regulatory strangulation. Suppose for a moment that you lived in Chicago and borrowed some money to start a small trucking business to carry freight to Cleveland, Ohio. That seems easy enough: Cleveland is not far from Chicago. Should you then rush out and invest in a few trucks? Sorry, the first thing you should do is file a request with the Interstate Commerce Commission. That will cost you $300 in filing fees, and you'll probably need a private lawyer to boot. Well, you say, the request must be only a formality and you can get started in a few weeks time. Sorry, but the request

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will almost inevitably lead to legal hearings and you will have to prove that existing service to Cleveland is inadequate and that existing carriers cannot be made to provide it.

The average request now takes 10 months to process and some have been known to take over three years. Protests by existing carriers often lead the ICC to give only restricted approval to requests from new carriers and, especailly along well-traveled routes, to deny many request altogether. Undaunted, you wait it out, obtain your approval, and decide that the best way to get a break on your competitors is to reduce the prices you charge to your customers.

Sorry, your proposed rate reduction will probably be protested by other carriers and then suspended by the ICC. In effect, the government will force you to charge higher prices, even though you could afford to charge lower ones. Nonetheless, even with the higher rates you win a few customers with exceptionally good service, and new customers appear, asking that you carry their goods from Cleveland back to Chicago. Good, you say, your business is expanding.

Sorry, the ICC won't allow it unless your original certificate specifically authorized you to carry those products on the backhaul from Cleveland. The ICC requires instead thatyou drive back to Chicago with an empty truck -- a practice that is still frequent even in a day of high cost energy. Despite all of these problems, you persevere and customers soon want you to carry their goods not only to Cleveland but also downstate to Columbus, Ohio. Sorry, but your ICC certificate says you can only go between Chicago and Cleveland; to drive to Columbus, you'll have to get a new certificate, and that means you'll have to start the whole process all over again -- lawyers, forms, hearings, rate settings, the works.

At that point, you might be justified in throwing up your hands and sending off for that pamphlet which tells you how to collect food stamps. I wish that I were exaggerating the complexities and frustrations of dealing with the government bureaucracy, but I'm sad to say that it's all true.

Some regulations, of course, are necessary. But others are obsolete, wasteful and counter-productive. And as President Ford has repeatedly stated, those regulations and regulatory bodies that no longer serve a useful purpose should be abolished, before we strangle in our own red tape.

But the problems caused by governmental intervention in our economy do not stop with red tape. They go far beyond that to basic questions such as capital investment, productivity, profits and jobs. These are a matter of concern to companies of all sizes, for it is obvious that as inflation has taken its toll and as government has required more and more money for its own programs, there has been less and less available to private enterprise for investment purposes.

Did you know, for example, that since 1960, the United States has invested less of its Gross National Product in private enterprise than any other major industrialized nation -- far less than Japan, West Germany and France, for instance. As a result, our private industrial base has not been growing as rapidly as it should, we sometimes have shortages in basic industries, and we are not creating jobs as rapidly as we could.

I believe firmly that there are few issues more important to our country's economic future than capital investment. But many Americans -- and many politicians -- still do not understand that capital investment translates into more jobs, higher personal incomes, higher productivity, lower inflation and, in turn, greater economic growth. And these -- not more Federal boondoggles -- are the basic ingredients of long-term prosperity.

Over the next ten years if we are to spur our economic growth and not lag behind our international competitors, we will have to:

-- Create almost 20 million new jobs, as contrasted to the 13 million we created over the past decade.

-- Invest as much as a trillion dollars to satisfy our special needs in energy.

-- Provide for greater worker safety and environmental safeguards in the building of new plant and equipment which already account for almost 10 percent of plant and equipment outlays in the manufacturing area.

-- And invest a staggering total of $4 1/2 trillion in private capital to meet our economic goals, or three times

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the $1.5 trillion of the past decade.

It is obvious that in order to meet these goals we must increase our level of savings and investment. We must tilt our economy slightly away from immediate consumption and federal spending towards greater savings and investment. We can do this by increasing the fraction of the Gross National Product that goes into savings and investment by about one percent -- from 15 1/2 to 16 1/2 percent.

The single most effective way of doing this is by cutting back on government spending and deficit financing. However, changes in the tax system will also encourage investment.

The Administration is now proceeding along two tracks in our efforts to reform the tax system.

For the short-term, President Ford outlined in his State of the Union message in January, reductions in individual and corporate income taxes and a series of tax incentives to encourage investment in America's future.

These measures include:

-- A permanent 10 percent investment tax credit.

-- A reduction in the maximum corporate tax rate from 48 percent to 46 percent.

-- Making permanent the current temporary tax cuts on the first $50,000 of corporate income.

-- A reduction in the corporate tax rates to 20 percent minimum for the first $25,000 of taxable income, 22 percent for the second $25,000.

-- A job creation tax incentive program permitting accelerated depreciation for construction of plant and equipment in areas with more than 7 percent unemployment.

-- And a six-point plan to stimulate construction of new electric utility facilities.

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For the long term we continue to advocate the plan for tax integration I presented to Congress last summer. This plan would provide for a phased integration of the corporate and individual income tax which would eventually eliminate the double tax burden now imposed on corporate dividends. This is the only major proposal I know of that seeks to correct the imbalance between corporate debt and equity by encouraging greater equity financing. We must redress this imbalance to allow the financial markets to more efficiently channel society's savings to the most promising investment opportunities. Small firms, in particular, would benefit by improving their access to the financial markets.

I firmly believe that double taxation -- the taxing of corporate incomes, and the subsequent taxing of individuals who receive corporate dividends -- must be eliminated in the interests of fairness, greater efficiency, more stable economic growth and greater job formation. It is high time we eliminated this injustice.

Today American business is being rocked by another serious problem. News of illegal corporate policitcal contributions, payments of millions of dollars in bribes to powerful foreigners to help influence their countries' business decisions and other questionable and illegal practices are coming to light. These revelations have rightly shocked millions of our citizens. Congressional committees have reacted strongly and many businessmen are calling for a voluntary business code of ethics and internal reforms.

No one has more to lose from crooked goings-on in the private sector than the vast majority of honest businessmen.

And no one has more to gain from wiping out corporate corruption before it endangers the whole free enterprise framework. You can help spread this message. Join your trade associations -- the National Federation of Independent Business -- The National Small Business Association and statewide and regional groups of independent businessmen and women. Make your views known where it counts on this issue as well as the issues of over-taxation and over-regulation -- to your Senators and Representatives.

The task ahead is critical. At stake is not only your survival as independent businessmen and women but the survival of all the values and traditions we hold dear.

Ladies and Gentlemen, the American free enterprise system has been the wellspring of our nation's strength throughout

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our history. It remains our hope for a better future.

The spirit of self reliance, the spirit of individual dignity that built our country is engrained in our national character. George Washington knew this when, in 1783 as the loose confederation of American states was faltering, he sent a message to the states. In it he spoke of America's potential for greatness and warned that if the American experiment in Democracy failed, Americans would have only themselves to blame.

"This is the time of their political probation," he wrote of the American people, "This is the moment to establish or ruin our national character."

Our national character was forged in the crucible of Valley Forge. It's legacy of freedom was consolidated in the Constitution in 1789. And it has been tested and proven by every generation since. In this Bicentennial year, if we keep alive the spirit that infuses our national character -- the spirt of free enterprise that each of you personifies -- we can be certain that it will endure for another 200 years and more.

But, if we let free enterprise wither and die, rest assured that our other freedoms and individual liberties will die with it. We must not, we cannot allow this to happen.

Thank you.

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WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR RELEASE AT 4:00 P.M. March 16, 1976

TREASURY'S WEEKLY BILL OFFERING

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 March 25, 1976, as follows:

91-day bills (to maturity date) in the amount of $2,400,000,000, or thereabouts, representing an additional amount of bills dated December 26, 1975, and to mature June 24, 1976 (CUSIP No.912793 ZN 9), originally issued in the amount of $3,107,050,000, the additional and original bills to be freely interchangeable.

182-day bills, for $3,100,000,000, or thereabouts, to be dated March 25, 1976, and to mature September 23, 1976 (CUSIP No.912793 B2 1).

The bills will be issued for cash and in exchange for Treasury bills maturing March 25, 1976, outstanding in the amount of $5,513,750,000, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,791,590,000. 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 non-competitive 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 Standard time, Monday, March 22, 1976. 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

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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 March 25, 1976, in cash or other immediately available funds or in a like face amount of Treasury bills maturing March 25, 1976. 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.

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FOR RELEASE UPON DELIVERY
MARCH 16, 1976

STATEMENT OF JOHN A. BUSHNELL
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
FOR DEVELOPING NATIONS
BEFORE THE SUBCOMMITTEE ON FOREIGN OPERATIONS
OF THE HOUSE APPROPRIATIONS COMMITTEE
MARCH 16, 1976 at 2:00 p.m. EST

Mr. Chairman, last year the four international development banks made commitments for new loans totalling $8.5 billion for 377 projects in 84 countries. This total is far more than the bilateral economic development program of the U.S. or any other country. For most developing countries outside the Middle East the programs of the international development banks have become the core of their external financing. Most aid donors from both Europe and the Middle East build their bilateral programs around, and in cooperation with, the banks' programs. The U.S. contribution to this truly mammoth development effort requires appropriations of a little over a billion dollars in FY-77. About $300 million of this total is for callable capital which is unlikely to result in any outlays ever from the U.S. Treasury. Callable capital is a guarantee facilitating the sale of bonds by the banks in the capital markets of the world.

Mr. Chairman, Treasury has testified each year about these banks and I would presume not to repeat the basic details on their creation and growth which you and the committee know so well. I shall try to focus on a few of the key reasons why continued support for the banks at the level requested is in the national interest, despite the many competing domestic demands for funds, and review the current funding situation and recent developments in each bank. Mr. Charles Cooper, the U.S. Executive Director for the World Bank Group, will review the activities of the International Development Association (IDA) and the International Finance Corporation (IFC) for which we are seeking money for the first time in

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nearly 20 years. Our Executive Director in the Inter-American Bank (IDB), Mr. John Porges, is here to explain the desperate need for early appropriation action for that bank. Detailed statements on the Asian Development Bank (ADB) and the African Development Fund (AFDF) are annexes to this statement. I shall do my best to answer questions on these institutions as well as on any general issues affecting all the banks. Finally, Deputy Assistant Secretary of State Paul Boeker is here to indicate the importance of the banks to our overall foreign policy objectives.

We believe that the World Bank Group and the three regional banks provide important extra dimensions to development assistance. Economic development is not primarily a matter of external funding. While money is needed, the key factors determining the success of development efforts are the policies and priorities followed by each country. The development banks make important contributions in precisely such areas by encouraging the adoption of sound economic policies, by assisting in institution building, and by supporting successful development efforts made by the countries themselves.

The 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 Development Bank there are more Americans than any other nationality, and overall Americans make up about 25 percent of the development bank staffs.

The banks are cost efficient institutions. For example, the combined administrative budgets of the banks in 1975 accounted for only 3 percent of the $8.5 billion lent out that year. Moreover, included in the administrative budgets are expenses for technical assistance, training centers, etc. which are not directly associated with the cost of making loans.

From the U.S. national point of view, these banks encourage development along lines compatible with our own economy. They stress the role of market forces in the effective allocation of resources and the development of outward-looking trading economies. Through contact with the international development banks, developing countries are learning to administer large procurement programs effectively and honestly. These programs will result in increased procurement of goods and services in the United States, expanded future markets for our products, thus increasing employment in our country. Our participation in the international development banks will also provide more assured access to essential raw materials, and a better climate for U.S. private investment in the developing world.

There is clear evidence that in all of the international development banks increasing attention is being given to, and a greater volume of loans are being made for, the direct benefit of the urban and rural poor. Assistance is being directed increasingly to the poorest countries and to low income groups in all borrowing countries.

About 92 percent of IDA credits are made to countries with per capita incomes below $200, and the ADB makes loans on concessional terms only to member countries with per capita incomes of less than $300. About 50 percent of IDB's concessional loans are being made to the nine poorest countries in Latin America, and this percentage is expected to continue rising steadily in the future.

All of the international development banks are increasing their lending for projects which directly assist the rural and urban poor. In recent years the banks have placed greater emphasis on agriculture, the family farm, and cooperatives -- an emphasis we have encouraged and supported. The IDB has been the leader, for example, in lending for integrated rural development, cooperatives, farm-to-market roads, and rural water supply. The World Bank and IDA have made several loans for population projects and for sites and services to improve living conditions for the poorest groups. The IDA, as well as the African Development Fund, have made loans for the drought-stricken Sahel region of Africa. The ADB is taking the lead in loans involving light and intermediate technology which benefit the poor.

I would emphasize that the change in emphasis toward direct assistance to the poor is slower than some of us would like and we continue to press within the banks for a greater concentration to reach directly the poorest groups in each borrowing member. We must also not lose sight of the fact that basic infrastructure projects -- roads, ports, electric power and major irrigation -- are still necessary to provide the basis for overall growth of the developing country economies.

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Because economic development is the primary purpose of the international development banks they become centers for work on development related problems such as the development and spread of technology appropriate for the poorer countries. Although most of the technicians in the banks have had their education and experience in developed countries, the fact that they devote their careers to developing countries, spend their time in developing countries, and work on development problems gives them a good mix of experience to advance the frontier of knowledge in the development of appropriate technology. The experts from developing countries on the staffs of the banks are particularly well equipped to adjust technology to the local conditions and to help find appropriate technologies where none previously existed. The worldwide work of the IBRD and the close relations between the IBRD and the regional banks uniquely establish the development banks as the most effective network for the rapid spread of new appropriate technology to many potential users.

However, there are also pressures against the maximum effectiveness in the use of appropriate technologies in the development banks. Some developing countries insist on emulating the richer countries and their technology, even when an alternative technology would be more appropriate. In many cases the capital equipment for bank-financed projects must come from developed countries and it is not possible to specify technology different from that already being used on established production lines. In spite of these difficulties the banks have made considerable progress. For example, in the ADB not only has the staff participated in a regional meeting on specific applications of intermediate technology but the Bank has recently included components of appropriate technology in several of its loans. (Specific examples are contained in the ADB Annex to this statement.)

The development banks are part of an international structure in which the developed and developing countries work together to solve problems. The development banks are not debating societies which engage in seemingly endless rhetoric about restructuring of the world economy -- they are working institutions that get things done. By cooperating with 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 the total development assistance of other industrial donor countries. The United States is no longer the leader in directing assistance through the development banks; the constraints on our support are a principal limitation on their growth as other countries, in general, are prepared to multilateralize a greater part of their assistance.

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.

In our contributions to the international development banks, we have been trying to reduce U.S. budgetary outlays by making less available to the soft loan windows of these institutions and relying more on U.S. contributions of callable ordinary capital. Callable capital does not involve budgetary outlays; thus, emphasizing callable capital fits in well with the Administration's strong efforts to achieve budgetary constraint. Moreover, since our private capital market is a major source of borrowing by the international development banks, it is appropriate that the United States provide an increased proportion of its overall contributions to these banks in the form of callable capital, while other donors with less well-developed capital markets undertake a greater share of funding for the soft loan windows of the banks. This shift in burden-sharing is illustrated by the recent trends in U.S. contributions to the concessional funds of the banks. Our contribution to the Fourth Replenishment of IDA is one-third of the total, as compared with 43 percent in our initial contribution in 1961, 42 percent of the First IDA Replenishment, and 40 percent of both IDA II and IDA III. In the case of the new IDB replenishment, our contribution to the Bank's concessional resources would be reduced to $600 million, or 57 percent of the total, as compared with $1 billion, or 67 percent of the total in the 1970 replenishment.

In the IFC, our share in the proposed total capital replenishment for FY 1977-79 would fall to about 25 percent as compared with 32 percent in the initial capitialization. And in the Asian Fund the U.S. share will also decline, although we want to maintain our share of the ordinary ADB capital through full appropriation of the amount requested for FY-77.

One of the advantages to the United States of burden-sharing in the international development banks is that it provides us with substantial leverage in the use of our foreign assistance funds. Thus our appropriations request of about $1 billion in FY 1977 will be associated with nearly $10 billion of total lending by these banks.

Because of burden-sharing by the other donor countries, and their consequent sharing of the role in the decision-making process as members of these institutions, we do not -- as we do in our bilateral aid programs -- have complete control over the activities of the banks. These institutions, as you know, are clearly not part of the U.S. Government. What we have to weigh, therefore, is whether, on balance, the international development banks generally perform in ways which meet U.S. objectives even if, for example, they make some loans or lend to some countries that do not meet with our approval. In this connection most of the total lending by the international development banks is to countries -- such as South Korea, the Philippines, Pakistan, Tunisia, Brazil, Egypt and Colombia -- where we have strong interests and where we now have or recently have had substantial bilateral aid programs.

Appropriations Requests

To provide for continued U.S. support of the international development banks in FY-77 we are requesting appropriations of $1,030.6 million of which $734.1 million will require Treasury outlays and $296.5 million is callable capital -- guarantees unlikely to require expenditures. The Administration is seeking:

-- $375 million for the second U.S. installment of the fourth replenishment of IDA;

-- $45 million as the first U.S. installment in the first replenishment in twenty years for the International Finance Corporation;

-- $240 million for the second installment of the fourth replenishment of IDB ordinary capital ($40 million of paid-in capital and $200 million of callable capital);

-- $200 million for the first installment of the replenishment of the resources of the IDB's soft loan window, the Fund for Special Operations (FSO);

-- $120.6 million for the third installment of the first capital replenishment of the ADB ($24.1 paid-in and $96.5 callable);

-- $50 million for the initial U.S. contribution to the first replenishment of the resources of the soft loan window of the ADB, the Asian Development Fund (ADF).

These U.S. contributions are part of the multilateral effort in funding the international development banks in which the U.S. contributes only a part -- and an increasingly smaller part as can be seen in the table attached to this statement. If other donors are to continue supporting these banks, we must do our part by delivering on the amounts we agree to contribute.

The Administration is not seeking a contribution for the "Third Window" of the World Bank which lends at an interest roughly half way between that of the World Bank and that of IDA because we believe priority should be given to IDA and IFC appropriations.

Our participation in the Fourth IDA replenishment was authorized by Public Law 93-373 and our participation in the replenishment of the capital resources of the Asian Development Bank in Public Law 93-537. Authorizing legislation for participation in the replenishment of the IDB passed the House of Representatives as HR 9721 on December 9, 1975, and is currently pending in the Senate. Legislation authorizing U.S. participation in the replenishment of the IFC and ADF was transmitted to the Congress in February.

HR 9721 provides for the United States to make three contributions of $400 million per year to the replenishment of the capital resources of the IDB beginning in FY 1976 and $450 million (all callable) in FY 1979. The bill also provides for U.S. membership in the African Development Fund with an appropriation in FY 1976. Additional budget authority for FY 1976 will soon be transmitted to the Congress requesting the appropriation of $240 million for the IDB ($40 million in paid-in inter-regional capital and $200 million in callable ordinary capital) and $15 million for the African Development Fund.

In the IDB a new class of shares, known as inter-regional capital, will be created to facilitate the entry of non-regional members. We are not requesting appropriation of the callable inter-regional capital because covenants limiting IDB borrowing to the amount of appropriated U.S. ordinary callable capital would not apply to inter-regional callable capital. Mr. Porges will explain this complicated issue in more detail.

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We signed up for IDA IV in January 1975 without appropriations because we knew that, while other donors had made advanced contributions to allow IDA to continue making commitments, they would contribute no additional funds until the United States formally agreed to the replenishment. Such action by the other donors would have forced IDA to stop lending to the world's poorest countries. By agreeing to contribute one-third of the funds for IDA IV we assured that others would contribute the other two-thirds of the funds and IDA has continued to make commitments for projects and programs in the poorest countries.

The nature of our current arrangements concerning IDA, frankly, give me a great deal of concern. We should be aware of the implications of the procedure under which we are beginning our contributions one year late and spreading our contribution to IDA IV over four years while IDA commits the funds in three years. Under the present schedule IDA will have committed all IDA IV resources three months before the end of FY-77. Yet we shall have half of our contribution pending appropriation in FY-78 and FY-79.

On the one hand we do not expect a problem in meeting the actual U.S. share of disbursements. We are behind now, but appropriation of the full $375 million for FY-76 will meet our share of disbursements through October of this year. The $375 million requested for FY-77 will meet disbursement requirements during that year. On the other hand, negotiations have already started on the next IDA replenishment. IDA hopes that the fifth replenishment will take effect by July, 1977, so that there is no period during which IDA commitments must stop. Some of you have suggested that we provide commitment authority to IDA subject to appropriation. This procedure would mean that in FY-78 appropriations would be necessary to meet not only the $375 million third payment for IDA IV but also for the first payment for IDA V. Such appropriations would total more than double the current request even if the U.S. share of IDA V is substantially reduced. Although I would welcome your views on this problem, I do not believe we can resolve it this afternoon. However, this situation does emphasize the great importance of full appropriation of the $375 million for FY-77 if the United States is to continue as an active supporter of IDA's key development role in the poorest countries. The Administration believes that for the United States to turn its back on IDA is unthinkable.

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The need for funds in the other banks is also urgent. The IDB ran out of commitment authority to make new loans in late 1975 and would have had to cease lending except for a change in its regulations that allowed it to make new commitments against loan reflows and certain reserves on a temporary basis until the new replenishment becomes effective. Even after doing this the IDB had only $73 million in remaining commitment authority from ordinary capital at the end of 1975; these funds have already been allocated for a couple of pending loans. Thus the IDB is now unable to make new ordinary capital loans. The supplemental FY-76 appropriations which are obviously urgently needed will be used in part to reverse this temporary accounting change made last year. Thus the Bank will again have exhausted its commitment authority by about the beginning of FY-77. The FSO will also run out of commitment authority by the beginning of FY-77 even if the full FY-76 request is appropriated and earmarking of FY-75 funds is removed.

The Asian Development Bank has only $41 million of commitment authority remaining for soft funds, and these funds remain only because it reduced its soft lending in CY-75 to $166 million from $173 million in CY-74. The Bank has made no soft loans so far in 1976. During 1975, the United States participated in negotiations on an ADF replenishment but did not commit itself concerning the specific timing or amount of any U.S. contribution. Last December, the ADB Governors approved a resolution providing for an $830 million replenishment with a suggested U.S. share of $231 million. The United States abstained on the resolution and no decision has yet been taken on the full amount to be requested from the Congress for a 3-year U.S. contribution. We are, however, requesting $50 million as the U.S. contribution to the ADF for FY 1977 to continue the level of U.S. support of the ADF in recent years.

The pipeline of available funds for concessional lending has been reduced below minimum levels by the delays in U.S. contributions. Soft convertible funds of the regional banks available for commitment declined from $285 million at the beginning of 1975 to only $100 million by the end of the year. The inability to make new commitments not only delays the financing of good projects but also weakens the morale and dedication of the banks' staffs.

The $45 million appropriation request for the IFC is part of a $480 million capital increase for the Corporation. The total U.S. share is about $112 million.

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The IFC, a member of the World Bank Group, is the only multilateral agency specifically designed to encourage private sector growth in the developing countries. It is unique among international development institutions in that it purchases equity and operates without government guarantees.

Our support for the IFC is based on the recognition that the financial resources necessary for development cannot and should not come entirely from public treasuries; the task is too great and the resources are too scarce. Moreover, the private sector has an immense contribution to make to development. IFC seeks to tap the managerial, technological and financial resources available in the private sector in order to increase its contribution to economic development.

This capital increase is the first since IFC's founding in 1956. The proposed increase is ambitious -- more than quadrupling the IFC's small capital base of $108 million. IFC's small capital base has impeded its equity operations, restricted its ability to borrow IBRD funds for relending, and resulted in IFC becoming a much more junior member of the World Bank than was contemplated when it was established 20 years ago. The capital increase will enable the IFC to play a more substantial role in the development process in association with private capital. The U.S., as the largest private enterprise economy in the world, is expected to be the leader in support of the IFC. Frankly, I wonder if we have done justice to our strongly held beliefs in the advantages of private enterprise by delaying a replenishment of the IFC in recent years while giving priority to the organizations lending mainly to governments. It is time to put the IFC at the top of our priority list.

Mr. Chairman, we are in an awkward situation today in discussing FY-77 appropriations when final action has not yet been taken on FY-76 appropriations. I have tried to avoid discussion of this other pending business by assuming that FY-76 appropriations are provided at the level the Administration has requested. I recognize that the Subcommittee might not agree with that assumption. Thus I should state for the record that it is present Administration thinking that we would amend the FY-77 request to include any amounts for the development banks requested for FY-76 and not appropriated. This procedure would also apply to the supplemental requests for the IDB and for the African Development Fund.

Before closing I would like to address briefly six additional issues which are of interest to the Congress and the Administration. First, let me comment on why it is important for the United States to contribute to four international development banks.

Our past experience with the regional banks leads us to believe that smaller institutions with a predominance of local citizens can do a better job of meeting certain requirements than the much larger World Bank Group. Countries in the regions -- Latin America, Africa and Asia -- concur in this belief, since the regional institutions give them more control over the course of their own development. Moreover, the work of these institutions and that of the World Bank Group are complementary. The World Bank concentrates on larger, more complex projects utilizing expertise gained from worldwide operations. The regional banks focus on smaller-scale projects and call upon the first-hand knowledge and experience of their staffs to meet problems unique to their areas.

Let me now address the effect of the international development banks on our balance of payments. Excluding short-term funds held by the development banks in U.S. financial markets, the total of all inflows and outflows of dollars resulting from transactions from their inception through December, 1975, has resulted in a net deficit of only about $200 million for the U.S. balance of payments. Moreover, the banks maintain substantial investments in U.S. short-term financial assets.

The absolute magnitudes of the various types of flows are of course much larger; the total net outflow of capital (subscriptions paid-in plus net sales of bonds, loan participations, etc. in the U.S.) totaled almost $11 billion as of end 1975, while the development banks' purchases of U.S. goods and services, direct expenditures and long-term investments in the United States totaled over $10 billion.

Because of our overall favorable payments situation in 1975 we opened our capital markets freely to the banks for the first time in several years. As a result they raised $1.8 billion in net long-term capital. Consequently the cumulative effect on U.S. international payments was less favorable at the end of 1975 than at the end of 1974. However, at the end of 1975, the banks held about $5 billion in short-term U.S. financial assets, which, if included in the above figure, would make the effect on total inflows and outflows from the U.S. positive by a large margin.

Let me turn now to procurement. One of the major benefits we derive from our membership in the international development banks is the opportunity it affords U.S. exporters to compete for procurement financed by the banks. The rules of the banks require international competitive bidding and other safeguards which give our exporters a fair chance to compete for business in the developing countries. One of the advantages in joining the African Development Fund is that U.S. companies will become eligible to compete for contracts financed by the AFDF and thus will have a greater incentive to compete for business in Africa, which has not been a traditional market for many U.S. suppliers.

We have increased efforts in the last year to obtain a larger share of procurement in the development banks. A consultant investigated ways to increase U.S. procurement in Asian Bank projects will issue a final report shortly. During the past nine months Treasury has had on loan from the State Department a senior foreign service officer who has concentrated on improving the U.S. procurement record at the banks. This record, I might add, is not bad at all. Although the U.S. share of world exports of goods and services in recent years has been approximately 17 percent, our share of bank-financed procurement has been running at 25 percent. Every $1 billion of procurement in the United States for bank-financed projects generates 47,500 man-years of employment in this country.

I know Congressional members are also interested in the foreign assistance activities of the oil-exporting countries as they relate to the international development banks. The vast increase in oil export earnings of the OPEC countries has made it possible for some of them to take on part of the development financing burden and to borrow substantially less from the international development banks thus permitting more lending to the poorer developing countries.

OPEC countries have provided co-financing totaling some $1 billion to complement 36 IBRD and IDA projects in 16 countries -- most of them over the past year or so. (These projects are listed in a table attached.) A substantial amount of IBRD/IDA resources was freed up for other projects and countries by this OPEC co-financing.

The pattern of lending by the development banks to OPEC countries has changed as a result of the higher incomes of these countries. Lending of soft funds from IDA, the

FSO and the Asian Development Fund to these countries has been stopped with the exception of limited amounts of FSO funding for Ecuador. These FSO loans to Ecuador have been financed from sources other than the U.S. contribution, including Ecuador's own contribution to the FSO. Lending to the OPEC countries with the highest incomes such as Venezuela and Iran has stopped. However, lending to the poorer countries such as Indonesia and Nigeria has increased, partly as a result of proceeding with loans on which work had already started before the oil price increase. We have urged the banks to concentrate their limited resources on those countries with the greatest need.

Now let me say a word about earmarking. The Administration has noted the constructive action recently taken by the House in removing the restrictions on the $50 million appropriated last year for a U.S. contribution to the Fund for Special Operations of the IDB. As we have indicated, we are strongly opposed to the earmarking of U.S. contributions to the international development banks because such earmarking would constitute a dangerous precedent inimical to U.S. interests. Contributions subject to use for specific purposes or countries are contrary to the charters of these institutions as well as to the multilateral framework within which the banks operate.

We cannot expect to control every dollar we contribute to these banks; some reduction in our control is the cost of ensuring burden-sharing whereby other donor countries contribute their fair share to the international development banks. We must be careful not to take a position which could well inhibit new contributions from others by attaching unilateral conditions to our own contributions.

My final point deals with our procedures to examine the work of these banks. 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.

The primary mechanism through which the Administration sets policy on the international development banks, both on general policy questions and on each individual loan, is the National Advisory Council on International Monetary and Financial Policies (NAC). Every loan and borrowing

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operation and every substantial technical assistance operation is reviewed in detail by the interested U.S. agencies in the NAC before instructions are given to our Executive Directors. Through this process we assist these institutions to do an even better development job by bringing the very considerable expertise found in the Federal Government to bear in reviewing their projects. I would especially like to mention the outstanding technical work of the Department of Agriculture and the Department of Transportation in contributing highly useful inputs to these reviews. AID is one of the most active agencies participating in the NAC and contributes its immense development experience as well as its knowledge of current conditions in developing countries. The Department of Commerce and the Export-Import Bank help us to be continually vigilant that American exporters have the fullest opportunity for business. The Federal Reserve provides extremely useful analysis of the monetary and financial situation in the borrowing countries. The State Department contributes its detailed knowledge of conditions in the borrowing countries and provides the key foreign policy element in NAC deliberations. In addition to chairing the NAC, we in Treasury are particularly concerned with general bank policies such as assurance of adequate self-help, avoiding financing of cost-overruns, a consistent approach to maturities and grace periods, and increased efforts to reach the agricultural sector and the poorer people in ways that will increase output. The NAC also reviews such general U.S. concerns as expropriation of U.S. investment and arrears on debts to the United States in connection with each loan.

The annual report of the NAC should be an integral part of the documents you consider in determining appropriations for the development banks. In particular, I would call your attention to chapter IV of the FY-75 report which reviews developments in the banks and includes tables covering such matters as the sectoral breakdown of lending and membership in the regional banks and appendix C which includes the NAC evaluation of all the loans approved during the year. If this appendix were not so long -- a hundred fine-print pages -- I would suggest you might include it in your report because it brings out the real life benefits for millions of people around the world made possible through the work of the development banks. The purpose and benefits of each loan are given. Let me quote just one example of the sort of information in the NAC report. For a $15 million loan to Kenya, half from the IBRD and half from IDA, the following is part of the analysis of benefits:

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"The major quantifiable benefits stemming from the project are substantial increases in marketed production of wheat, maize, milk and coffee estimated at $10.1 million per year after full development. The project should also ensure employment --either permanent or seasonal and depending on the number of group owners involved-- for about 13,000 group farm owners, and will benefit farm families comprising 80,000 persons. These families are from the lower income levels of Kenya's rural population, most of which would be landless and unemployed if steps were not taken to protect their investments. At full development, the annual income of each family should have gained-- in addition to its subsistence income--$84 on the mixed farms, and $420 on the coffee estates. Currently, the average per capita income of the rural family in Kenya, including subsistence produce, is only about $70 per annum."

I know that some of you have felt the United States, especially the Congress, cannot make a sufficient review of the lending operations of the development banks in advance of loan approval. Unlike the situation for the bilateral aid program, we can not present you with a list of specific projects that will be financed with the appropriations before you today. This situation is inherent in the nature of these multilateral institutions where the United States provides only one dollar out of every three, four, or five they lend. It would obviously be infeasible for them to present their programs in advance to the governments and parliaments of all their members, or even to the 20 to 25 donor members. However, these institutions do not make sharp changes in the pattern and nature of their lending from year to year. Thus a review of last year's lending program will indicate quite accurately the nature and direction of their lending programs this year and next year.

In conclusion Mr. Chairman, I would like to apologize for having dealt so much with figures, procedures and burden-sharing. Underlying all these aspects we must keep in mind that the fundamental purpose of these institutions and of all the funds you appropriate for them is to help the people in developing countries improve their miserable living conditions. Support for the development banks is important in building and maintaining the broad framework of international cooperation that is important to continued U.S. prosperity. But this is an additional benefit. The basic justification for the appropriations has to be that these banks do a good job in using the money to help the developing

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countries help themselves and that this development reaches the people in these countries in a way that justifies U.S. taxpayer support. I think the examples that others have in their testimony on the individual banks and an examination of the NAC report demonstrate that the job these institutions are doing would receive the support of most Americans if they had the opportunity to examine it carefully.

We have not asked for the amounts of money that these institutions could use to accelerate development worldwide. Given the need for budget stringency, which we in Treasury know is so essential in the United States today, we have asked for the minimum amounts necessary to keep these institutions going in a manner consistent with the highest priority needs of the poor countries and contributions being made by others. The decisions you will make on these appropriations may receive much attention in the capitals of the world. But the practical effects of the appropriations will be spread to the poorest villages, slums, and isolated areas where little is known of the United States, burden-sharing or these institutions, but where improved seed, a well, a visiting health team, availability of credit, or a road to the market can make -- at small cost -- an immense difference in the quality of life.

ASIAN DEVELOPMENT BANK

The Asian Development Bank was created in 1966 to foster economic growth and cooperation in the poorer countries of Asia and the Far East. The Bank has 27 regional members providing 72% of its capital and 14 nonregional members, including the United States, Canada, and 12 West European countries providing 28% of its capital. The aggregate voting power of the developed member countries, which include all the non-regional members plus Australia, Japan, and New Zealand, represents approximately 54% of the total. The United States participated actively in the establishment of the Bank and its subscription to the Bank's capital stock currently amounts to $361.9 million or 11% of the total.

Bank Resources

The Bank's ordinary capital lending, at interest rates of 8.75 and terms of 15-25 years, is financed from its subscribed capital and the proceeds of its borrowings. As of December 31, 1975 the ADB's subscribed capital stock amounted to $3,201.5 million of which 33% was paid in and 67% was callable. Callable capital is used exclusively to guarantee borrowings from the international capital markets and represents a potential budgetary outlay only in the unlikely event that the Bank could not meet its obligations to bondholders. Through a bond covenant the ADB is restricted to borrowing an amount not more than approximately 97% of its convertible callable capital, currently $1,264.4 million. If the Bank were to limit its new commitments to amounts which could be financed without additional capital, the Bank had resources sufficient to commit only $184 million in new loans as of December 31, 1975. Given the virtual exhaustion of commitment authority, the Bank has already initiated discussions on a capital replenishment. The U.S. has not yet taken any position on the size and timing of such a replenishment, although it is clear that additional funds are needed relatively soon.

The U.S. subscribed its first of three installments to the first ADB capital replenishment in FY 1975. Most other countries completed their subscriptions to the replenishment during 1973-1975. The request for $120.6 million in FY 1977 completes the US contribution to the replenishment and is vital to the lending program of the ADB as the figures mentioned above indicate. The funds are urgently needed to permit continued ADB lending to countries such as the Philippines, South Korea, Indonesia, and Thailand -- the major 1975 ADB borrowers. These Asian rim countries have shown strong self-help efforts to achieve economic growth and are of particular importance to the United States.

Of the $120.6 million sought for FY 1977 only $24.1 million are paid-in funds which will entail budgetary outlays. The remaining $96.5 million is callable capital which is not likely to require any US outlays. In FY 1975 only the $24.1 million of paid-in was appropriated, but on the basis of authorizing legislation the US subscribed the full $120.6 million first installment. However, we subscribed to the callable capital only reluctantly because we believe callable capital for this relatively new bank should be appropriated. The callable capital proportion of the third installment is being requested in FY 1977 for appropriation. Appropriation of this amount does not increase Treasury outlays but it gives financial analysts and the bond market greater confidence in the ADB's bond issues and, thus, with no real cost to the United States, the ADB will be able to borrow at better rates and longer terms than otherwise. Completion of the US subscription to the first replenishment will also allow us to increase our voting power in the Bank, which is now 9.5 percent, to close to the original 16 percent.

In 1975 the ADB borrowed $322.8 million in world capital markets of which $75 million (23%) was raised in the United States. This was the first ADB issue in the U.S. since early 1971 as the Bank has been relying more heavily on the Japanese and West European markets. The U.S. notes, with an 8.5 percent coupon rate, were priced at 99 percent with full maturity in five years.

Bank Lending Activities

From its establishment through December 31, 1975 the Bank has approved 150 loans from ordinary capital resources, for projects in 15 member countries, in an aggregate amount of $1.925 billion, of which $684 million has been disbursed. In CY 1975 the Bank committed $494 million for new loans. The Bank has become an important institution in Asian development, and being a regional organization, plays a major role in mobilizing self-help resources and bringing local knowledge to Asian development problems.

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In response to suggestions by the Administration and Congress and by its own borrowers, the ADB has been paying increasing attention to the social impact of its operations. Of particular concern to the Bank are efforts to create employment opportunities and increase rural incomes. Lending for agriculture and agro-industry was over 37% of total ADB/ADF lending in 1975 compared with 24.5% in 1974. The extent of this change in sector emphasis during the past couple of years is shown by the fact that despite the 1975 lending program cumulative Bank loans to public utilities currently equal $907 million (35.1%) compared with agriculture's $589.4 million (22.8%).

Recent irrigation and land development projects have been used by the Bank to provide not only infrastructure, but also farmers' credit, seeds, fertilizer, and other inputs as well as improved marketing facilities. Additionally, more attention is being given to the development of extension services and other farmers' institutions. The objective of such integrated projects is to ensure that all the various factors needed to increase productivity are provided in the appropriate balance. An example is the Pulangui River Irrigation Project in the Philippines approved in 1975 which includes all of the following elements:

-- construction of irrigation canals, drainage system and roads;

-- establishment of two pilot farms for demonstration of extension services and the introduction of intensive rat control measures;

-- the improvement of the land tenure system;

-- other farm services such as timely supply of farm credit, fertilizer, and other farm inputs.

The benefits of the project include employment totaling 2.6 million man-days during the construction period and about 477,000 man-days after the construction of the Irrigation Project and improved income distribution in the area as crop production incomes of nearly 3000 small farmers increase from $191 at present to $1,572 after 1982 for self-owners and $1,365 for leaseholders.

Many of the same concerns are also being addressed for the first time in other sectors. For example, in 1975 the Bank provided financial and technical assistance for sewerage and slum redevelopment projects. These projects, together with water supply, are a part of the ADB's efforts to increase the direct impact of its operations on lower income groups in urban areas. Under the Bandung Urban Development and Sanitation Project a comprehensive study will be conducted for the improvement of housing, roads, footpaths, water supply, sewerage, solid waste disposal, health clinics, and other facilities. The first stage of the subsequent project will improve living conditions of about 34,000 households with average incomes of less than $50 per month.

Another area of expanding Bank interest is the use of intermediate technology in rural development projects and in connection with development bank subloans to small and medium scale industries. In June 1975, the Bank approved a $13.5 million loan to the Philippines to finance, in part, farmer credits for hand tractors, baby threshers, and small driers for rice. An ADF agricultural credit loan in December to Bangladesh will be used to finance small (6-15 hp) power tillers. A $1 million loan to a Western Samoa development bank will be used for small subloans for nail manufacturing, car repair shops, mechanization of various handicrafts, and other small manufacturing shops.

The Bank has just recently approved funding of a second Asian Agricultural Survey, patterned after the Bank's successful survey of 1967, which recommended the application of new technologies as a means for accelerated agricultural rural development.

Asian Development Fund

When the Bank was established it was recognized that it would have to provide financing on concessional terms to meet the needs of its poorer developing member countries. Prior to 1973 the ADB's soft-loan special funds were contributed on an unscheduled basis through bilateral arrangements made by the Bank with donor countries.

In 1973, the ADB's Board of Governors, with United States support, adopted a resolution creating a new multilateral special fund, the Asian Development Fund, to which all contributions would be made and used on the same terms and conditions. Subsequently, agreement was reached among the Bank's developed country members on an initial resource mobilization for the new ADF of $525 million for the three-year period ending December 31, 1975. In FY 1972 and FY 1975 the Congress authorized

U.S. special funds contributions totaling $150 million, of which $100 million has been appropriated and contributed to the ADF. The final U.S. contribution of $50 million to the initial mobilization is included in the FY 1976 appropriation request.

As of December 31, 1975 the ADF/SF had committed $658.8 million for concessionary loans. This left only $40.9 million remaining for new commitments in 1976, not including the $50 million U.S. contribution requested for FY 1976.

Recognizing the depletion of ADF resources, multilateral negotiations were held in 1975 with a view to replenishing the ADF's resources. During these negotiations the U.S. representative stated that he could give no indication of the amount or timing of a U.S. contribution, in part because the United States had not yet completed its contribution to the initial resource mobilization of the ADF and consultations concerning U.S. participation in a replenishment had not yet been held with Congress. The U.S. representative did indicate that the U.S. continues to be a strong supporter of the ADB and would, in principle, expect to continue contributing to the ADF.

Recognizing that the U.S. was unable to commit itself concerning the specific timing or amount of any U.S. contribution, the ADB Board of Governors on December 3, 1975, adopted a resolution providing for the replenishment of ADF resources. The resolution provides for an ADF replenishment in an amount not to exceed $830 million for the 1976-78 period. Most donor countries agreed to contributions equal to approximately 150 percent of their initial contributions. As no decision has yet been made on the total U.S. contribution to be requested for the ADF replenishment, the United States reserved its position on the $231 million proposed in the resolution for the U.S. share while commenting that such an amount seemed large. We formally abstained on the resolution.

Pending final determination of the total three year U.S. contribution level, draft legislation authorizing an initial U.S. contribution of $50 million for FY 1977 has been transmitted to Congress. Since contributions by other countries beyond the first year of the replenishment are contingent on U.S. participation, a U.S. commitment of the $50 million in FY 1977 is essential for the successful implementation of the total ADF replenishment package. This amount represents the same level appropriated in FY 1974 and FY 1975 and requested in FY 1976. The Administration has not yet determined the level of ADF appropriations to be requested for FY 1978 and FY 1979; in any case the level will be below the suggested $231 million.

Special Fund Operations

In 1975 the ADF approved concessionary loans totaling $166 million, which was considerably less than the Bank's expected program of $200 million in part because no loans were approved for South Vietnam, Cambodia, or Laos. The loans went to the poorest South Asian and Pacific states with Bangladesh, Pakistan, Burma, and Sri Lanka as principal borrowers. Agricultural and agro-industry projects accounted for 65% of the total lending and public utilities for 29%. Only Asian countries with 1972 per capita incomes of less than $300 are eligible for the loans which carry a service charge of 1% with maturities of 40 years including 10 years grace period on repayments.

Indochina

The Asian Development Bank, with strong U.S. support, made loans to South Vietnam, Cambodia, and Laos in previous years when conditions in these countries were quite different from the present situation. In April, 1975, the Bank suspended all loan operations in Vietnam and Cambodia. Operations have not resumed and no new loans have been considered or approved. There has been no contact by the ADB with Cambodia since last April. Although the Vietnamese have indicated some interest in the IMF, IBRD, and ADB, our attitude, and that of the ADB, is that benefits are limited to those countries willing to accept and implement the obligations and responsibilities of membership including Bank staff access to national economic data, freedom of staff entry and movement, adherence to conditions stipulated in loan agreements, and international competitive bidding for project procurement. Until the present governments of South Vietnam and Cambodia agree to follow these procedures we expect no ADB financial assistance to these countries. At this time there is no evidence that these countries are prepared to comply with ADB requirements.

In Laos the ADB is closely monitoring its operations to ensure that loan conditions are being met and the projects properly implemented. As indicated below, the actual amount of funds disbursed to suppliers for projects in Vietnam, Cambodia, and Laos as of December, 1975, was only $12 million.

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ADB/ADF Indochina Loans

(U.S. millions $)

	Loans Approved	Amounts Disbursed	Paid-In 1/ Convertible Currencies
South Vietnam	$44.6	$5.7	$ 4.5
Cambodia	1.7	.6	1.2
Laos	11.7	5.7	0.2

1/ Contributed to ADB by these countries

Conclusion

As Secretary Simon pointed out in his speech at the ADB annual meeting in Manila last year, Asia has a special significance for the United States. He echoed President Ford's promise that the United States would continue to work cooperatively with others in maintaining the security and building the prosperity of the region. In an increasingly interdependent world, the United States, as a nation of the Pacific as well as the Atlantic, must remain involved. The competence of the Asian Development Bank is a strong asset in assisting our efforts to achieve these goals.

ANNEX 2

AFRICAN DEVELOPMENT FUND

Authorization for US membership in the African Development Fund (AFDF) is presently pending before Congress. The House of Representatives voted in favor of the authorizing legislation (HR 9721) on December 9, 1975. The Administration is requesting an amendment to the FY 1976 budget or a supplemental budget to provide $15 million to be made available to the AFDF in three annual installments over the FY 1976-1978 period.

African Development Bank. The AFDF is the concessional loan affiliate of the African Development Bank (AFDB). The AFDB was established in the early 1960's to assist in the economic and social development of the newly independent African nations and to promote economic cooperation among them. The Bank's membership is exclusively African, with 41 member countries persently subscribing convertible currencies to the ordinary paid-in capital of the Bank amounting to $235 million. Through December 31, 1975, the Bank had authorized $317 million for ordinary capital loans for 107 projects in thirty-seven member countries, mainly in the public utilities and transport sectors.

The Bank faces an extremely challenging task because Africa is the world's least developed continent. Over half of the twenty-five poorest, least developed countries in the world are in Africa; thirteen of the world's eighteen land-locked developing countries are African; twenty-two of thirty-three of the United Nations' "most seriously affected" (MSA) countries are African. About 75 percent of the African population is engaged in subsistence agriculture and in half of the countries per capita income is less than $100 per year. Because of these dramatic problems many of Africa's developing states simply cannot afford to borrow at the 6% rate of interest for 8 to 20 years offered by the Bank for many of their high priority development projects. To meet the need for softer terms for these projects, the Bank decided to establish a source of concessional funds.

Establishment of the African Development Fund. In 1966, in recognition of these problems and in an effort to increase the involvement of the industrial nations in African development efforts, the Bank undertook discussions with developed countries on establishing a concessional facility associated with the Bank. After six years of negotiations, and with U.S. assistance in drafting the charter, the African Development Fund was inaugurated in July 1973. The present members of the Fund are Canada, Brazil, Japan, Saudi Arabia, twelve European donors and the Bank itself representing all of its member countries.

The Fund is legally spearate from the Bank and managed by its own board of directors, six of whom are chosen by the Bank and six by the door countries. A 75 percent weighted vote is required for all operational decisions.

The Fund uses the Bank's staff and draws upon its expertise, as do the concessional funds of the other international development lending institutions. All loans bear a 3/4 of one percent service charge, with a forty-year maturity plus a ten-year grace period. The Fund directs its loan resources toward social development projects. Although all members of the AFDB are theoretically eligible for concessional loans, only the poorest recevie them in practice.

Fund Resources. Since the Fund's establishment, donor nations have pledged about $145 million in concessional loan resources and the Bank has contributed another $7 million. The proposed U.S. appropriation of $15 million for the African Development Fund--which represents about 9 percent of the contributions so far pledged by members would bring the level of total subscriptions to about $167 million. The United States would be the fourth largest contributor, after Canada which has pledged $25 million and Japan and Germany, each of which has pledged $16.7 million.

The AFDB recognizes the importance of concessional lending in a region as poor as Africa and is continuing to seek additional resources for the Fund, through the enlistment of new members, the increase in donor subscriptions, and bilateral loans and grants. The replenishment of the Fund's capital resources for the 1976-1978 period was discussed in Paris in November 1975, the fourth in a series of such meetings. The AFDF hopes that the current donor members will contribute twice as much in the next three years as in the last three years. The proposed U.S. contribution would be

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paid in over the new replenishment period. Thus, it is likely that the United States share would drop substantially in donor ranking.

Fund Operations. During the first two years of operation (1974 and 1975) the Fund made 40 loans totalling $140 million to finance projects, predominantly in the area of agriculture. Sixteen of these loans, for $60 million, have been for long-term development projects such as village wells, roads, earthen dams, and irrigation in the six drought-affected countries comprising the Sahel.

The Fund staff has laid out an ambitious lending program over the next three years. Management has estimated that during the 1976-78 period, the Fund will lend between $350 and $385 million. As of October 1975 the Fund's pipeline contained 93 projects, mainly in the agricultural and transport sectors, totaling $304 million.

During late November 1975, a delegation of Treasury officials, Congressmen and Congressional staff visited four West African countries in order to view at first hand the activities of the World Bank and the African Development Bank and the economic problems of the borrowing countries. In Mali, of one of the world's poorest countries which has suffered from severe drought in recent years, the group visited two projects which had benefited from AFDB/AFDF loans. One, a state-owned textile mill, manufactured printed cloth to be marketed locally from raw cotton produced in Mali. The plant not only provided much needed employment for some 850 Malians, but helped conserve scarce foreign exchange by reducing the need for importing the goods. The group was also shown a demonstration well shaft that had been dug by hand and reinforced with concrete to teach people from outlying bush areas modern well-drilling techniques. The AFDF project uses non-capital intensive or intermediate technology, which can be used in villages and on farms. This "operation wells" program designed by the Government of Mali to meet the water requirements of the rural population and livestock, is a significant example of a development project (to which the AFDF contributed $4.4 million) directly improving the daily lives of the poor.

In Liberia the delegation visited the Liberian Bank for Development and Investment (LBDI) which had received $3 million from the AFDB. The AFDB has made similar loans to national development finance corporations like the LBDI throughout Africa. In visiting a Liberian-owned chicken farm near Monrovia, the group saw an example of how the AFDB line of credit was being used effectively to extend small loans to individual Liberians, for productive purposes.

US Membership in Fund. Because the US participated in the drafting of the agreement establishing the Fund, we would have been eligible to be an "original participant" had we contributed to the Fund by December 31, 1974. This would have made our membership in the Fund automatic and entitled us to participate in the election of directors in May 1975. Because we did not meet the December 31 deadline, the terms of our membership are not at this moment defined and our entry into the Fund is subject to unanimous approval by the Board of Governors. We believe that, if the proposed appropriation is approved, we will be able to negotiate membership in the Fund under terms similar to the original charter conditions.

One aspect on which we have already held informal discussions with the Fund Management concerns Article 13 of the Fund's charter which provides for maintenance of value on currency holdings during the period after a member's contribution has been paid and before the funds are lent out or exchanged for another currency. In order to avoid being subject to this limited maintenance of value obligation, we have secured agreement from the Fund management that our contribution would be converted to another currency on receipt. According to Article 13, this procedure will free the US from any maintenance of value obligation.

Importance of Africa to U.S. Africa has a growing economic significance for the U.S. Total U.S. exports to all Africa rose from $3.7 billion in 1974 to around $5.2 billion in 1975. As a result, Africa's share of U.S. world exports grew from 3.7% in 1974 to 4.2% in 1975. Under the articles of the Fund, procurement of goods and services for projects financed by the Fund is limited to members only. Until the United States joins the Fund U.S. exporters and contractors will be unable to compete for this potentially substantial source of export earnings represented by Fund projects. Moreover, our export sector and service firms will be at a major disadvantage in terms of follow-up business and will not have incentives to establish markets in some African countries.

During the ten-year period from 1964 to 1974, U.S. investment in Africa quadrupled. Investment and trade in minerals and petroleum account for the largest share of U.S. economic activity in Africa. Three-quarters of U.S. direct investment in Africa are in these areas. In 1974, African petroleum alone accounted for 26 percent of total U.S. imports of crude oil. For the first nine months of 1975 Africa's share rose to 34 percent. During the same period we obtained the following percentages of our mineral imports from Africa: cobalt--36%; manganese--44%; antimony--40%; platinumum--39%. In addition to minerals, we obtain 21% of our coffee and 48% of our cocoa from African exporters.

Despite several problems, U.S. participation in the AFDF is consistent with our national interest. Looking at the African continent from the perspective of the long term, the extent to which we can assist, through the AFDF, in raising the living standards of Africa's poor, is clearly in the U.S. interest.

Following enactment of the authorization the Administration hopes that prompt action will be taken on the request for $15 million of appropriations in FY 1976 for the AFDF. Early action is necessary to permit the U.S. to join the Fund before the annual meeting in early May. At that meeting elections will be held for executive directors, providing what may be the only opportunity during the next three years for election of a U.S. executive director. If these appropriations are provided in FY 1976, the Administration does not plan to request additional appropriations for the AFDF in FY 1977.

TRENDS IN SHARE OF INTERNATIONAL DEVELOPMENT BANK
RESOURCES PROVIDED BY THE UNITED STATES
(% of Contributed Resources)

	IBRD	IDA	IDB		ADB	
			OC	FSO	OC	SF
Initial Contribution	41.4	42.6	43.1	68.5	20.0	28.6
First Replenishment	32.9	41.9	43.1	68.5 1/	18.2	
Second Replenishment	28.0	40.0	43.1	83.3		
Third Replenishment		39.9	41.2	75.0		
Fourth Replenishment		33.3	32.4	66.7		
Fifth Replenishment				57.4		
Cumulative U.S. Share	25.3	37.7	40.4	69.2	18.8	28.6

1/ If the SPTF is included, the U.S. provides a total of 90.7% of IDB concessional resources through the first replenishment.

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OIDB
March 12, 1976

International Development Bank Loans To OPEC Countries
FY 1974 Through FY 1976
(millions of dollars)

Country	FY 1974 World Bank Bank	FY 1974 World Bank IDA	FY 1974 ADB/IDB OC	FY 1974 ADB/IDB SF FSO	FY 1974 Total	FY 1975 World Bank Bank	FY 1975 World Bank IDA	FY 1975 ADB/IDB OC	FY 1975 ADB/IDB SF FSO	FY 1975 Total	FY 1976 1/ World Bank Bank	FY 1976 1/ World Bank IDA	FY 1976 1/ ADB/IDB OC	FY 1976 1/ ADB/IDB SF FSO	FY 1976 1/ Total	Grand Total
Abu Dhabi	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Algeria	157.5	-	-	-	157.5	48.0	-	-	-	48.0	46.0	-	-	-	46.0	251.5
Ecuador	23.2	5.5	-	55.7	84.4	4.0	-	35.0	23.5	62.5	-	-	40.7*	-	40.7	187.6
Indonesia	48.0	84.0	11.78	21.54	165.32	332.0		77.1	14.2	423.3	68.0		66.05		134.05	722.67
Iran	265.0	-	-	-	265.0	52.5		-	-	52.5	-	-	-	-	-	317.5
Iraq	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Kuwait	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Libya	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Nigeria	75.0	-	-	-	75.0	173.0	-	-	-	173.0	-	-	-	-	-	248.0
Qatar	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Saudi Arabia	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Venezuela	22.0	-	-	-	22.0	-	-	-	-	-	-	-	-	-	-	22.0
Total	590.7	89.5	11.78	77.24	769.22	609.5	-	112.1	37.7	759.3	114.0	-	106.75	-	220.75	1749.27

Includes $29.6 million from Venezuelan Trust Fund.

Through March 1, 1976.

OIDB March 11, 1976

ANNEX 5

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CO-FINANCING OPERATIONS BETWEEN BANK/IDA AND ARAB DEVELOPMENT BANKS (in US$ millions equivalent)

COUNTRY AND PROJECT	FY	IBRD LOAN	IDA CREDIT	CO-FINANCING INSTITUTION	AMOUNT LENT	TOTAL PROJECT COST
Burundi- Coffee Improvement	76		5.2	Kuwait Fund	1.2	7.5
Rwanda- Highways	70		9.3	Saudi Fund	5.0	25.7
	76		9.5			
Sudan- Irrigation	73		42.0	Kuwait Fund	11.0	96.0
Supplemental	75		20.0	Kuwait Fund	39.0	148.0
				Arab Fund	14.5	
				Saudi Fund	28.0	
Tanzania- Textiles	75	15.0		Kuwait Fund	15.0	44.3
Maize	76		18.0	BADEA 1/	5.0	38.0
Zaire- Mining	75	100.0		Libyan-Arab Foreign Bank	100.7	435.0
Water Supply	76	21.5		BADEA 1/	10.0	70.4
Ghana- Cocoa	76	14.0		BADEA 1/	5.0	30.0
Mauritania- Ports	76		8.0	Kuwait Fund	8.3	27.5
Highways	75		3.0	Kuwait Fund	3.8	13.7
Nepal- Hydroelectric	76		26.0	Kuwait Fund	17.5	68.0
Algeria- Ports	74	70.0		Arab Fund	20.0	293.2
				Kuwait Investment Company	60.0	
Cement	76	46.0		Local Algerian Banks	89.8	214.4
Egypt- Fertilizer	74		20.0	Arab Fund	22.1	132.4
				Kuwait Fund	23.8	
				Abu Dhabi Fund	10.2	
				Libyan-Arab Foreign Bank	10.1	
				Qatar	3.4	
Cotton Ginning	74		18.5	Saudi Fund	25.6	40.4
Suez Canal	75	50.0		Kuwait Fund	34.5	288.0
				Saudi Fund	50.0	
				Abu Dhabi	34.5	
				Qatar	10.0	
Cement	75	40.0		Arab Fund	23.0	84.0
Railways	75	37.0		Saudi Fund	65.0	296.3
Telecommunications	75		30.0	Saudi Fund	23.0	173.4

1/ Arab Bank for Economic Development in Africa

COUNTRY AND PROJECT	FY	IBRD LOAN	IDA CREDIT	CO-FINANCING INSTITUTION	AMOUNT LENT	TOTAL PROJECT COST
Jordan - Thermal Power	73		10.2	Kuwait Fund	10.2	25.0
Power	76		5.0	Arab Fund	13.4	22.0
Syria - Thermal Power	74	25.0		Kuwait Fund	33.0	62.6
	75	8.6		Abu Dhabi Fund	15.0	
Tunisia						
Gas Pipeline	71	7.5		Kuwait Fund	2.5	14.3
Phosphate	73	23.3		Kuwait Fund	6.9	64.2
Sewerage	75	28.0		Saudi Fund	30.0	86.1
Yemen, A. R.						
Agriculture	73		10.9	Kuwait Fund	5.9	17.5
Water Supply	74		6.25	Abu Dhabi Fund	1.0	6.8
Agriculture	75		10.0	Abu Dhabi Fund	10.0	23.2
Highways	75		9.0	Kuwait Fund	5.0	15.7
Water & Sewerage	75		8.1	Arab Fund	21.0	31.2
Yemen, P.D.R.						
Highways	75		15.5	Kuwait Fund	15.3	31.8
Ports	76		3.2	Arab Fund	13.6	17.6
Yugoslavia						
Oil Pipeline	76		49.0	Kuwait Fund	125.0	377.0
				Libya	70.0	
Totals		485.9	366.65		1,141.8	3,321.2

March 15, 1976

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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STATEMENT BY THE HONORABLE JOHN M. PORGES
UNITED STATES EXECUTIVE DIRECTOR
OF THE INTER-AMERICAN DEVELOPMENT BANK
BEFORE THE SUBCOMMITTEE ON FOREIGN OPERATIONS
OF THE HOUSE COMMITTEE ON APPROPRIATIONS
MARCH 16, 1976, at 2:00 P.M., EST

Mr. Chairman: I am pleased to testify today in support of the Administration's request for funding of U.S. participation in replenishment of resources and expansion of membership for the Inter-American Development Bank. This participation is part of two international agreements which will increase IDB resources by more than $7.0 billion. Authorizing legislation has already passed the House and is now pending in the Senate. I hope for rapid approval of the authorizing measure in the Senate and urge prompt funding of our appropriations request which is indispensable to continued operations of the Bank.

This year is a critical time in the life of the IDB because we have now committed all available resources from both the ordinary capital and the Fund for Special Operations.

The most urgent need is for a 1976 supplemental appropriation of $240 million. Of this amount, $40 million is paid-in inter-regional capital and $200 million is callable ordinary capital. We are not requesting appropriation of $160 million which is being authorized for our contribution to inter-regional callable capital. The callable capital portion is a contingent liability of the U.S. Government. It would constitute an actual budgetary outlay only if called to meet funded debt payments of the Bank. No call of this kind has ever been made in the past and the possibility is highly unlikely in the future.

For fiscal year 1977, we are requesting a second tranche of $240 million for ordinary and inter-regional capital, of which $40 million is paid-in and $200 million is callable. We are also requesting $200 million for the first installment of our participation in the replenishment of FSO resources for concessional lending.

At this point, I would like to explain why we are asking for U.S. subscriptions to both ordinary capital and inter-regional capital. The inter-regional capital was specifically created for the non-regionals a to avoid constraint of a borrowing limitation in the covenants of bond issues previously made by the Bank. These covenants restrict ordinary capital borrowings to an amount not more than the callable capital contribution of the United States. Although these covenants are no longer being made, the effect of the older covenants runs to 1995, the final maturity date for some of the bonds.

Thus, a new class of inter-regional capital was necessary to permit the Bank to fully utilize the capital contributions of members other than the United States by borrowings against their callable capital portions. Any member country can subscribe in whole or in part to either ordinary capital or inter-regional capital. For this replenishment period (1976-78) the United States is making one-half of its subscription to inter-regional capital. Canada, Venezuela and the non-regional countries are making 100 per cent of their subscriptions to this new class of capital.

There is absolutely no difference between the two classes of capital in terms of voting power or pre-emptive rights. In fact, a merging of the two is expected when the restrictive covenants are no longer outstanding.

I have said that approval of this request is urgently needed if operations of the Bank are to continue. The regular limits of ordinary capital commitment authority were reached in September, 1975. Only a temporary change in regulations has permitted further commitments against loan reflows and certain categories of reserves and this temporary authority is now completely committed or allocated for pending loans. In point of fact, the IDB has suspended Board approval of ordinary capital loans. The full amount of our supplemental request for ordinary capital in FY 1976 is, therefore, needed as rapidly as possible for resumption of lending as well as for a return to our regular accounting practice.

Meaningful planning of this year's lending program has become extremely difficult. Processing of individual loan applications within the staff is only being done on the assumption that the funds we are now requesting will be approved.

Until we effectively subscribe to our share of the first installment of ordinary and inter-regional capital, the subscriptions of the other member countries cannot become effective and thus cannot be used for lending operations. In addition, prospective non-regional members have counted on timely action by us as they go forward with their own subscriptions.

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So far as the Fund for Special Operations is concerned, the 1976 program can proceed with final Congressional approval of the remaining $275 million due under terms of the 1970 replenishment agreement. Accordingly, we have not asked for appropriation of FSO funds under the 1975 agreement until FY 1977.

Having spoken of our need for funds, let me turn now to consideration of burden-sharing. A more equitable distribution of the burden of providing international economic assistance has been a continuing objective of the United States. In fact, during negotiation of previous replenishments we called on Latin American countries to consider expanded membership of the Inter-American Development Bank as one way of meeting this objective. The 1975 replenishment and its concurrent expansion of membership are the successful conclusions to these first steps.

During 1976, 12 non-regional members will join the Bank and contribute an additional $745 million to its resources. Of this amount, $440 million will be in cash for conventional and FSO lending. The remaining $305 million will be in callable form to serve as backing for Bank borrowing. In return, the non-regionals may hold up to 8 per cent of the voting stock. The regional countries of the Bank, aside from Canada and the United States, will also take up a special increase of $440 million in capital stock in order to maintain at least 53.5 per cent of the voting power. As a result of these measures, the U.S. voting share will decline to 34.5 per cent from the current 40 per cent. This is still sufficient, however, to maintain a U.S. veto of FSO lending proposals.

There is, however, a second and regional aspect to the issue of burden-sharing. Several of the relatively more advanced developing countries of the hemisphere now have donor status with respect to the Fund for Special Operations. Argentina, Brazil, Mexico, Venezuela and Trinidad and Tobago are prepared to make convertible all or part of their contributions to the Fund. They have further agreed not to borrow in convertible currencies from the Fund. These actions have the effect, of course, of directing more concessional funds toward the least developed countries of the hemisphere, which is another one of our long-sought objectives. In addition, I should also mention the establishment of a Venezuelan Trust Fund of $500 million and the agreement by Venezuela to make convertible an additional $100 million in FSO funds already in the Bank for concessional lending.

To sum up these points, Mr. Chairman, let me say that the share of the United States in the provision of new resources has declined to 30 per cent of the total. For purposes of comparison, the corresponding percentage figure for the 1970 replenishment was 48 per cent. In terms of absolute amounts, the U.S. share of the total replenishment and membership expansion package is $2.25 billion. A substantial amount of callable capital, however, reduces the actual budgetary outlay figure to $720 million. Again, for purposes of comparison, the corresponding budgetary outlay figure for the 1970 replenishment was $1.15 billion. What we have achieved, therefore, are very substantial reductions in the U.S. share in both percentage terms and absolute amounts.

Heavy use of callable capital and reliance on borrowing operations to raise private capital have provided needed leverage and reduced U.S. budgetary outlays, clearly very desirable results. Last year, the Inter-American Development Bank began what I consider a very promising major new effort to raise additional private funds for economic development projects.

A new "Complementary Financing" program permits commercial banks and other organizations to take up without recourse the earlier maturities of specific loans. In turn, the IDB agrees to perform the necessary technical analysis and act as collection agent for a fee. The interest rates charged by the commercial banks vary at a given spread above a reference rate. (Either the prime rate in the United States or the Libor in London.)

This new procedure makes possible direct participation by private banks in the development process at appropriate maturities and interest rates and at reduced risk. Thus far the IDB has utilized $30 million of complementary financing. For this calendar, we are hopeful of mobilizing an additional $100 million. The procedure also helps to introduce some IDB borrowers to the private capital markets. As their creditworthiness reputation develops, they will be able to borrow more in this area and eventually require less lending by the IDB.

In yet another exercise to expand usable resources, the Bank and its member countries are looking for ways to improve the "four currency agreement" in which local currency of one developing member country may be used to finance projects in another. I, myself, have recently asked Bank management for a further study of how we can derive maximum benefit from the local currency contributions of our member countries.

At this point, Mr. Chairman, I would like to report to the Subcommittee on the most recent development of lending policies within the Bank. Emphasis continues on channeling assistance to the poorest and least developed member countries. In calendar year 1975, for example, $306 million of FSO resources went to category D borrowers which are the least-developed members of the Bank, including such countries as Haiti, Paraguay, Bolivia and Central America, exclusive of Costa Rica.

Emphasis is also being placed on helping the poorest elements of the population within these countries. For some time, the IDB has led the way in financing of potable water, rural electricity, and health and education projects. We have also tried to reach poor farmers with agricultural credit programs. In this particular respect, I can report that during calendar year 1975, the Bank approved loans totalling $138.7 million to cooperatives and similar organizations. Of this total, $53.67 million came from FSO resources and $9.0 million was supplied from the Social Progress Trust Fund. Bank management estimated that more than 1.6 million individuals will benefit from the work to be

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undertaken by the cooperative enterprises.

In January of this year, we also approved additional loans involving $12.1 million for cooperatives in programs which should benefit 110,000 more people. In the same month, we also approved expenditures of $48.0 million over three years to assist the Inter-American Foundation in its programs. The Administration of the Bank is now preparing a proposal to provide between $10 and $20 million to the Inter-American Savings and Loan Bank. In this program, concessional funds from the Social Progress Trust Fund would be used for the benefit of lesser income participants of S and L's in Latin America.

In its legislation appropriating funds for the IDB for fiscal year 1975, the Congress included language which earmarked $50 million for cooperatives, credit unions, and savings and loan associations. The examples I have just cited show that the Bank is doing a great deal in these areas. In my opinion, the earmarking is not necessary. The Bank has said it cannot accept such funds because of charter limitations and that it would create a precedent for earmarking by other countries for other purposes. For all these reasons, I welcome the fact that the House bill for FY 1976 does not contain the same provision. From an equity or welfare viewpoint, the Bank is already making a very significant contribution to economic and social development in its member countries.

At the same time, the Bank also is concerned with efficiency. Last year, we took the lead in establishing a new Hemispheric Committee to help promote greater agricultural production. Its membership consists of representatives from A.I.D., the World Bank and other international organizations interested in agriculture. The objective of this group is innovative and constructive change, not only in the projects we and others finance, but also in the government policies which ultimately determine how successful these individual projects will be. Greater participation by private business and application of modern method is certainly one avenue to be followed.

Another extremely important prospect is the application of intermediate technology. The use of idle labor with new methods and simple or less sophisticated tools needs much greater emphasis as a factor for more effective utilization of scarce foreign capital. Within the Bank, we have made particular efforts in this respect in agriculture in Brazil, Colombia, the Dominican Republic and Mexico.

A recent loan to Mexico for integrated rural development offers especially interesting possibilities for application of intermediate technology. It was approved by the Bank's Board of Directors in October of 1975. It is designed to provide permanent employment and raise income levels of 1.3 million people in 15 regions of Mexico. Directly productive investments under the loan include establishment of small orchards and development of quarries and industries including brick-making, garden produce processing plants, and sewing shops. Naturally, the leading objective of employment generation calls for use of the most appropriate technologies and this aspect of the program will be closely supervised.

As a necessary correlative to these direct investment projects in Mexic there are such infrastructural investments such as water supply systems, home schools and health centers. Completion of the entire program is expected to double or triple annual family income in the 15 regions and to increase the total value of production by $35 million per year.

Another recently-approved loan which I can bring to the Subcommittee's attention involves rural health services in Haiti. It presents an excellent example of how the Bank's work in a critically important field is affecting poor people in rural areas. The loan amounts to $6.3 million from FSO resources and is designed to build and equip 36 dispensaries, 23 health centers and one new health and training center. Bank management has estimated that it will benefit 1.9 million people in both the northern and southern regions of the country.

I have cited these two specific examples to show how the Bank is responsive to the concerns expressed by the Congress. During my tenure in the Bank, I have personally visited several dozen urban and rural projects and have been very impressed with how needs of

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under-privileged people have been addressed by the Bank's work. Last spring, for example, I was in the Dominican Republic and inspected an integrated rural development project, similar to the one which is just starting in Mexico. In one sub-project, the herds of cattle of smaller participants had been increased from 10 to 30 head. In another sub-project, technical support and training were being provided for better extension services to complement the flow of credit.

In my opinion, a great deal has been accomplished in reorienting Bank lending, especially FSO, toward the least developed countries and the poorest elements of their populations. So far as intermediate technology is concerned, our activity in this area is much more recent, and because of this the actual progress is both less apparent and less satisfactory. Personally, however, I am very much convinced of the advantages of this approach -- especially the resource-stretching aspects. I think the results of the Mexican operation will be watched carefully and other opportunities will be sought for specific application of this concept.

Before concluding, I would like to comment briefly on the economic situation and prospects for Latin America. Overall, it has been a story of success. Gross national product for the region as a whole has grown in real terms at almost 7 per cent per annum. Before oil prices increased, Brazil and the Dominican Republic were increasing their production by 10 per cent per annum. Value added in manufacturing

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and the installed electrical capacity in Latin America have both more than tripled.

In social terms, primary school enrollments tripled; adult literacy grew from 52 per cent in 1950 to 73 per cent in 1970. The number of rural families with access to potable water also tripled. Of course, the IDB has played an important part in all of these achievements.

Serious problems remain, however, and have worsened with the oil price increases. Some countries have severe balance of payments difficulties. Others experience debilitating rates of inflation. Much remains to be done in meeting basic nutritional requirements; giving more children primary educational opportunities, and reducing infant mortalities.

It is with these thoughts in mind, Mr. Chairman, that I request rapid approval of the IDB appropriations request for fiscal years 1976 and 1977. The development possibilities for the hemisphere have been much enhanced by our replenishment of resources and expansion of membership. I hope the United States will do its fair part in continuing the process of economic and social development in a region which is so vital to our own national interests.

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STATEMENT BY MR. CHARLES A. COOPER
UNITED STATES EXECUTIVE DIRECTOR AT THE
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
BEFORE THE FOREIGN OPERATIONS SUBCOMMITTEE OF THE
APPROPRIATIONS COMMITTEE OF THE HOUSE OF REPRESENTATIVES
FOR FY 1977 IDA APPROPRIATION

TUESDAY, MARCH 16, 1976
2 P.M.

Mr. Chairman:

I am pleased to appear before this Sub-committee today to support the Administration's Fiscal Year 1977 request for $375 million for the International Development Association (IDA) and $45 million to initiate U.S. participation in the first capital increase for the International Finance Corporation since its founding twenty years ago.

The request for IDA represents the second instalment of the U.S. share of the IDA Fourth Replenishment, which was authorized by the Congress in July 1974. The IDA is the arm of the World Bank which provides concessional lending to support projects in the world's poorest countries which cannot afford to borrow at the near commercial rates which apply to standard World Bank loans. It is the largest multilateral source of assistance of this type. It follows the same rigorous standards, and enjoys the same high reputation throughout the world, as does the World Bank itself.

Sixty-six countries of Asia, Africa, and Latin America with annual per capita incomes below $375 have received IDA credits. Currently, most credits

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go to countries with per capita incomes of less than $200. In FY1975-1976, 92% of IDA credits were to these poorest countries. The greatest concentration of projects is in Asia and Africa, reflecting the fact that the bulk of the world's poorest people are living in these regions. About 60% of IDA credits go to South Asia -- where 61% of the population of all countries with per capita incomes below $200 live.

The appropriation request before you is for the second instalment of IDA's ongoing Fourth Replenishment. This replenishment was negotiated with 24 other donor countries after consultation with Congressional committees. In that negotiation, we sought, and achieved, broader sharing of the burden by reducing the U.S. share. The U.S. share of the $4.5 billion IDA IV is 33 percent, or $1.5 billion, down from earlier U.S. participation levels which had averaged 41 percent since the inception of the Association in 1960.

While the IDA IV resource replenishment will support new lending commitments over the period fiscal year 1975-77, it gives donors the option of deferring their initial contribution to fiscal year 1976 and paying in four annual instalments. The United States is planning to follow this course. Most other donors are making their contribution to IDA IV in three equal annual instalments over the three-year replenishment period. As a result, most donors have already made two-thirds of their contributions to IDA IV while the U.S. has not yet paid its first instalment.

By the end of October 1976, all of the first U.S. instalment of $375 million requested for FY1976 will be needed to cover the U.S. one-third share of disbursements on approved credits. Subsequently, calls will be made requiring the FY77 appropriations under discussions today. Full U.S. contributionsto IDA IV are essential to insure the continued participation of the other donor countries and the continued operation of IDA at the lending levels contemplated under the IDA IV agreement. Unfortunately worldwide price inflation since the negotiation of IDA IV has reduced the real value of IDA pledges substantially below what was contemplated at the time international agreement was reached -- this makes it all the more important to provide the full amount of funding requested. Such continued financial assistance from IDA is vitally necessary if the momentum of development in the poorest countries of the world is to be maintained at anything approaching adequate levels.

I would emphasize that the purpose of IDA lending is not relief or make work. It is rather to expand productivity, for only in this way can lasting improvement in the lives of the poor be achieved. Toward this end all IDA projects are appraised against strict rate of return standards, in exactly the same manner as projects supported by World Bank loans on harder terms.

IDA credits are extended on highly concessional terms: repayment is over 50 years at three-fourths of 1 percent. This is consistent with the fundamental purpose of IDA, which is to provide badly needed assistance to the borrower rather than yield a commercial rate of return to the lender. Most of the countries which borrow from IDA lack the capacity to service external debt on conventional terms, and even if they could, repayment on conventional terms would mean a lower rate of return for the borrowing country itself, and thus a smaller contribution to improved living standards and rising domestic savings and investment capacities.

IDA's focus, particularly in the IDA IV period, is on assistance to the poorest developing countries, and within these countries emphasis is given to projects benefiting the poorest groups of people. In FY1974-75, about 40% of IDA lending was for agriculture and a further 25-30% for basic infrastructure -- transportation, communications, power and water supply. A complete

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list of IDA projects in FY1975 and so far in FY76 is attached to this statement.

The increased emphasis on agriculture reflects IDA's growing role in helping these countries meet their food production goals. Solving the world food problem has to be achieved by increasing food output in the food deficit countries themselves -- India, Pakistan, Bangladesh, and a number of countries in Africa.

An example of a recent agricultural project is a $27 million IDA credit to Ethiopia for the development of its vast rangelands region which was hit by a severe drought during the years 1970-73. Before this drought, Ethiopia's livestock resources were the largest of any country in Africa. The true dimensions of the losses attributable to the drought are not yet certain. However, it is estimated that about 15% of the national herd was lost, largely in the rangelands areas.

The project will consist of three separate subprojects, each with its own organizational structure. Each of the subprojects -- the Southern Rangelands, Jijigga, and the Northeast Rangelands Development Projects -- will provide an integrated program of range management and veterinary services along with improved roads and water facilities. They will help lay the foundation for a sound future development of the livestock economy in the range areas.

At full development the project is expected to result in an increased market production from the ranges of 100,000 head of cattle, 48,500 sheep and goats, and 3,000 camels annually. The project would also result in an increase in milk production of about 7.8 million liters annually. Incremental crop production from water development in the Northeast Rangelands area would total about 1.1 million kg of cotton, 320,000 kg of sorghum or maize, and 120,000 kg of groundnuts annually. The total annual value of incremental production attributable to the project would be about $11 million. Overall, the project is estimated to affect 100,000 families in the rangeland areas, raising their average per capita income significantly above its present bare subsistence level.

A number of IDA projects are also directly aimed at increasing the availability of the inputs vitally necessary to expanded food production -- seeds, extension services, fertilizer, etc. A project recently approved for India is a notable example.

In recent years, consumption of fertilizers has increased in India. But it still remains very low relative to usage in other countries. In 1974/75, consumption stood at 2.74 million nutrient tons. Although domestic production of fertilizer has grown at an average annual rate of 16% since 1953/54, it supplies less than 60% of consumption. The level of capacity utilization is low, reaching only some 60% of the installed capacity of 2.6 million tons. The IDA credit of $105 million will allow production in existing facilities to be raised from the present industry-wide average of about 60% of capacity to 85% by 1979. The credit will assist 10 fertilizer plants in removing production bottlenecks, improving pollution control and increasing the production of industrial chemicals. The project will help to increase fertilizer production by 253,000 tons per year of nutrients.

IDA infrastructure projects typically provide key elements in the borrowing countries' national development efforts. An example is a $14 million credit to Guinea for a highway project which will help to link widely dispersed population centers and productive areas to the port of Conakry. The project, designed to enhance government efforts to revitalize the agricultural sector, will include (a) rehabilitation of approximately 2,500 kilometers of high priority roads and initiation of proper maintenance operations on these roads;

(b) repair of existing equipment and plant and rehabilitation of workshops; (c) purchase of needed equipment, spare parts, and training materials; and (d) technical assistance to the Ministry of Public Works, Mining and Geology in implementing the projects and strengthening its managerial capabilities. The project is expected to insure greater transport reliability, expand the seasonal use of the most important unpaved roads and reduce transport costs.

Another example of a basic infrastructure project recently done by IDA is a $26 million credit to Nepal to help finance a $68 million hydroelectric power project. Nepal has a very large undeveloped hydroelectric power potential of over 80,000 Megawatts (MW). Total installed capacity is some 54 MW, of which only 33 MW is hydroelectric power. Electricity at present reaches only about 3% of the population. But demand for electrical energy has been growing at the rate of 22% a year, and existing generating capacity is insufficient to meet the demand.

The project is located about 30 kilometers southwest of Kathmandu, the nation's capital. It includes the construction of a 107-meter high rock-fill dam, a powerhouse with two 30 MW generating units and associated transmission and substation facilities. When fully utilized, the project will replace use of energy equivalent to about 65,000 tons of oil per annum, saving approximately $8 million per year in foreign exchange.

IDA lending operations have also focussed increasingly on equipping the populations of the poorest countries with the skills essential to economic progress. For example, an $11.6 million credit to Malawi was made in support of a Government investment program giving priority to the growth of primary education, the improvement of secondary schools in the rural areas, and the strengthening of various non-formal education programs. The IDA project consists of the construction and equipping of 22 new model primary schools which can be easily duplicated in the rural areas, 22 rural education centers, one teacher training college including a demonstration school, and additional laboratories, workshops, dormitories and staff quarters for seven existing secondary schools.

The project will provide facilities to expand and strengthen on-going education programs and help meet the rapidly increasing demand for basic skills. It will also reduce socio-economic disparities by increasing the enrollment of girls in secondary schools and by teaching adults, through rural development centers, the basic skills they require for productive employment.

Within these overall sector priorities, IDA's lending activities have reflected increased emphasis on projects which contribute to economic development by directly increasing the employment, productivity, and incomes of the rural and urban poor. Strategies to accomplish these objectives cut across virtually all lending sectors. In the interest of maximizing employment opportunity and widening the impact of income increasing efforts, project costs are held to a minimum and technology is adapted to local conditions and needs.

In this fiscal year IDA has approved several rural development projects embodying an integrated approach to the poverty problem. An example is a $10.7 million project for rural development in Niger. The project includes the provision of extension services, applied research, and credit aimed at the improvement of groundnut, millet and cowpeas production in 15 selected areas; strengthening of cooperatives; expansion of education and training programs, including a functional literacy program, a training school for extension workers, and the provision of training scholarships for project personnel; a study of means for developing the nation's irrigation potential;

construction of 80 kilometers of feeder roads; planting of 500 hectares of trees in fuel wood plantations; and improvement of livestock services and provision of credit for the purchase of livestock by pastoralists who lost their herds during the Sahelian drought.

It is estimated that increased production from the project will result in higher incomes for some 37,500 farm families and 14,000 pastoral families. After full development in 1982 it is expected that average yields in the project area will be close to those previously obtained only in years of most favorable rainfall. Yield increases are estimated to result in increments in annual production amounting to 18,100 tons of millet, 19,800 tons of groundnuts and 600 tons of cowpeas. In addition, new production of 500 tons of seed cotton, 900 tons of sorghum and 7,000 tons of tomatoes and other vegetables is expected to result from new irrigation facilities. An increase of about 3,000 tons per year in annual livestock production is also anticipated.

Every week the Board of Directors of the World Bank, in which voting power is weighted according to financial contribution to IDA, reviews and approves IDA credits proposed by the institution's professional Management. All such projects are first subjected to rigorous technical and economic appraisal. Firm cost estimates are made; required technical and managerial assistance is provided for; and institutional reforms essential to project success are made a condition of credit disbursement.

IDA draws upon a pool of skilled personnel, established policies, procedures and a wealth of experience in making effective use of its resources. The managerial and technical excellence of the World Bank is widely recognized throughout the world. Of the joint IBRD/IDA professional staff, roughly 27 percent comes from the United States. The remainder comes from 110 other nations.

Once a project is approved by the Board, IDA closely watches its subsequent execution. Careful supervision is exercised at the procurement stage to assure compliance with fair international competitive bidding and the award of contracts to the lowest evaluated bidder. Disbursements are only made when satisfactory documents evidencing progress of the project, in conformity with the credit and project agreements, have been received and reviewed by IDA staff. Reports on project implementation are regularly received and frequent on-site inspections by IDA officials are made. As each new credit is submitted for approval of the Board of Directors, a status report is presented on all ongoing projects in the country to enable the Board to assess the country's capabilities for taking on further work.

Effective internal auditing and evaluation functions are also well established. The evaluation department, established a few years ago at U.S. urging, has continued to grow in stature and effectiveness. It evaluates all projects within one year after loan or credit funds have been fully disbursed with a view to strengthening future operations. It also undertakes broad country and sector program evaluation. The evaluation unit reports directly to the Board of Directors.

A number of countries which once received IDA credit have now advanced economically to the point where it is no longer necessary. Three developing countries are making contributions to IDA IV. They are Spain, Israel, and Yugoslavia.

Among the oil exporting countries, only Kuwait, which has contributed to IDA since 1960, is contributing to IDA IV, the negotiation of which preceded the dramatic increase in oil prices. The World Bank, however, is in close contact with the oil exporting countries to solicit their cooperation and efforts to assist the developing countries. The Bank is urging several of them to participate in the Fifth Replenishment of IDA as contributing members, and expects that they will. The United States strongly supports this goal and in the preliminary international meetings on this subject has stressed the importance of such OPEC participation. In the meantime, a number of Arab oil exporting countries, have joined with the Bank and IDA in co-financing projects. To date, these countries have contributed financing of $1.0 billion to 35 IBRD/IDA projects. These additional resources enable the Bank and IDA to significantly expand the scope of their activities.

The Administration firmly believes that IDA has been, and continues to be, an effective and valuable instrument for the advancement of vital interests which the United States shares with other nations of the world. The President, as well as the Secretaries of State and Treasury, have all underscored IDA's continued priority importance to U.S. foreign interests, both political and economic.

The appropriation requested today will enable the United States to carry out its share of the IDA IV agreement negotiated among twenty-five governments to attack the problem of world poverty which is of direct concern and relevance to all nations. I urge the committee to act favorably and prompt on it. Other nations are fulfilling their promised participation and expect the U.S. to do the same.

As noted by Mr. Bushnell in his general statement, the Administration is requesting $112 million as part of a $480 million capital increase in the International Finance Corporation. International negotiations concerning this capital increase have not yet been completed although this proposal has received widespread support from both developed and developing countries, and we anticipate formal international agreement in the very near future. Incident the proposal would result in a substantial reduction -- from 33% to 25% -- in the U.S. share of IFC capital.

As the Committee has not had occasion to deal with IFC for many years, I would like to review briefly the role and the activities of IFC before going into the specifics of the capital increase.

Role

The IFC was established in 1956 to promote private investment in the developing countries. While it is organizationally and financially separate from the World Bank, it is affiliated to it by a common Board of Directors and President and its 104 country members must be shareholders of the World Bank in order to join.

The Corporation's interest lies in stimulating and supporting private sector activities in developing countries and its principal function is to stimulate the flow of private capital into productive investments by bringing together investment opportunities, domestic and foreign private capital, and experienced management. Among international development institutions, it is unique in its ability to operate without a government guarantee on its loans, or on its participation in equity investments.

The Corporation's policy is to make an investment only where sufficient private capital could not be obtained on reasonable terms and where the project will contribute to development and have the prospect of being profitable Where it invests in capital stock, it remains a minority partner without management control. It basically supports its private enterprises although under certain conditions, IFC will participate in enterprises in which there is some government ownership provided they are managed on a business-like basis. IFC loans are made at near commercial interest rates with seven- to twelve-year maturity. Where it buys stock, it expects to receive reasonable dividends.

Activities

Considering its small initial capital base of $100 million, the Corporation has had a significant impact upon development because of its success in leveraging its own funds: it has generated more than $4 of private investment for every $1 of its own in projects. Since its inception, the Corporation has been associated with about $6.4 billion of investments and has assisted in financing some 250 enterprises in 57 developing countries. Most of these enterprises have been medium-sized firms, controlled by local groups with local management.

After a slow beginning, IFC's commitments have grown rapidly in recent years from $51 million in 1968 to $212 million in 1975. IFC's cumulative gross commitments of $1.3 billion, as of December 31, 1975, are more than four times the 1968 level.

Some Examples of IFC Projects

IFC, in its projects, serves a number of purposes and activities. In the area of large mineral projects, IFC's key function is not the provision of capital, which large international companies can provide, but to act as the neutral intermediary between the companies who fear nationalization, and the governments of developing countries, which want to be assured that such projects will be in their long-term economic and social interests. A good example of IFC's involvement in a $620 million copper venture in Peru, a country whose relations with multinational corporations has been difficult. IFC's investment was small -- $15 million; but its presence, which has been approved by the Government of Peru, serves as an assurance of fair treatment on both sides. The project will develop the copper deposits of Cuajone in Southern Peru, with reserves estimated at 468 million tons in accordance with an agreement between the Government of Peru and the Southern Peru Copper Corporation, a consortium of four U.S. firms. It will produce 2,500 jobs and earn Peru about $150 million annually by 1982 in foreign exchange. In accordance with national legislation, the employees and workers will eventually own half of the project.

Another example, Kenya, a country of less than $200 annual per capita income, illustrates IFC's role in the transfer of technology. The project is the first integrated pulp and paper mill in East Africa, will introduce a technology new to the area and provide training to local workers. IFC is investing $17 million of a total cost of $50 million. Its role in developing project feasibility and arranging financing was crucial. With the associated tree replanting, the project will result in 2,300 jobs, and produce 45,000 tons of paper annually saving Kenya $8 million per year in foreign exchange.

Another example, the Maria Cristina Chemical Industries, Inc. in the Philippines -- approximately $2 million was invested in this company to help finance a $4.7 million electric arc furnace that will double productive capacity by producing some 21,000 metric tons of ferroalloys a year. The project, located in a depressed area on the island of Mindanao, will be supplied by more than 2,000 new backyard charcoal makers who are expected to earn well over twice the average annual family income in the region. It also will use other locally available raw materials and hydroelectric power, thus permitting production for world markets at competitive costs. Prospective annual net foreign exchange benefits were estimated at $5 million, partly through exports and partly through import substitution. In addition, ownership of the company is being broadened by including greater employee participation in the equity. A list of IFC projects in FY75 and so far in FY76 is attached to this statement.

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Capital Increase

The Corporation needs a capital increase now in order to maintain its growth rate of the past five years. Without the assurance of an increase, it would have to begin to restrict planned commitments beginning in fiscal 1977 and new equity investments would essentially cease by the following year.

The U.S. strongly supports such a capital increase for several reasons. We believe that international support for the private sector will make a notable contribution to accelerating the pace of development and is very much in accord with U.S. interests and our own confidence in the free enterprise and private sector. Second, while IFC has done an excellent job in spreading its small initial funds thin, after 20 years, in which the World Bank's capital has tripled, it seems reasonable that IFC has some catching up to do if it is to remain a significant international institution. Third, the present capital base has become so small that it inhibits the Corporation from undertaking somewhat riskier ventures for smaller business and in poorer countries for fear of unacceptable losses. Fourth, the scale of significant investment projects has increased enormously since the '50s and the IFC should be in a position to support reasonably large projects as well as small ones. We would, for example, like to see IFC take more of the role than it has already played as a intermediary in the minerals field facilitating arrangements between large private corporations and the governments of developing countries.

The U.S. share of the $480 million increase in issued capital stock is $112 million, or about 23% compared to our 33% share of current capital. This proportion reflects more accurately our current position in the World Bank than the present share which is based on our position in the late '50s. Germany, Japan and the OPEC countries will have larger shares.

The resolution governing the capital increase requires that if a country is not in a position to make a binding commitment to pay for all its subscribed shares, it must be in a position to do so for at least 40% of its quota. We interpret this to mean that if the authorization bill is approved by the Congress, then we will need an appropriation for 40% of our subscribed shares in order to make an initial commitment to IFC. As a result we are requesting a $45 million appropriation. This figure differs from the figure in the budget of $41.7 million because negotiations were not fully defined when the budget submission was made. We would expect to ask for appropriations for two additional installments in FY 1978 and 1979.

I am also submitting for the record an annex to this statement which will provide greater detail about IFC's activity, its sources of financing and the capital increase.

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In conclusion, Mr. Chairman, I would like to stress my personal conviction that the World Bank Group is in its activities making the kind of contribution to the world economy which is very much in the US national interest to support. It is also my conviction that US interests in the policies and operations of the Bank and its affiliates are substantial, and that our own voice and our influence on such international financial institutions can only be as strong and compelling as our basic support for them. Consequently I urge prompt and favorable action on the appropriations requests for IDA and the IFC which are before you for FY 1977.

Geographical Distribution of Loans and Equity Investments

The table below indicates the geographical distribution of IFC activity. Latin America is the regional leader followed by Asia. The Southern Europe designation is mainly Turkey and Yugoslavia, as well as loans to Greece and Spain.

TABLE 1

GEOGRAPHICAL DISTRIBUTION OF IFC ACTIVITIES

(as of December 31, 1975)

	No. of Enterprises	Amount ($ Millions)
I. Regional		
Latin America	100	$ 545.1 (41%)
Asia	63	317.0 (24%)
Southern Europe	37	288.6 (22%)
Africa	37	122.3 (9%)
Middle East	14	58.2 (4%)
	251	$1,331.2 (100%)
II. Leading Countries		
Brazil	21	$262.9 (20%)
Yugoslavia	9	128.5 (10%)
Turkey	12	118.1 (9%)
Philippines	13	76.1 (6%)
Mexico	13	69.9 (5%)
Indonesia	9	58.4 (4%)
Argentina	8	53.2 (4%)
India	11	51.8 (4%)
Korea	8	44.1 (3%)
Iran	7	42.5 (3%)

Source of IFC Financing

The two tables below illustrate a) IFC's dependence on borrowing from the private sector via loan participation, and from the IBRD, and the diminishing importance of capital as a source of financing and of equity as a form of investment.

For loan operations resources, IFC relies primarily on borrowings from the World Bank. It is limited in the amounts of its borrowings by its Articles which prohibit total debt from exceeding four times IFC's net worth (unimpaired subscribed capital and surplus), so long as IFC is indebted to the Bank. As of June 30, 1975, IFC's net worth was $178 million, placing the limit upon IFC borrowings at $712 million. As of the same date, IFC had already borrowed $448 million and would reach the ceiling in early FY1979 at presently projected rate of operations.

Because World Bank loans cannot be used to purchase stock, IFC's equity investments may not exceed its unrestricted mainly capital and accumulated reserves resources. As of June 30, 1975, these resources totalled $183 million, compared to existing investments of $127 million.

TABLE 2

SOURCES OF IFC FUNDS

($ Millions)

	Actual - FY71-75
Income	42 (7%)
Capital Subscriptions and Loan Repayments	78 (13%)
IBRD and Netherlands Loans	272 (46%)
Portfolio Sales	25 (4%)
Calls on Participants	166 (29%)
	583 (100%)

TABLE 3

IFC FINANCING TRENDS

	6-30-70	6-30-75
a) Financed by 1) capital and reserves	90%	40%
2) borrowing	10%	60%
b) IFC debt outstanding as % of its disbursed loans	18%	78%
c) Equity investment as % of portfolio	30%	22%

The information pertaining to the capital increase is summarized in tabular form.

FACTUAL SUMMARY OF CAPITAL INCREASE

(in millions of dollars)

	Proposed Increase	After Increase
1. Authorized capital (12/31/75)		
110	540	650
2. Issued capital stock (12/31/75)		
107.6	480	587.6
3. Unallocated shares		
2.4	60	62.4

4. Form of Commitment

a) subscribe to shares allocated, and b) make a binding commitment to pay. Exceptional procedure where a commitment to pay must be qualified because of legislative procedures: commitment for payment for a minimum of 40% must be unqualified, and, appropriate legislative action allowing an unqualified commitment to pay for the remaining 60% should be obtained as quickly as practicable. Since our commitment to pay is subject both to authorization and appropriation legislation, this is the procedure the United States will follow.

5. Payment schedule

a) August 1, 1977
20% - U.S. share of 22.5
20% unqualified commitment for additional share of 22.5

b) August 1, 1978
Unqualified commitment above is due

c) August 1, 1979
20% - U.S. share of 22.5

d) August 1, 1980
20% - U.S. share of 22.5

e) August 1, 1981
20% - U.S. share of 22.5

6. Schedule for U.S. legislation on IFC

	Date of Submission	Amount ($ Millions)
Authorization bill	March 1976	112
FY77 Appropriation	March 1976	45
FY78 Appropriation	January 1977	33
FY79 Appropriation	January 1978	33

General Data

1) Resolution approving increase will become effective on December 31, 1976, or such later date as the Directors may determine.

2) Shares related to the increase will not be issued before August 1, 1977.

3) Shares will be issued only when paid for in U.S. dollars.

4) Each share has a par value of $1,000 and is issued at par.

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-IDA credits approved, by area, country and purpose, July 1, 1974 to June 30, 1975

[Millions of dollars equivalents]

Area, country	Amount	Purpose
Total	1,576.15	
Total, Africa	511.55	
Cameroon	16.0	Rubber estate.
	[1] 1.0 [8]	Highway.
	1.2 [S]	Education.
Dahomey	4.0	Education.
Egypt	[2] 35.0	Agriculture program loan.
	30.0	Telecommunications.
Ethiopia	9.5	Agriculture development.
	32.0	Roads.
	16.0	Telecommunications.
	23.0	Education.
Ghana	13.6	Oil palm.
Guinea	7.0	Pineapple development.
Kenya	[3] 7.5	Group farming.
	[4] 8.0	Urban development.
	[5] 10.0	Forestry.
Lesotho	4.0	Education.
Malagasy Republic	9.6	Rural development.
	[6] 6.75	Forestry.
Malawi	10.0	Highways.
	8.5	Rural development.
Mali	13.3	Livestock.
	2.6 [8]	Rice.
	8.3 [8]	Highway.
Mauritania	3.0	Highway.
Mauritius	[7] 3.5	Education.
Morocco	14.0	Agriculture.
Rwanda	8.0	Education.
Senegal	15.0	Education.
	1.0	Irrigation.
	[8] 7.0	Agriculture development.
Sierra Leone	[9] 5.0	Rural development.
Somalia	8.0	Education.
Sudan	10.0	Education.
	23.0	Power.
	20.0	Irrigation.
Swaziland	5.0	Education.
Tanzania	8.5	Sites and services.
	10.0	Rural development.
	10.2	Highways.
	[10] 9.0	Sugar.
Togo	6.0	Cocoa/coffee.
Upper Volta	9.0	Livestock.
	7.5	Rural roads.
Zaire	26.0	Highways.
	26.0	Railway and river.
Total, Asia	1,016.10	
Afghanistan	13.0	Agriculture.
	9.0	Water supply and sewerage.
Bangladesh	75.0	Industrial imports.
	33.0	Fertilizer.
	15.0	Population.
	27.0	Irrigation.
Burma	24.0	Forestry.
	21.0	Telecommunications.
India	83.0	Canal-Rajasthan.
	91.0	Fertilizer.
	27.7	Dairy.
	16.4	Dairy.
	35.0	Drought.
	200.0	Industrial imports.
	45.0	Irrigation.
	75.0	Agriculture refining corporation.
	34.0	Rural development.
	24.0	Chambal command.
Jordan	7.5	Irrigation.
	6.0	Education.
	1.0	Potash engineering.
	5.0	Power.
Pakistan	36.0	Telecommunications.
	30.0	Development finance company.
Sri Lanka	9.0	Dairy.
	15.0	Program loan.
	4.5	Development finance company.
Western Samoa	4.4	Highways.

IDA CREDITS APPROVED, BY AREA, COUNTRY AND PURPOSE, JULY 1, 1975 to JANUARY 31, 1976

(millions of dollars)

Country	Amount	Purpose
Total, All Areas	915.4	
Total, Africa	196.1	
Burundi	5.2	Coffee Improvement
Cameroon	3.0	SMEI
Chad	5.0	Polders
Ethiopia	27.0	Rangelands
Gambia	4.0	Tourism
Ghana	10.0	Highway
Guinea	14.0	Highway
Liberia	6.0	Rural Development
Madagascar	5.6	Highway
Malawi	11.6	Education
Mali	10.0	Highway
Mauritania	8.0	Port
Niger	10.7	Rural Development
Rwanda	9.5	Highway
Senegal	2.0	Terres Neuves
Sierra Leone	7.3	Education
Somalia	5.2	Mogadiscio Port
Sudan	7.0	Development Finance Company
Tanzania	10.0	Dairy Development
"	6.0	Technical Assistance
"	11.0	Education
"	18.0	Maize Development
Total, Asia	677.1	
Bangladesh	4.6	Water Transport
"	100.0	Imports
"	22.0	Irrigation
Burma	7.5	Livestock
India	57.0	Rural Electrification
"	40.0	Water Supply & Sewerage
"	110.0	Railway
"	105.0	Fertilizer
"	4.0	Forestry
"	150.0	Power
"	18.0	Cotton Development

Country	Amount	Purpose
Nepal	26.0	Power
Pakistan	8.0	Tarbela Dam
Sri Lanka	25.0	Agricultural Development
Total, Europe, Middle East, and North Africa	38.2	
Afghanistan	10.0	Irrigation
Egypt	25.0	Development Finance Company
Yemen, POR	3.2	Aden Port
Total, Latin America	4.0	
Paraguay	4.0	Pre-investment

-1.—*IFC investment commitments July 1, 1974 to June 30, 1975*

[Millions of dollars]

Country	Total	Loan	Equity	Purpose
Total	211.61	190.6	21.01	
Argentina	14.0	14.0	....	Steel.
Brazil	10.0	10.0	....	Chemicals.
	8.0	8.0	....	Cement.
	7.2	6.2	1.0	Chemicals.
Cameroon	.5	....	.5	Manufacturing.
Colombia	3.6	3.6	....	Cement.
	.14	....	.14	Capital markets.
Ecuador	.03	....	.03	DFC.
Greece	1.2	1.0	.2	Food processing.
India	9.5	9.5	....	Steel.
Jordan	3.2	....	3.2	Fertilizers.
Korea	17.3	16.0	1.3	Manufacturing.
	9.0	6.9	2.1	Textiles.
	5.6	5.0	.6	Capital markets.
	3.5	2.8	0.7	Tourism.
Lebanon	3.9	3.9	....	Textiles.
	1.2	....	1.2	Capitals.
Mexico	15.6	12.0	3.6	Steel.
Nepal	3.5	2.8	.7	Tourism.
Pakistan	.04	....	.04	DFC.
Paraguay	5.4	4.4	1.0	Manufacturing.
Peru	15.0	15.0	....	Mining.
Philippines	7.0	7.0	....	Textiles.
Tunisia	3.2	2.5	.7	Tourism.
Turkey	25.0	25.0	....	DFC.
	15.0	15.0	....	Chemicals.
	10.6	10.6	....	Cement.
	8.9	7.5	1.4	Steel.
	1.5	....	1.5	DFC.
	1.3	1.3	....	Textiles.
Venezuela	.7	....	.7	Capital markets.
	.3	....	.3	Do.
Zambia	1.0	.7	.3	Manufacturing.

Source: International Finance Corporation.

IFC INVESTMENT COMMITMENTS, JULY 1, 1975 to JANUARY 31, 1976
(millions of dollars)

Country	Amount	Purpose
Total	88.97	
Philippines	2.8	Edible Oils
Israel	7.0	Chemicals
Kenya	9.13	Textiles
Korea	0.4	KIFC
Korea	5.53	Paper
Pakistan	1.8	Paper
Rwanda	0.53	Tea
Thailand	10.0	Cement
Turkey	1.6	Nasas
Yugoslavia	50.0	Zenica
Africa - Regional	.18	Sifida

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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For information on submitting tenders in the Washington, D. C. area: PHONE WO4-2604

FOR IMMEDIATE RELEASE March 16, 1976

TREASURY TO AUCTION $2.5 BILLION OF NOTES

The Department of the Treasury will auction $2.5 billion of 4-year 10-1/2-month notes to raise new cash. Additional amounts of the notes may be issued to Federal Reserve Banks as agents of foreign and international monetary authorities at the average price of accepted tenders.

The notes now being offered will be Treasury Notes of Series E-1981 dated April 5, 1976, due February 15, 1981 (CUSIP No. 912827 FM 9), with interest payable on August 15, 1976, and thereafter on February 15 and August 15. The coupon rate will be determined after tenders are allotted. The notes will be issued in registered and bearer form in denominations of $1,000, $5,000, $10,000, $100,000 and $1,000,000, and they will be available for issue in book-entry form to designated bidders.

Payment for the notes must be made on April 5, 1976. Payment may not be made through tax and loan accounts.

Tenders will be received up to 1:30 p.m., Eastern Standard time, Wednesday, March 24, 1976, at any Federal Reserve Bank or Branch and at the Bureau of the Public Debt, Washington, D. C. 20226; provided, however, that noncompetitive tenders will be considered timely received if they are mailed to any such agency under a postmark no later than Tuesday, March 23. Each tender must be in the amount of $1,000 or a multiple thereof, and all tenders must state the yield desired, if a competitive tender, or the term "noncompetitive", if a noncompetitive tender. Fractions may not be used in tenders. The notation "TENDER FOR TREASURY NOTES" should be printed at the bottom of envelopes in which tenders are submitted.

Competitive tenders must be expressed in terms of annual yield in two decimal places, e.g., 7.11, and not in terms of a price. Tenders at the lowest yields, and noncompetitive tenders, will be accepted to the extent required to attain the amount offered. After a determination is made as to which tenders are accepted, a coupon yield will be determined to the nearest 1/8 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 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. Tenders at a yield that will produce a price less than 99.001 will not be accepted.

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 $500,000 or less, will be accepted in full at the average price of accepted competitive tenders, which price will be 100.000 or less.

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(OVER)

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 the 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 commercial and other banks 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, Federal Reserve Banks, and Government accounts. Tenders from others must be accompanied by payment of 5 percent of the face amount of notes applied for. However, bidders who submit checks in payment on tenders submitted directly to a Federal Reserve Bank or the Treasury may find it necessary to submit full payment for the notes with their tenders in order to meet the time limits pertaining to checks as hereinafter set forth. Allotment notices will not be sent to bidders who submit noncompetitive tenders.

Payment for accepted tenders must be completed on or before Monday, April 5, 1976, at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt in cash, in other funds immediately available to the Treasury by April 5, 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) Wednesday, March 31, 1976, 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, March 29, 1976, 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. Where full payment is not completed on time, the allotment will be canceled and the deposit with the tender up to 5 percent of the amount of notes allotted will be subject to forfeiture to the United States.

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The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR RELEASE ON DELIVERY

STATEMENT OF THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
ON MAJOR TAX REVISIONS AND EXTENSION OF
EXPIRING TAX CUT PROVISIONS
BEFORE THE SENATE FINANCE COMMITTEE
WASHINGTON, D. C., WEDNESDAY, MARCH 17, 1976, 10:00 A.M.

Mr. Chairman and members of this distinguished Committee:

I am pleased to be here this morning as you begin your deliberations on major tax revisions and the extension of expiring tax cut provisions. You have before you an extremely challenging agenda.

This morning I will discuss H.R. 10612--the House-passed Tax Reform Bill. While many of the provisions of H.R. 10612 incorporate proposals initiated by the Administration in 1973, more work remains to be done.

I will also discuss the President's proposals to cut individual and business taxes and to reduce the rate of growth of Federal spending. I will present proposals to encourage capital formation. These proposals include integration of the corporate and personal income taxes; a job creation incentive proposal; the six-point utilities tax program; a proposal to reduce the tax on capital gains and alleviate the burden of taxation on inflationary gains by the mechanism of a sliding scale; and elimination of the withholding system on foreign investments. In addition, I will discuss general and specific estate tax revisions, as well as the relationship of the Administration's energy policy and tax policy.

The overall objectives of the Administration's tax policy are simple and fundamental. First, and foremost, our tax system must be fair. Its fairness and integrity rest upon three premises: equity, simplicity, and efficiency. A tax system not built on this foundation erodes both the confidence of taxpayers and the incentive required for economic progress and well being.

Second, our tax policy must complement and supplement our basic economic goal of achieving a growing, vigorous, and noninflationary economy. We achieve this by removing the tax barriers which impede our growth and prevent the most efficient use of our economic resources.

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Third, our tax policy must contribute to a sound energy policy. Here, again, I must emphasize that allowing market incentives to operate would be the most efficient and effective means of achieving energy independence. As long as we are unwilling to rely on the market, we should retain the tax incentives we now have in place and by no means erect further impediments by increasing the tax burden on oil and gas investments.

The Administration has already proposed the following measures:

-- Permanent personal and business income tax reductions coupled with corresponding reductions in the size of the Federal Budget. This is the proposal which the President first made last October and reiterated in his 1976 State of the Union Message.

-- A plan to integrate corporate and personal income taxes and thereby eliminate the perverse effects of the current double tax on equity investments. This is the proposal I presented last July before the House Ways and Means Committee.

-- A six-point utilities tax program to stimulate construction of additional facilities by electric utilities, to reduce imports of foreign oil, and to insure adequate electric generating capacity in the years ahead.

-- A proposal to repeal the undesirable and inefficient present withholding system on portfolio dividends and interest earned by foreign investors on U.S. securities.

The Administration has also taken new initiatives to maintain and improve the health and vigor of the economy. These proposals are:

-- A job creation incentive program which provides for accelerated depreciation of new plant facilities and equipment in areas which experienced unemployment of 7 percent or more in 1975.

-- A tax incentive to encourage broadened stock ownership by low and middle income working Americans by allowing deferral of taxes on certain funds invested in common stocks.

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-- Estate tax relief which will alleviate the effect of inflation by increasing the estate tax exemption from $60,000 to $150,000. The current exemption level has been in effect since 1942.

-- Estate tax relief for farmers and owners of small businesses to make it easier to continue the family ownership of a small farm or business after the owner's death.

-- A proposal to encourage capital formation and the efficient allocation of investment resources by the introduction of a sliding scale for the taxation of capital gains which will, in addition, alleviate the burden of taxation on inflationary gains.

The Administration is also committed to an energy policy that will achieve our goal of energy self-sufficiency.

In January 1975, the President proposed measures to conserve energy, increase domestic production and provide for strategic reserves. Although the Energy Policy and Conservation Act contemplates eventual decontrol of oil prices, its immediate effect is to roll back the average price of oil. Prices of natural gas are still controlled in interstate markets. As long as we refuse to remove these government-imposed controls, and thereby prevent free market incentives from increasing domestic energy supplies, we will continue our dependence on foreign imports and our vulnerability to political blackmail. For these reasons, we are opposed to the provisions of H.R. 10612 which would erect further impediments by increasing the tax burden on investments in oil and gas.

Further, in order to accelerate the replacement of obsolete oil and gas fired electric generating capacity, we are proposing that you enact the six-point electric utilities program recommended by the President's Labor Management Advisory Committee.

With respect to tax reform, the Administration's goals are to:

-- Improve the equity of our tax system at all income levels. This principle goes beyond the concept of vertical equity or progressivity which holds that those with higher incomes should pay a larger share. It extends to the more basic idea that the tax system of a democratic society must be fair to all taxpayers and must be widely recognized as such;

-- Simplify many of the tax provisions of the Code which seriously affect the taxpayer's ability to cope with the preparation of his income tax return;

-- Make improvements in the ways in which our tax law is administered.

At the same time, of course, our tax system must be conducive to the stable growth of our domestic economy and the long-run improvement of our position in world markets.

In 1973, the Administration made a number of tax reform proposals. In the nearly three years that have elapsed, much has been done by the House Ways and Means Committee. H.R. 10612 incorporates to varying degrees many of our 1973 proposals. We are, therefore, renewing the following proposals:

-- LAL (Limitation on Artificial Losses) to deal effectively with the problems associated with tax shelters by a solution which reaches their most common feature: Bad tax accounting rules which mismatch expenses and revenues and thereby produce artificial accounting losses. While we continue to endorse the LAL concept, under current circumstances we find its application to oil and gas investments to be inappropriate and inefficient.

-- MTI (Minimum Taxable Income) which, in combination with LAL, deals with the problem of taxpayers with high economic income who pay little or no Federal income tax. H.R. 10612 rejects this proposal in favor of an expansion of the current minimum tax which does not subject taxpayers with high economic income to progressive tax rates.

-- A simplification package designed to alleviate the intolerable reporting burden imposed upon the average taxpayer.

We also have a number of specific recommendations on various aspects of the House Bill and I shall therefore devote a substantial portion of my time to H.R. 10612.

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I. CONTEXT FOR TAX POLICY

MAINTAINING AND IMPROVING THE HEALTH AND VIGOR OF THE ECONOMY

The Administration's economic policies, as outlined by the President in his State of the Union Message, are designed to keep the economy on an upward path toward two central long-term objectives:

-- Increasing steadily the number of real, rewarding, permanent jobs, and

-- Sustained noninflationary economic growth.

The most immediate concern, of course, has been to support the recovery of the economy from the most severe recession in the post-World War II period in a manner which will achieve full employment as rapidly as possible without rekindling inflationary pressures and expectations. Achievement of this objective will not only provide jobs for all who wish to work but, equally important, will reestablish the basic economic conditions necessary to sustain strong and continuous real economic growth which can provide permanent employment gains and a rising standard of living for all Americans.

Status of Economy

I am pleased to be able to report substantial progress in the recovery of the U.S. economy. Gross national product in real terms has increased by 5 percent since the trough of the first quarter of 1975 and is rapidly approaching the peak level of the fourth quarter of 1973. (Table 1). At the same time, the rate of increase in consumer prices has continued to diminish. During the last three months of 1975, the rate of inflation fell to 6.6 percent on an annual basis. January data are even more favorable, showing a seasonally adjusted annual rise of only 5 percent in the consumer price index (Table 2). The recent declines in the wholesale price index augur well for continuing progress on the inflation front.

Civilian employment continues to improve, showing an increase, seasonally adjusted, of over 900,000 in January and February to 86.3 million, the highest level since mid-1974. This improvement is reflected in unemployment rates which dropped seven-tenths of a percentage point in January and February to 7.6 percent--substantially below the peak unemployment rate of 8.9 percent in May of last year. Furthermore, improvements in employment have been accompanied by greater labor productivity which increased over 4 percent from the first quarter to the last quarter of 1975.

Short-Term Policies

Despite this advance of the economy, the overall rate of utilization of physical and particularly human resources remains unacceptably low relative to long-term objectives. Many advocate a highly stimulative fiscal and monetary policy to cure this problem quickly. However, the risk in greatly stimulating the economy at this time is that this will set off another round of inflation, thereby undermining the economic recovery under way. Thus, our policies for the short term must be to keep the present recovery on track in order to provide a steady and sustainable increase in productive jobs. While employment might be raised somewhat more rapidly in the short run with massive fiscal and monetary stimulation, such stimulus would lead to renewed inflation, an eventual decline in the pace of economic activity, and renewed unemployment.

There is still an important role for tax policy for the short term. Thus, as discussed in more detail later, the Administration proposed special temporary tax incentives to encourage construction of new facilities and purchases of equipment in areas in which unemployment exceeds 7 percent. The objective of this program is two fold. First, it will provide immediate relief to the unemployment problem of the construction industry, one of the most depressed industries in our economy. Second, the incentive will be provided in areas of high unemployment where new jobs are most needed.

Long-Term Policies

Our policies for the long term must be to create an economic environment which encourages individuals to save and businesses to invest, and thereby to restore the dynamism of our economy. The Administration has long and continuously emphasized the need for a higher rate of capital formation, and I shall have more to say on this topic in a moment. At this point, I simply note that we cannot expect businessmen to assume the risks of business expansion unless the Federal government does its share to provide a stable climate in which sound business decisions can be made. This means stable prices, ready access to financial markets, and the certainty that the Federal government will not make increasing tax claims on the returns flowing from these investments.

Two conditions are essential if we are to make substantial progress toward achieving our long-term goals:

First, the rate of growth of Federal spending must be reduced and we must move to a position of budgetary balance. The Administration's program of spending restraint coupled with tax reductions will help us meet the first condition. The Federal deficit will be reduced from an estimated $76 billion in Fiscal 1976 to $43 billion in Fiscal 1977 and to budgetary balance by Fiscal 1979.

Second, economic incentives must be provided for saving and investment in order to increase the rate of capital formation. Several of the tax proposals which the Administration recommends are designed to promote such saving and investment. More precisely, these recommendations are designed to remove some of the disincentives to saving and investment which are inherent in our existing tax structure. Thus, as I will discuss in greater detail later, we recommend the following tax measures:

-- A permanent reduction in corporate income tax rates from 48 percent to 46 percent and a permanent reduction of the tax rate on the first $50,000 of corporate income to replace the current temporary provisions,

-- A permanent 10 percent investment tax credit,

-- Elimination of the double tax on corporate dividends,

-- Revisions in the taxation of capital gains,

-- Tax incentives to broaden stock ownership,

-- Tax incentives to expand the use of individual retirement accounts.

We also recommend the elimination of withholding taxes on foreign investment to encourage the inflow of capital from abroad.

All of these recommendations are made out of a deep concern that the failure to increase the rate of capital formation can have profound consequences for our economy for years to come.

The dangers that can arise from inadequate capital investment over a period of years are best illustrated by the 1973 production bottleneck. In that year, industries that process such materials as steel, paper, fertilizers, chemicals, cement, nonferrous metals, and textiles were operating at the limits of their physical capacity. But they still were not producing enough goods and services to meet the demands from industries that manufacture automobiles, clothing, machine tools, and other finished products. This situation contributed to the rapid rise in inflation and ultimately to the recession of 1974-75.

Another consequence of inadequate saving and investment is that annual gains in productivity, that is total output per worker, have significantly slowed during the post-World War II period. As shown in the figures below, the growth rate of productivity, which had averaged between 2.0 and 3.3 percent per year until the mid-sixties decreased to an average of 1.5 percent over the past ten years.

U.S. Productivity Growth, 1950-1975
(Average Annual Rate Over Five Year Intervals)

Period	Gross Domestic Product Per Employed Person
1950-54	2.44
1955-59	2.13
1960-64	3.27
1965-69	1.73
1970-74	1.33

The diminishing of U.S. productivity gains takes on added significance when compared with the experience of our major trading partners. Over the past fifteen years, Japan, West Germany, France, Canada, Italy and the United Kingdom have all experienced more rapid rates of productivity growth than the U.S.; and, taken together, their rate of productivity growth is more than double ours (Table 3).

The rate of capital formation is a major determinant of the growth of productivity. Therefore, an increased rate of capital formation is required to maintain the competitive positioning of U.S. business in world markets.

Increased productivity also means that higher wages need not be passed forward as higher prices so that real income can rise for all. This point should be emphasized. In a world where yearly increases in money wages are customarily expected, our main line of defense against inflation is an economy with growing productivity. Wage increases need not lead to higher per unit costs of production as long as output per worker, or productivity, rises sufuciently. This can happen if we provide workers with more and better equipment, that is, if we maintain high rates of capital formation.

However, as I have noted on other occasions, our investment performance has not been satisfactory. The share of our national output which goes to investment has been below that of other major industrialized countries. When we look at the future, we find little grounds for believing that our capital needs will become any less intense. Indeed, all studies on this subject conclude that if we are to realize our economic goals, we must commit an even higher portion of our income to national saving and investment in the future than we have in the past.

Consider, for example, a recent study by the Bureau of Economic Analysis of the Department of Commerce on projected capital needs of the country in 1980--only four years away. That study concluded that in order to achieve our goals of full employment, greater energy independence, and pollution abatement, the ratio of business fixed investment to GNP for the decade of the seventies must be increased.

Several other studies have also concluded that to meet employment and growth objectives, the demands for investment as a proportion of GNP will increase very substantially beyond what had been experienced in the recent past. To finance the shift in resources toward more investment, more private savings and sharp reversals of government deficits will be required.

Results of these studies are summarized briefly in Table 4. Taken together, they imply a need for an increase in the rate of private savings from 15 percent to 16 percent of GNP.

Sources of Demand for Capital

The sources of demand for capital should be carefully identified.

First, there are enormous investment demands generated just in maintaining a growing labor force properly equipped with capital. Between now and 1985, the labor force will expand by approximately 16 million persons. When we add to this the three to four million unemployed today, the total is nearly half again the 13 million jobs generated during the past decade.

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Second, capital is needed to achieve specific public policy objectives: accelerated development of new energy resources to make us more self-sufficient; improvement of environmental quality; safer working conditions; better housing. In the energy field alone, estimated investment needs for the next decade total $1 trillion.

Third, and most important, is the economic necessity to increase our production efficiency to raise the real standard of living enjoyed by Americans. If anything has been clearly established by economic studies over the years, it is the close relationship between capital investment and productivity. Capital investment is a key factor in increasing productivity, economic growth, and real earnings.

I do not mean to imply that investment in plant and equipment is the only factor that affects productivity. There are, of course, other factors such as new technology, the skills and growth of the labor force, access to raw materials, and the stage of the business cycle. But the more capital investment we have, the more these other factors can increase productivity.

The tax proposals which I have already mentioned and will discuss in considerably more detail are directed towards stimulating more saving and investment to meet our long-term capital needs. They will operate through increasing the after-tax profitability of investment and thereby encourage businessmen to undertake more capital projects. The proposals will also provide a higher after-tax return to those who save, thereby encouraging them to reduce somewhat the customary amount of consumption. Along with the reduction in the growth of Federal spending, these proposals should help tilt slightly the overall allocation of our total income in favor of investment.

Other Capital Formation Problems

There are a number of related problems concerning capital formation which our tax policies address. These problems are:

-- The tax bias against savings and investment,

-- The inefficiency with which the present capital stock is used,

-- The overstatement of profits as a result of inflation, and

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-- The problems of corporate finance.

Let me comment on each of these in turn.

Tax Bias Against Saving and Investment

The willingness of people to save and invest depends in large part on the financial reward which flows from the investment. Thus, to the extent the income tax system takes away the reward, it lessens the incentive to save and invest. Our income tax system is heavily biased against investments producing financial returns that constitute taxable income.

A simple example illustrates this point: Assume you have $5,000 and that the question is whether to spend it on consumption items or to save it and buy a bond. In weighing the consumption alternative, you would not take income taxes into account, but in weighing the bond alternative, you would have to consider the fact that some percentage of the interest income on the bond would go to the government in the form of income taxes. While this result is not necessarily improper, it does mean that the existence of the income tax system, or any income tax system, tilts the scale significantly when people are deciding whether to save or consume.

Moreover, it is frequently forgotten that income from capital is not only included in our income tax base, it is also taxed more than once in our Federal tax system--as corporate income, as personal income, and when transferred at death or by gift under the estate and gift taxes--and that such income is also taxed in state and local tax systems.

In sum, the existing tax system--the combination of income, estate and gift and state and local property and income taxes--imposes a heavy burden on capital. Obviously, if we wish to increase saving and investment, a lessening of this tax burden is the logical place to begin.

Inefficiency in the Use of Capital

While I have emphasized the need to increase the total volume of investment, we should be concerned as well about the tax system's effect on efficient allocation of investment among competing uses. In fact, to the extent that existing investment may be made to work more efficiently, we would be reaching much the same results as we would from additional investment. We should, therefore, work to remove those features of the tax system which cause the flow of savings to be channeled away from more productive investment and into less productive investment. The most important such distortion in the existing tax system is the two-tiered tax upon corporate income.

Moreover, viewing the economy in the aggregate, it is not just corporate shareholders who have lower earnings as a result of this tax. If that were the case, that is, if corporate stock investments provided a lower rate of return than other kinds of investment, no one would invest in stock. In a competitive capital market, capital is constantly flowing from one kind of investment to another until the after-tax rates of return are comparable. If investment in corporate equities is less profitable, then capital will flow out of such investment, or less capital will flow in. If there is less demand for stock on the stock exchange, the price of stock will fall and yields will rise. For example, if a $100 stock pays a $5 dividend, the return is 5 percent. But if the demand for stock declines and the price falls to $80, the $5 dividend provides a yield of better than 6 percent. At the same time, capital which is diverted from corporate stock accounts will increase and result in a greater demand for bonds and other debt instruments as well as a greater demand for investments in assets and enterprises not held in corporate form. The greater demand for that kind of investment will in turn depress the return on that investment.

The market, therefore, operates to equalize rates of return between different kinds of investment. In the end, a part of the corporate tax is a net additional burden on wage earners and consumers, and a part is a burden distributed across the owners of all kinds of capital, not just corporate shareholders.

The factors I have just described have major implications for the efficient use of capital and for tax policy. The price charged by corporations to their customers must be adequate to provide funds to cover the return. This necessarily means that prices for goods produced by corporations must be relatively higher than prices of goods produced in the noncorporate sector. In turn, consumers are discouraged from purchasing goods from the corporate sector and spend less of their money on such goods than they would if taxes were neutral with respect to different kinds of investment. If the extra tax burden on corporate investment were eliminated, this bias would disappear and there would be increased demand for corporate goods and services. People would be able to have more of the things which they prefer, and the efficiency of our stock of capital would be increased. The real income of the nation would rise significantly, as more desired output is substituted for less desired output. Thus, the two-tier tax on corporate income is a barrier to the most efficient use of existing capital.

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Getting more out of the capital we already have is as good as having more capital. In fact, it is better because in order to get more capital we must give up some current consumption, which need not be the case if we are only increasing the efficiency of what we already have.

Overstatement of Profits as a Result of Inflation

Inventories and depreciation are two major elements which substantially overstate profits in periods of inflation.

The inventory situation may be illustrated by assuming a company that normally maintains an inventory of 100,000 widgets. Under traditional FIFO accounting, if inflation causes the price of widgets to increase by $1, from $2 to $3, 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 1940s, separated it from profit figures.

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.

These inventory and depreciation effects produce a dramatic overstatement of real income: Nonfinancial corporations reported profits after taxes in 1975 of $60.1 billion as compared to $37.2 billion in 1965, an apparent 62 percent increase. But, when depreciation is calculated (under the double declining balance method) 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 were constant: $35.8 billion in 1975 and $35.6 billion in 1965. However, income taxes were payable on the fictitious profit element. In effect, then, there has been a rise in the effective tax rate on true profits from about 43 percent in 1965 to 51 percent in 1975.

The overstatement and overtaxation of operating profits caused by inflation is a problem for all business which represents yet another barrier to our goal of stimulating a higher rate of capital formation. Our recommendations to reduce business taxes should be considered in this context.

Problems of Corporate Finance

One of the factors which can inhibit the future growth of needed capital formation is the financial condition of American corporations. Analysis of debt-equity ratios indicates that corporate balance sheets have shown signs of deterioration over the past decade, which is a break from the pattern which persisted in earlier periods. Debt has increased dramatically, both in absolute terms and relative to assets and income. Interest costs have risen appreciably, roughly doubling over the past ten years. The combination of increased debt financing and higher interest rates has resulted in a decline in the coverage ratios reported by American corporations--that is, the ratio of earnings to interest charges. The ratio of liquid assets to debt has shrunk. As a result of these developments, there is a serious question about the potential capability of companies to be able to finance the capital investment that will be required to achieve our basic economic goals of reducing unemployment and inflation as I outlined earlier in my testimony.

For many years there has been a discernible trend toward growing dependence by business on outside funds to finance their growth. The percent of business financing needs raised externally by nonfinancial corporations declined from 1958 to 1964 and averaged about 30 percent of total needs during that period. However, that trend was reversed beginning in the mid-1960's and the proportion of external financing rose to over 60 percent in 1974. The growing dependence on external financing really began in the mid-1960's and has risen steadily since then. This shift in financing methods from reliance on internal to external sources of funds follows the pattern of inflation pressures which also began to accelerate in the mid-1960's. Inflation rapidly increases the costs of new investments and erodes corporate profits which are a major internal source of capital for financing new projects. The distorting effects of inflation force companies to rely more heavily on external sources of funds.

Another, and perhaps more important, change appearing on corporate balance sheets is that the increased emphasis on external financing has been dependent on debt rather than equity sources of funds. There are several fundamental reasons for the shift toward debt: (1) corporate treasurers have been reluctant to raise new equity capital because the sale of additional shares of ownership dilutes the earnings per share and ownership rights of existing stockholders; (2) in the 1950's and throughout most of the 1960's, the cost of debt was low relative to the cost of equity; (3) because of the depressed level of stock prices in recent years, the shares

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of many companies have had historically low price earnings ratios--indeed many stocks are selling at prices below their book values which discourages new equity financing; (4) the financing costs of arranging new debt issues or loans are usually must less than the costs of selling new shares of stock and there is less uncertainty about placement of the securities; and (5) the use of debt enables the borrower to deduct the interest payments from earnings before determining the amount of taxes to be paid. The tax deductibility of interest payments creates a major advantage in favor of debt financing and has encouraged the sharp shift in the debt-equity relationship. Unfortunately, the emphasis on debt commitments has made our financial system more rigid and more vulnerable to economic shocks.

From 1965 to 1974 nonfinancial corporations raised a total of $267.4 billion of long-term funds. Long-term debt accounted for 83 percent of that total. This means that the incremental debt-equity ratio for external funds was an extremely high 4 to 1. The balance sheet impact of this change was to cause long-term debt outstanding to rise from $141.4 billon to $362.3 billion over the same time span--a two and one-half fold increase in just 10 years time. What this means, of course, is that there has been a significant rise in debt-equity ratios over the past decade. These have roughly doubled for manufacturing firms as indicated in Table 5.

The implication of these fundamental shifts in the patterns of financing is that the structure of corporate balance sheets is much more brittle and less liquid than it was 10 years ago. Obviously there is no single level where the corporate financial structure suddenly becomes too illiquid and inflexible, but at the same time an ever higher burden of debt commitments relative both to financial assets and to income is a matter for some concern. Coverage ratios have dropped sharply over the past decade and operating breakeven points have risen. This makes companies less able to withstand even modest-sized recessions. Accordingly, the potential for bankruptcy has greatly increased across the entire spectrum of U.S. business. This potential in and of itself will discourage future investment as lenders become more reluctant to make long-term commitments and companies become less willing to take on fixed payements of interest and repayment of debt obligations. Some investments which would have been undertaken in earlier periods will be passed over in the future.

We must achieve fundamental reforms in our tax system to redress the imbalances in corporate balance sheets and broaden equity ownership--reforms that will encourage the levels of savings and capital investment that are so vitally needed for our future. The increasing aversion to risk taking in the lending and investing process must be arrested.

Toward those ends, the Administration is proposing to integrate corporate and personal income taxes. This proposal would eliminate the double taxation of corporate earnings which results from first taxing corporate incomes and then taxing individuals who receive dividends. I strongly believe that this proposal--which has already been adopted in most of the other major industrialized countries--would make a significant contribution toward meeting our capital needs of the future. Moreover, it is the only major tax proposal of which I am aware that comes to grips with the growing imbalances between corporate debt and equity.

ENERGY POLICY

No subject is more basic to the future of our economic prosperity than energy. Unfortunately, we have been without a comprehensive energy policy for too long. The oil embargo of 1973 and subsequent price increases demonstrate how vulnerable we have become. Neither the supply nor the price of a central ingredient in our economy is under our control. Our well-being and progress have become subject to the will of others. If there is a major lesson to be learned from our past energy policies, or the lack of them, it is that a system of patchwork government regulations and short-run measures designed to head off specific crises leads to more patchwork regulations and short-term measures--not to a viable energy policy that will produce energy efficiently at the lowest prices to consumers.

The President is committed to ensuring an energy policy that will achieve our goals. In January 1975, he submitted a set of measures to conserve energy, increase domestic production and provide for strategic reserves. The Energy Policy and Conservation Act contains important steps in the right direction, but the penalty for ultimately ending oil decontrol is first to roll back the average oil price. This action, coupled with the action taken by Congress to effectively repeal 70 percent of the depletion allowance for oil and gas, cannot help but have a retarding effect on exploration and development. The President is committed to bringing about decontrol as rapidly as possible, and we must make sure that the 40-month period for decontrol is not extended.

This legislation is certainly not the end of our efforts to bring about a more rational energy policy. Prices of our natural gas are still prohibited from rising to their market level in interstate markets, and shortages will continually plague us unless price is allowed to rise. Domestic marketed natural gas production has declined by approximately 11 percent in the last two years--a trend that must be reversed.

We have the resources to change this if we will only adopt policies that will develop these resources. As long as we refuse to remove these government-imposed controls, and thereby prevent free market incentives from increasing domestic energy supplies, we will continue our dependence on foreign imports and our vulnerability to political blackmail. For these reasons, we are opposed to the provisions of H.R. 10612 which would erect further impediments by increasing the tax burden on investments in oil and gas.

Further, in order to accelerate the replacement of obsolete oil and gas fired electric generating capacity, I am once more urging this Committee to enact the six-point electric utilities program recommended by the President's Labor Management Advisory Committee.

TAX REFORM

The third major issue before you concerns the ways to enhance the fairness and simplicity of the tax system.

Over the years, the continuing efforts by various groups to achieve narrow, but often worthy, objectives through the use of special provisions in the Code have led us to a situation in which the confidence of the American taxpayer in the very foundation of the Federal revenue system--the individual income tax--is being seriously threatened.

We are fortunate to have a highly successful tax system, one which has over the years commanded widespread respect and a high degree of voluntary compliance. We can be sure that Americans will continue to support this system so long as they have confidence that all are paying their fair share and as long as they feel they are getting their money's worth. However, as the system has become increasingly complex, we have begun to erode that basic faith in the fairness of the system. Many people today feel that taxes are being imposed upon them without their consent, that too many of their fellow taxpayers are escaping their responsibility through dozens of loopholes, and that the Code itself has become a Byzantine labyrinth of legal double talk.

To be sure, reasonable persons will differ on the importance of particular bits or pieces of the income tax law. Broad agreement can be reached on the overall objectives toward which meaningful tax reform strive:

-- The tax system should be fair and equitable,

-- The tax system should be simple,

-- The tax system should promote efficient use of the Nation's resources.

I have addressed earlier some of the critical ways in which the tax system needs to be improved in the interests of efficient allocation of resources. When we focus instead on the fairness or equity of the tax system, we must be concerned with the relationship of tax burdens borne by households to their ability to pay. Tax burdens should be similar for taxpayers whose opportunities and capabilities of supporting a standard of living are the same. Further, the tax burdens of those relatively better off should also be relatively larger. Because of some of the provisions in the Code, we have reached a situation in which there is a widespread perception that neither of these criteria is sufficiently well satisfied by our tax law.

As I shall subsequently develop in greater detail, the Administration's tax cuts will also promote fairness and simplicity. Thus, the proposed permanent increases in the standard deduction and personal exemptions as well as the reduction of the tax rates will more equitably relate tax burdens to the ability to pay and simplify considerably the preparation of tax returns. These tax cuts also continue the pattern of reducing the tax burdens of low-income families--removing many from the tax rolls--while moving to restore the eroded position of the middle-income group.

The House Bill contains many provisions designed to limit the benefits which high-income individuals receive from certain investment incentives provided in the Code. These incentives include preferential capital cost recovery deductions to encourage investment in such activities as real estate, minerals and farming. The effect of these incentives is a deferral of taxes which is worth more to taxpayers in the highest marginal tax brackets. Individuals responding to these incentives are not acting illegally and represent a small fraction of all taxpayers. However, excessive use of such incentives by high-income individuals may undermine the progressivity of the income tax as well as its perceived fairness.

In 1973 the Administration originated the LAL (limitation on artificial losses) proposal which limits the benefits of these tax incentives--often called tax shelters. We are pleased that the House Bill generally follows our proposal and we continue to support the broad objectives toward which LAL is directed.

Further, to deal with the problem of high income taxpayers who do not pay their fair share of tax, the Administration is renewing in modified form, its 1973 MTI (minimum taxable income) proposal. MTI is an alternative tax which will subject taxpayers to progressive income tax rates. We continue to feel that this approach is superior to the minimum tax which is an additional flat rate tax on tax preferences, primarily capital gains. H.R. 10612 would increase the minimum tax rate and would leave intact its structural deficiency as an additional tax.

The objectives of equity, simplicity, and efficiency can best be served by appropriate broadening of the base for the income tax, moving toward a more inclusive concept, and ultimately leading to a lower structure of rates for all. Whereas the minimum tax represents an additional layer of complexity in the system, the minimum taxable income concept is consistent with the long-term program of developing an alternative and more comprehensive tax base and taxing that new base at lower rates.

While the House Bill contains some measures to improve the simplicity of the tax system as it is encountered by the average taxpayer, it need hardly be pointed out that the overall effect of H.R. 10612 is to add another substantial dose of complexity to the Code. In my view, we have reached the situation in which the objective of simplicity, which might ordinarily be viewed as merely a minor or supporting objective of the fundamental objectives of fairness and efficiency, has to be raised to a level of first importance.

Much of the complexity of the tax system is encountered by relatively affluent households or by business firms. Yet, the number of taxpayers affected by such complexities as the computation of the retirement income credit or the sick pay exclusion has steadily grown. Furthermore, the complexity of the Code as it confronts the relatively affluent must be of concern to all taxpayers since it is this very impenetrability of the law which leads to the feeling of the average taxpayer that his neighbor who can afford highly talented tax advisors is able to manipulate the system to his advantage. We are, therefore, renewing many of our 1973 simplification proposals including the miscellaneous deduction allowance to substitute for hard-to-itemize deductions, repeal of the sick pay exclusion, and revision of the retirement income credit.

Having set the context for our approach to the issues before this Committee, let me turn now to some of the specifics. I shall take up first the main elements of the Administration's tax proposals, discuss the relationship of energy policy and tax policy, and close with a discussion of tax reform, focusing specifically on H.R. 10612.

II. ADMINISTRATION PROPOSALS

PERMANENT TAX REDUCTIONS

Last October President Ford proposed that permanent large tax reductions be made possible for American taxpayers by Congress joining with him to limit the rate of growth of federal expenditures. Specifically, the President proposed a $28 billion tax cut (Table 6) linked to the adoption by the Congress of a spending ceiling of $395 billion for Fiscal 1977. That spending ceiling, and the budget presented to the Congress this January, represent a reduction of about $28 billion from the projected levels of spending that would have applied for Fiscal 1977 had actions to limit federal spending not been taken.

In my testimony before this Committee last December 9, I set forth in detail the budgetary and economic trends that had caused the President to conclude that decisive action to regain control over the budget was immediately required. Today I will summarize briefly the objectives underlying the Administration's proposal for permanent tax reductions. I will also describe the details of that proposal, as modified to take account of the temporary tax cuts enacted last December.

Administration Objectives

The proposed dollar-for-dollar reduction in federal taxes and federal expenditures has two fundamental objectives. The first is to restore fiscal discipline in the consideration of tax and expenditure measures; the second is to return more decision-making discretion to individuals and families to determine how they will allocate their incomes and personal financial resources.

. Fiscal Discipline

Our recent fiscal history demonstrates that the failure to link tax cuts with expenditure cuts, and expenditure increases with tax increases, has resulted in substituting the capricious tax of inflation for the more equitable, but politically difficult, legislated tax increase.

In Fiscal 1962 the Federal budget exceeded $100 billion for the first time in history. By Fiscal 1971 it exceeded $200 billion. By Fiscal 1975 it exceeded $300 billion, and a figure of $425 billion was in prospect for Fiscal 1977 without some restraint -- a fourfold increase in just 15 years! Federal government outlays increased at an annual rate of 6.6 percent during the period 1961-1966, at 9.4 percent per year during the next 5 years, and at 11.8 percent per year from 1971 to 1976. If Fiscal 1977 expenditures should be permitted to grow to $423 billion, the rate of growth will reach 14.3 percent.

Furthermore, the growth in spending has far exceeded the growth in revenues. During these same years we have posted a string of budget deficits that are unprecedented in peacetime. The Federal Government (including its agencies) will have been forced to borrow over $350 billion from our private money markets over the decade ending with the current fiscal year. That is over a third of a trillion dollars that might otherwise have been used to build new plants and to create new jobs in the private sector.

It is no wonder that inflation has been such a severe problem and that interest rates have risen to historic levels as a natural consequence of these policies. Moreover, an even worse result of such budgetary practices is that continuing deficits tend to undermine the confidence of the public in the capacity of our government to deal with inflation.

Thus, a principal goal of the President's program is to restore the Federal budget to balance. Reducing the projected Fiscal 1977 deficit to $43 billion will make possible a balanced budget by Fiscal 1979. We are, of course, extremely pleased that your Committee, in its budget recommendations for Fiscal 1977, has substantially agreed with the President's target for that year's deficit and, as provided in section 1A of the Revenue Adjustment Act of 1975, has accepted the basic premise underlying the President's program that expenditure increases reduce, dollar-for-dollar, the total tax reductions that may be enacted.

. Decision-Making Process

The second objective of the President's program is to return more decision-making discretion to individuals and families to determine how they will allocate their incomes and personal financial resources. The growth of Federal expenditures has brought with it increasing government dominance in basic decisions respecting the use of our nation's resources and a corresponding diminution in the role of private decision-making.

Over the past 10 fiscal years, Federal expenditures have grown 175 percent while total GNP has increased about 120 percent -- that is, the rate of growth in government outlays was nearly 50 percent greater than that of the economy itself.

Some analysts have claimed that the surge of government spending and deficits is only temporary and that more moderate outlay growth rates and budget balance will return as soon as economic conditions stabilize. It is true that part of the increases in the budget outlay can be traced to the "automatic stabilizers" that should respond to recession problems. For example, unemployment compensation benefits have increased from $6 billion in Fiscal 1974 to over $19 billion in Fiscal 1976. However, a review of the actual budget figures clearly indicates that large spending increases have been occurring across the traditional programs of the entire federal government. These spending increases cannot realistically be regarded as "temporary" since government programs are rarely eliminated or curtailed.

Our choice then is clear. We can regain control over Federal spending, stop the trend toward the Federal Government's direction of the use of an ever increasing portion of our national wealth, and restore a greater share in decision-making to individuals and families through large permanent tax cuts. Or, we can continue down the road of the past which leads toward even larger budgets, continuous deficits, and increasing domination of government over our economic affairs.

Description of Administration Proposal

Let me turn now to the specifics of the Administration proposal for permanent tax reductions. The enactment of the Revenue Adjustment Act of 1975 has made it impossible to apply the President's full proposed tax cuts for all of 1976. We are, thus, proposing distinct liability changes for 1976 and 1977, which have the combined effect of applying the Administration's permanent tax reductions effective July 1, 1976.

Calendar Year 1977 and Beyond

The Administration's permanent program has the following major features:

-- an increase in the personal exemption from $750 to $1,000,

-- substitution of a single standard deduction--$2,500 for married couples filing jointly and $1,800 for single taxpayers--for the existing low income allowance and percentage standard deduction,

-- a reduction in individual income tax rates (Tables 7-8),

-- a permanent 10 percent investment tax credit,

-- a reduction in the maximum corporate income tax rate from 48 percent to 46 percent and making permanent the current temporary tax cuts on the first $50,000 of corporate income,

-- a program to stimulate construction of new electric utility facilities to insure that long-run economic growth is not limited by capacity shortages in the production of electricity.

Calendar Year 1976

Since taxpayers compute their taxes on a calendar year basis, the Administration is proposing tax liability changes for calendar year 1976 that mesh the permanent proposal with the Revenue Adjustment Act of 1975 and approximate the effect of applying in 1976 the current temporary tax cuts for six months and the Administration's permanent tax cuts for six months. The Administration's full proposed tax liability changes will apply for 1977 and subsequent years.

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The Administration's proposals would result in lower withholding tax rates (and higher take-home pay) effective July 1, 1976. The lower withholding tax rates would reflect the full impact of the tax cuts proposed by the President last October and would remain constant in 1977.

The specific tax liability provisions that will apply in calendar year 1976 are:

	Tax Cuts (Compared to 1974 law)
For individuals:	
-- a personal exemption of $875	$ 5.4 billion
-- a per capita exemption credit of $17.50, with alternative taxable income credit equal to 1 percent of the first $9,000 of taxable income (i.e., maximum credit equals $90);	$ 4.9 billion
-- standard deduction changes	$ 3.9 billion
. a low income allowance of $2,300 for joint returns and $1,750 for singles;	
. a percentage standard deduction of 16 percent of Adjusted Gross Income with a maximum of $2,650 for joint returns and $2,100 for singles;	
-- an average of the rate structures under present law and the President's permanent tax cut program (see Tables 7-8);	$ 3.6 billion
-- an earned income credit equal to 5 percent of earned income with a maximum of $200, phasing out at $8,000 of earned income or adjusted gross income, whichever is greater.	$ 0.7 billion
TOTAL INDIVIDUAL CUTS	$18.5 billion

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	Tax Cuts (Compared to 1974 law)
For business:	
-- a reduction in corporate rates	\$ 3.2 billion
. the rates will be 20 percent for the first \$25,000 of taxable income, 22 percent for the second \$25,000 of taxable income, and 47 percent for taxable income above \$50,000.	
-- the program to stimulate construction of electric facilities, effective July 1, 1976.	\$ 0.6 billion
TOTAL INDIVIDUAL AND BUSINESS TAX CUTS	\$22.2 billion

Tables 9-13 illustrate the effect of the Administration's tax cut proposal when it is fully effective in 1977 on different individual taxpayers compared to (1) tax liabilities under 1972-74 law, (2) 1975 tax liabilities, (3) 1976 tax liabilities under the Revenue Adjustment Act, (4) the Administration's transitional proposal for 1976, and (5) proposed 1977 law.

. Individual Tax Cuts

The recently adopted budget recommendations of your Committee and of the House Ways and Means Committee contemplate that reductions in taxes from 1974 law will be provided through calendar year 1977, without specifying the details of those reductions. Consistent with that approach, and in recognition that the so-called "temporary" tax reductions are in fact in process of becoming permanent, we believe it is essential to face the necessity for making fundamental decisions regarding the permanent structure of the individual income tax, as opposed to the patchwork approach that has prevailed to date.

The Administration's proposed individual tax reductions are designed to achieve two important goals. The first goal is to simplify the existing tax structure by providing a single standard deduction as a substitute for the present low income allowance and maximum standard deduction. The second goal is to begin the difficult, but most vital, task of realigning the tax rate structure to relieve the middle income taxpayer from the onerous tax burden imposed as a result of industriousness and thrift.

Let me elaborate: simplification should begin with those provisions that affect the greatest number of taxpayers. The provision of a single standard deduction would in itself be a major simplification. In contrast, the addition of the per capita exemption credit has been a major complication, and many taxpayers are failing to claim the credit. The situation will be worsened by the addition of the alternative taxable income credit by the Revenue Adjustment Act of 1975.

Because of rising productivity, but more particularly because of the effect of inflation on nominal money incomes, families comprising the middle and upper-middle classes of society have been moved up the tax scales to positions previously occupied by only the top one or two percent of American families. As a result, the middle-income taxpayers find that larger and larger tax bites are being taken from their paychecks and entrepreneurial incomes. For this particular group of taxpayers, the rewards of enterprise, of sustained effort, and of the accumulation of capital have been eroded. As we all benefit from the vigor of this group, so are we hurt when its vitality is threatened. The Administration's proposals are designed to reverse the trend, by providing relief to the middle-income taxpayer while more than preserving the gains of the lower-income taxpayer.

Tables 14-21 provide further information on the individual tax cuts.

. <u>Business Tax Cuts</u>

The Tax Reduction Act of 1975 increased the nominal rate of the investment credit to 10 percent from 7 (4 percent in the case of utilities) for the years 1975 and 1976. The President's proposal would make the increase permanent. It is well known that any tax provision intended to encourage investment is most effective when investors may regard it as permanent, for then they may take it into account over the full range of their investment planning horizons, which are frequently 10 years or longer. As part of a program of structural fiscal change, the investment credit helps offset the anti-capital formation bias of the Federal tax system and should have permanent status..

The Tax Reduction Act, for the year 1975, raised the corporation surtax exemption to $50,000 from $25,000, and lowered the tax rate on the first $25,000 of taxable income from 22 to 20 percent. The Revenue Adjustment Act of 1975 extended this tax reduction an additional six months. Again, the President's proposal would make this change permanent.

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In addition to this modification of the corporation tax schedule, the President proposes to reduce the top rate 2 points so that the maximum applicable tax rate would be 46 percent. Until we, working with the committees of Congress, can effect integration of the corporation and personal income taxes, this modest relief of the extra burden of tax should cause beneficial increases in the rate of capital formation.

Finally, the President's proposals include a 6-part tax incentive program for electric utilities to accelerate the replacement of facilities now made obsolete by the higher costs of fossil fuels and to encourage the application of more adequate capital cost pricing formulas by utility commissions.

Table 22 indicates the business tax cuts.

JOB CREATION INCENTIVES

As I mentioned earlier, this Administration is committed to two fundamental economic policies: sustained noninflationary economic growth and jobs for all who seek work. The proposed tax cuts, coupled with the corresponding reduction in the growth of Federal spending which I have just described, go a long way toward achieving our goal over the long run. But tax cuts alone are not enough. There is a pressing need for more immediate measures to alleviate the unemployment problem that is particularly severe in certain segments of our industry and in certain areas of our Nation. What we need and must do is to create a favorable climate for private industry to create more jobs. This, we believe, can best be accomplished by the adoption of tax incentives. As the President stated in his State of the Union Message, "One test of a healthy economy is a job for every American who wants to work. Government--our kind of government--cannot create that many jobs. But the Federal Government can create conditions and incentives for private business and industry to make more and more jobs."

The Administration has proposed just such a job-creation incentive. Introduced in the House as H.R. 11854, the proposal will permit rapid depreciation for businesses which construct new plants or expand existing facilities in areas where the unemployment rate exceeds 7 percent, or purchase equipment for use in these new or expanded facilities. The tax incentive approach to provide jobs through the private sector is preferable to creating public

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service jobs. Public service jobs typically are temporary, often not productive, and subsequently require the recipient to find permanent employment after the program has been terminated. Public service jobs also typically require bureaucracies that are difficult to establish and difficult to liquidate. The purpose of the Administration's proposal is to establish rewarding, permanent employment opportunities through the private sector.

The Administration's proposal has the following advantages:

First, the stimulation of plant construction and expansion, and equipment purchases will lead to the creation of new and permanent jobs, in the private sector, in areas where they are needed most.

Second, we expect the proposed tax incentive will provide substantial impetus for businesses to embark upon projects now deferred and to undertake new projects which otherwise might not get started.

Third, the Administration proposal will provide immediate benefit to the construction industry, one of the most depressed in the economy. The plan will stimulate construction in areas where that industry has been hardest hit by the recession and thereby provide jobs for unemployed persons concentrated in those areas.

Fourth, the proposal will also encourage capital investment. While not directly affecting the overall supply of capital, the plan will provide an incentive for capital spending to create jobs. By improving the cash flow of companies, it will encourage investment in 1976.

Let me turn now to some of the specifics of the Administration's proposal.

Timing of Plan

The plan is proposed as a temporary measure, pending return to full employment in an economy that is steadily recovering from the recession. Therefore, investment projects must begin during the year beginning on January 19, 1976, and must be completed within 36 months. That is, facility construction must be commenced, or production equipment ordered, on or after January 19, 1976, and before January 20, 1977, and must be completed and placed in service within 36 months thereafter.

This time period has been chosen for several reasons. The requirement that projects be begun in the year starting January 19, 1976, will result in immediate employment opportunities--particularly in the construction sector. The plan will also have immediate employment effects in the capital goods industries, which also have been badly hit in the current recession and are operating at well below normal utilization rates throughout the country. Furthermore, requiring projects to be completed and placed in service within three years will avoid the risk of unduly extending the temporary relief measure. The bulk of construction and equipment manufacture will take place in 1976 and 1977, when capacity will be available. Moreover, because of its short time period, the plan will not threaten the relocation of projects already planned.

Qualifying Location

Facilities and equipment will qualify for rapid depreciation under the plan only if constructed and placed in service in areas which had an average unemployment rate of 7 percent or more for calendar year 1975. Geographic areas with high unemployment will be defined by the Department of Labor in accordance with the functional definition of Labor Market Areas (LMAs) presently used by the Department of Labor in the development of unemployment statistics. Areas of a state that are outside defined LMAs will be considered as a whole, and if this portion of a State had an unemployment rate of 7 percent or more in 1975, it also will be eligible. Attached is a list of potentially qualified areas.

With the 7 percent trigger, about two-thirds of the metropolitan areas of the country will be eligible for the plan. Eligible areas are found in 42 States, plus the District of Columbia and the Virgin Islands, and include about 80 percent of the labor force.

According to the Department of Labor, since the middle 1960s there has been a dramatic shift toward greater regional variation in unemployment. Pockets of high unemployment are not only persisting but increasing. By focusing our efforts on pockets of high unemployment, we hope to provide stimulus to areas with the greatest need. A desirable by-product of these efforts is the potential benefit to the Nation as a whole because equipment orders will flow to productive areas, whether or not they also may be an area eligible for relief.

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Application to Real Estate

The Administration proposal will apply to any commercial or industrial facility located in a qualifying area, the construction of which is started and finished within the time period previously described. Commercial and industrial facilities include factories, warehouses, shopping centers and office buildings. Distinct additions to existing facilities will also qualify, but not mere alterations or improvements.

Certain limitations will be applicable to the proposal. Thus, the tax incentive will not be applied to facilities used for lodging or to governmental facilities or facilities of certain tax-exempt organizations. Moreover, the proposal will not apply to any residential real estate activiites. Housing and residential construction have received substantial stimulus from recent actions by the Department of Housing and Urban Development and will receive additional stimulus from other proposals made by the President in his State of the Union Message. This particular proposal seeks comparable incentives for the nonresidential sector.

Amortization of qualified real estate will be allowed over a period equal to one-half the shortest life which a taxpayer may now claim under the provisions of the Internal Revenue Code and the regulations. This is a very substantial tax incentive. For example, in the case of a building with a 30-year useful life, the taxpayer will be able to write off one-third of the cost in the first five years as compared with 23 percent under the most accelerated method of depreciation now available. Recapture of depreciation upon a disposition of qualified real estate, under the rules of Code section 1250, will apply.

Application to Equipment

The proposal will also apply to equipment which is ordered during the year beginning January 19, 1976, and placed in service within 36 months thereafter in a facility or addition which also qualifies for the incentives under the Administration's proposal. Equipment placed in existing facilities in areas of high unemployment will not qualify. Nor will over-the-road equipment or rolling stock.

Under the proposal, at the taxpayer's election, straight-line amortization of qualified equipment will be allowed over 60 months commencing on the date the equipment is placed in service. For example, the amortizable cost of equipment with a 10-year useful life could be written off in five years compared to about 67 percent under the double declining balance method which would now be available. For this purpose, the definition of equipment--as distinguished from real estate--will be the same as is used in the investment credit provisions. Here, too, the depreciation recapture rules will apply upon a disposition of the property.

Notwithstanding the election to amortize qualified equipment over five years, the full investment tax credit will still be allowed if the useful life of such equipment is seven years or more. This is a most significant benefit which will make the election to amortize much more attractive than if the electing taxpayer were limited to two-thirds of the investment credit as is the case under current law with respect to property with a useful life of five years.

This proposal will not apply to those electric utilities covered by the Administration's six-point utility program which I will discuss later.

Revenue Estimates

The revenue cost of the proposed job-creation tax incentive is estimated at $300 million for Fiscal Year 1977, $650 million for 1978, $900 million for 1979, and $1.0 billion for 1980. However, over the long-run, the same amount of taxes will be paid because, generally, accelerating depreciation of capital investment simply defers taxes.

BROADENED STOCK OWNERSHIP PROPOSAL

I would like to turn now to the subject of broadened stock ownership in the United States. The Administration believes that broadening the private ownership of business will further an American tradition, and thereby strengthen the economic, social and political base of support for our free enterprise system. In this respect, it is important to encourage participation by low and middle income working Americans in private ownership. Widespread stock ownership among all Americans will promote stability in the financial markets, provide individuals with a greater sense of participation in the free market system, and give them an opportunity to build a reasonable estate for themselves and their heirs.

There are many approaches which can foster broadened stock ownership through the tax system. In his State of the Union Address, the President proposed the adoption of a Broadened Stock Ownership Plan (BSOP). This plan would have three principal characteristics which the Administration deems important to any program designed to encourage broadened stock ownership. First, the plan should be available to all Americans, whether self-employed, employed by a corporation, or employed by the government, federal, state or local. Second, participation should be voluntary, but the plan can be established by individuals or by their employers through payroll deductions. Third, participants in a BSOP should have a choice as to their investment in common stocks.

Other aspects of the plan include the following:

First, contributions would be deductible from taxable income, with participation being restricted to individuals in the low- and middle-income ranges and limited to the maximum amount eligible for deduction. In addition, there would be a phase-out of the amount deductible at the higher income levels. For example, a taxpayer might be allowed to deduct $1,500 a year or, if less, 15 percent of his compensation, subject to a phase-out in the case of compensation between $20,000 and $40,000.

Second, income earned by a BSOP would be exempt from income taxation until withdrawn from the plan. Upon withdrawal, a participant would be subject to a current tax at capital gain rates to provide participants with the benefits normally associated with the accumulation of capital values. However, there would be a holding period requirement. Thus, funds held in a BSOP would have to remain invested for at least seven years. Premature withdrawals would be subject to a penalty tax in order to discourage early withdrawals.

Third, the contributions made to a BSOP would have to be invested in common stocks, the selection of which would be entirely up to the participant. He could, for example, select individual stocks or mutual funds.

Under the Administration's proposal, taxpayers could establish a BSOP on or after July 1, 1976, and qualify for a full tax deduction for calendar year 1976. Further details of the BSOP proposal will be worked out with Congress.

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It should be noted that BSOPs would have no effect upon a taxpayer's ability to participate in any pension or profit-sharing plan established by his employer, or to establish his own individual retirement account or Keogh plan. The contemplated statutory pattern for BSOPs would be unrelated to deferred compensation, retirement or employee benefit plans.

ELECTRIC UTILITIES TAX PROGRAM

The electric utilities tax program is another important part of the Administration's program. It not only will serve as a stimulus to construction of additional facilities by electric utilities, but will also provide a means to minimize imports of foreign oil and to insure adequate electric generating capacity in the several years ahead. The construction activity will help put many people back to work in the near term and, in the longer run, will help insure that economic expansion will not be limited by energy shortages. In sum, the program is highly important to the national economy.

Background

The proposal I presented last July 8 before the House Ways and Means Committee, and before your Committee on December 9, represents the recommendations of the President's Labor-Management Committee, and the President has endorsed them. The need for this legislation has not lessened since I last urged its adoption. In summary, the reasons for this legislation are:

1. Financing difficulties have prevented the construction, or completion, of badly needed nuclear and coal fired plants.

2. The need to minimize our dependence on foreign oil demands adoption of means to increase electric generating facilities fueled otherwise than by petroleum products.

3. The energy shortage must be met. Insufficient electric power will inhibit construction of new manufacturing and commercial facilities. This cannot be allowed to happen.

This Committee is acutely aware of the nature of our overall energy shortage and the adjustments that our economy must make. We will never again want to rely on foreign oil, as we did for so many years. We must greatly increase our

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domestic capacity for the generation of energy, and we must begin to make progress immediately. The indispensable core of any sensible energy program is the construction of electric power facilities which do not operate on petroleum products--which, today, means primarily coal, nuclear and hydroelectric. But these electric power facilities will not come off the shelf in someone's store. The lead times required to construct these generating plants range up to seven or eight years. Generating plants are complex and their construction cannot be turned on and off without incurring major expense and causing great delay. The coal and nuclear fueled electric power plants that we defer today will be missing tomorrow and will prolong our dependence on foreign oil imports.

A recapitulation of the problems of the electric power industry may be helpful. When fossil fuel prices started their rapid rise in mid-1973, the consequence for electric utilities, whose rates are regulated, was a shrinkage in the residual cash-flow. This reduced the return to equity and made increasingly difficult the simultaneous (1) maintenance of dividend payments which were needed to continue to attract and hold equity capital, (2) payment of interest on obligations to bond-holders, and (3) carrying out of investment programs to replace existing capacity as well as to add additional capacity needed to meet forecast growth in demand for electric power.

This squeeze on the electric power industry, resulting from what is commonly called "regulatory lag" or the slow adjustment of allowable prices to reflect changed cost conditions, was exacerbated by two other factors: the actual costs of replacement capital were pushed-up by inflation while the allowances for this portion of capital cost embedded in utility rate structures remained unchanged; and interest rates on refunding and new issues of bonds rose to incorporate the inflation premium. For many utility companies the resultant drop in realized return to equity owners was so severe that dividend payments were suspended and/or construction programs were cancelled or suspended.

It is true that the problems visited on the utility sector differed only in degree from those faced by the entire private sector. Unregulated businesses were also caught in a cash-flow squeeze as their costs rose more rapidly than the prices they could recapture in the market. But, in the unregulated sector, restoration of balance between prices and costs has been quicker, not only because price regulation procedural lags are generally absent, but also because their capital costs are generally a smaller fraction of total costs.

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Specifics of Program

I would now like to turn to the specifics of the six-point proposal.

First, the proposal would increase the investment tax credit permanently to 12 percent for all electric utility property except generating facilities fueled by petroleum products. Under current law, utilities, like other taxpayers, are eligible for a maximum investment tax credit of 10 percent. Although the 10 percent credit is scheduled to revert to lower rates at the end of this year, the Administration has proposed the higher rates be made permanent.

Second, the proposal would give electric utilities full, immediate investment tax credits on construction progress payments for construction of property that takes two years or more to build, except generating facilities fueled by petroleum products. Under present law, utilities, like other taxpayers, are entitled to investment tax credits as they make progress payments on long-term construction projects. However, the Tax Reduction Act of 1975 provided a five-year phase-in of construction progress payment credits so that entitlement to the full investment credit at the time a progress payment is made will not occur until 1980.

These proposed changes with respect to the investment credit would be limited to those utilities which "normalize" the increase in the investment credit for ratemaking purposes and which are permitted by their respective state regulatory agencies to include construction work in progress in their rate base for ratemaking purposes. "Normalization" means reflecting the tax benefit for ratemaking purposes pro rata over the life of the asset which generates the benefit instead of recognizing the entire tax benefit in the year the utility's taxes are actually reduced. In the absence of normalization, the entire tax benefit would flow through immediately in the form of reduced utility rates for consumers, and no real economic benefit would result for the utility.

Third, the proposal would permit electric utilities to begin depreciation of major construction projects during the construction period. Under present law, a deduction for depreciation is allowed commencing when a depreciation asset is placed in service. The depreciation deduction would be based on the accumulated construction costs which qualify for the investment credit under the construction progress payment system enacted as part of the Tax Reduction Act of 1975. Accelerated methods of depreciation would be permitted, and the depreciation deduction would be based on an assumed useful life which would include the remaining construction period plus the estimated useful life (or asset depreciation range period) attributable to the property as of the time it is placed in service. Depreciation after the property is placed in service would be reduced by depreciation taken during the construction period.

Electric generating facilities fueled by petroleum products would not qualify for this construction period depreciation. Further, construction period depreciation would be conditioned on the utility's normalizing the benefits of the provision for ratemaking purposes and upon the agreement of the relevant state regulatory agency to include construction work in progress in the utility's rate base for ratemaking purposes.

Fourth, the proposal would provide for extending to January 1, 1981 the period during which pollution control equipment installed in a pre-1969 plant or facility will qualify for rapid five-year straight-line amortization in lieu of normal depreciation and qualification for the investment credit. Section 169 of the Internal Revenue Code, which provides for this treatment of pollution control equipment, expired December 31, 1975, and the proposal is to extend the qualification period an additional five years.

Fifth, the proposal would provide an election of five-year amortization in lieu of normal depreciation and the investment credit for the costs of converting an electric power generating facility fueled by petroleum products into a facility fueled by nonpetroleum products, or for the cost of replacing petroleum product fueled facilities.

Sixth, the proposal would permit a shareholder of a regulated electric utility to postpone tax on dividends paid by the utility on its common stock by electing to take additional common stock of the utility in lieu of a cash dividend. The receipt of the stock dividend would not be taxed. The amount of the dividend would be taxed as ordinary income when the shareholder sells the dividend stock, and the amount of capital gain realized on the sale would be decreased (or the amount of capital loss increased) accordingly. Dividend stock would be deemed sold by the shareholder before any other stock of the same utility.

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Revenue Estimates

Altogether, the six-point electric utilities tax program will reduce tax revenues by an estimated $200 million in the transitional quarter of 1976 and $800 million in Fiscal 1977. The long-run benefits are an orderly restructuring of the American electric utility plant to de-emphasize the use of petroleum-based fuels and an acceleration of annual investment to meet future electric power needs of the economy.

PROPOSAL FOR INTEGRATION OF CORPORATE AND PERSONAL INCOME TAXES

I would like to turn now to a specific proposal to integrate corporate and personal income taxes. In my testimony before the House Ways and Means Committee last July, I discussed the details of such a proposal. Much of what I will present today is drawn from that testimony. I will also attempt to answer some of the criticism which has been levelled at the proposal.

Perverse Effects of the Double Tax on Corporate Dividends

Under our system of taxation, income earned by corporations is taxed twice: first to the corporation and then again to the shareholder, if and when it is distributed as a dividend or realized on sale. The existence of this two-tier tax has a number of perverse results:

1. The system reduces rates of return for all savers. Viewing the economy in the aggregate, it is not just corporate shareholders who have lower profits because of the double tax on dividends.

With due allowance for risk, no one would invest in corporate equities if the return to him, after payment of tax at the corporate level, differed from that which he could earn from investment in real estate, bonds, or other assets. In a competitive capital market, there are constant flows of capital from one kind of investment to another until the after-tax rates of return are comparable. If investment in corporate equities is less profitable, then capital will flow out of such investment (or less capital will flow in). If there is less demand for stock on the stock exchange, the price of stock will fall and yields will rise. At the same time, capital which is diverted from corporate stock will flow into other kinds of investment. Money in savings accounts will increase and there will be a greater demand for bonds and other debt instruments and a greater demand for investments in assets and enterprises not held in corporate form. That greater demand for that kind of investment will in turn depress the return on it. For example, when more people wish to have money in savings accounts, the interest rates which banks are willing to pay falls.

Since investors have had 25 years to accommodate to the nearly 50 percent rate of corporate tax, yields to investors after the tax have surely been equalized with those elsewhere. This means that the corporate tax has reduced the yields on all forms of saving, and that eliminating the extra tax on dividends will reverse the process, raising rates of return to all savers.

2. By imposing an extra penalty on the rewards for saving, the existing system restrains the capital expansion needed to meet our economic goals. I have already detailed the crucial importance of increased capital formation. Integration will help to achieve our needed increases in the capital stock in three ways.

First, domestic savings will respond to the increased return. The response may be small, but even a modest change in savings habits would lead to a substantial savings increase in the aggregate. Several recent econometric studies of savings behavior have shown this saving response to be positive and significant.

Second, with a higher return to capital in the United States, relatively more of the world's investment will take place here. Less domestic savings will flow abroad, and more investment by foreigners will be undertaken here.

Third, the method of integration which we propose allows deductions to the corporation for a portion of dividends currently paid. This makes available additional cash flow to businesses for immediate investment. While in the long run, this aspect of the policy is less important for capital formation than is increased profitability, additional cash flow may help to speed the adjustment to the larger volumes of capital investment.

3. The extra tax on corporate income leads to economic inefficiency by requiring that prices of corporate sector products be relatively higher than prices of products produced by unincorporated business. The products of corporations must sell at prices high enough to cover the additional burden of the corporation income tax or else corporations would be unable to attract and hold the capital needed to product those goods.

This tilting of prices makes corporate products relatively less in demand than they would be in the absence of the extra corporate tax. Economic activity will, of course, be carried on in the corporate form in order to aggregate the large amounts of capital required and to assure continuity of management. Heavy manufacture, minerals development and production, and the utilities could operate in no other way, and there are many other activities for which the sheer economies of scale outweigh the advantages of personal management and the tax savings possible in a proprietorship or partnership. But, the inefficiency of the corporation income tax is that it makes it more expensive to realize these advantages of corporate organization.

Consequently, as measured by the prices we are willing to pay in the market place, we have too little output from the corporate sector and too much from elsewhere. If we could eliminate the cause of this misallocation of resources, we would clearly be better off: we would have more of the things we currently value more highly, fewer of the things we value less. Professor Harberger, who has pioneered the analysis of this waste, has estimated that the value of this loss to society is equal to 0.5 percent of our national product annually.

4. The double tax is an extra inducement for corporations to seek debt financing, rather than increased equity capital, because the tax applies only to the income attributable to equity investment. Corporations must earn enough gross income to cover the interest payments made to compensate bondholders and other creditors for the savings which they have supplied. But interest payments are deductible at the corporate level and thus--unlike dividends--are not included in the <u>net</u> income which is taxable to the corporation. If we were able to remove the extra tax on dividends, we would make equity financing much more attractive and would reverse the steep and dangerous increase in debt-equity ratios of recent years. I have already indicated how high debt-equity ratios make businesses extremely vulnerable to business cycle changes and that a high proportion of debt in the financial structure will further discourage investment by introducing added uncertainty for lenders and borrowers. This is just another example of how the tax structure hinders the efficient operation of markets, in this case by increasing the cost of equity compared to debt capital. We must remove this tax impediment to business expansion and economic growth.

5. A double corporate tax creates a market bias against dividend yielding stocks. So long as earnings are retained, the second tax on dividends need not be paid. If the stock is ultimately sold, its value will

generally be higher because of the retained earnings, but the capital gains tax on the increase in value is imposed at preferential rates. Thus, the second tax in the case of retained earnings may be substantially lower than in the case of dividends. Consequently, companies like utilities which have traditionally relied on high dividend payouts to attract the capital needed for expansion, are placed at a substantial disadvantage because the double tax imposed on their income is greater than the double tax on companies which retain earnings and do not distribute them. Moreover, moderate income investors who prefer dividends to capital gains are discouraged from stock ownership. Elimination of the second tax would greatly assist utilities and other companies similarly situated in raising equity money. Given our energy problems, this is a particularly important point.

6. The double tax places a heavy penalty on corporate decisions to distribute earnings. In an ideal free market, the tax system would be neutral with respect to retention or distribution of earnings. Corporate managers would be led to retain earnings only if they would use them more productively in their businesses than their stockholders might use them in other investments. Integration would remove the tax reasons for retaining rather than distributing earnings. At present, the tax penalty on paying out earnings puts corporate managers under great pressure to do almost anything that might be productive with retained earnings rather than pay them out. The double corporate tax thus tends to "lock-in" corporate capital and keep it out of the capital markets which allocate capital more efficiently among uses.

International Comparisons

For many years our system of imposing a double tax on corporate profits by taxing them at each of two tiers was also widely used abroad, and it is often referred to as the "classical" system of corporate taxation. So long as tax rates at the corporate level remained relatively low, the system did not create undue mischief. In the United States, the corporate tax rate was less than 15 percent as late as 1935; it rose to 40 percent during World War II, dropped back to 38 percent in the last of the 1940s and rose again to 52 percent during the Korean War. The current 48 percent rate was enacted in 1965. Thus, basically, it was only as recently as the Korean War in the early 1950s that corporate rates reached their present high levels.

Similarly, corporate rates have been rising in other countries, but not so fast as in the United States. As rates have risen abroad and as the need for economic development and investment increased in other countries, changes were made in their corporate tax system. Today, virtually all of our major trading partners eliminate much of the double tax. Such systems are in effect in Canada, the United Kingdom, France, Germany, Belgium and Japan.

The European Economic Committee has adopted a resolution urging all of its members to adopt such a system and is presently engaged in an effort to promote greater uniformity of existing systems and to harmonize the differences that remain. Since our two-tier tax system results in higher prices for corporate products, and our major trading partners have taken steps to eliminate this extra tax burden, we have placed U.S. corporations at a competitive disadvantage in international markets.

The Administration's Integration Proposal: Combination of Dividend Deductions and Stockholder Credits

We propose eliminating the double tax on income from savings invested in corporate equity and to do so in six phases, with the first phase effective January 1, 1978. The remainder would phase in equally over the succeeding five years. The proposal would, thus, have no effect on the budget for Fiscal 1977.

We propose to eliminate the double tax by combining the two mechanisms of a dividend deduction and a stockholder credit. When fully effective, the credit at the stockholder level in combination with the dividend deduction at the corporate level will completely remove the double tax on dividends.

The Dividend Deduction

Approximately half of the total relief would be accomplished by a dividend deduction. Thus, ultimately there would be a deduction from corporate taxable income of roughly 50 percent of the dividends distributed. The reason that I say "roughly 50 percent," rather than exactly 50 percent is that in order for the mechanism to achieve its objective with the maximum simplicity, the fraction deductible at the corporate level must be geared to the stockholder credit procedure.

The accompanying table illustrates the effect of dividend deductibility at the corporate level.

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Illustrative Computation of 50% Corporate

Dividend Deduction

	(1)	(2)	(3)
		Proposed Law	
	Present Law 1/	with Same Dividend Payout	with Maximum Dividend Payout
A. Corporate Income Subject to Tax	$100	$100	$100
B. Dividend Paid	50	50	66.67
C. 50% Dividend Deduction (50% of Line B)	-	25	33.33
D. Taxable Corporate Income (Line A-Line C)	100	75	66.67
E. Corporate Income Tax (50% of Line D)	50	37.50	33.33
F. Corporate Income After Tax (Line A-Line E)	50	62.50	66.67
G. Retained Earnings (Line F-Line B)	0	12.50	0

Office of the Secretary of the Treasury
Office of Tax Analysis

March 11, 1976

1/ Assumes, for simplicity, a 50% corporate tax rate.

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For simplicity, we assume the corporation earns $100, that the corporation tax rate is 50 percent and that 50 percent of the dividends are deductible at the corporate level in computing the corporation income tax. Under present law, as is shown in the table, the corporation pays $50 in tax and has $50 left over, to retain or pay out in dividends. Under the proposed dividend deductibility procedure, if the corporation merely continues to pay out $50, its tax payment is reduced to $37.50, for its taxable income is $100 less 50 percent of $50, or $75, and the tax rate is 50 percent. Without changing its dividend payout, the corporation has $12.50 of additional retained earnings. On the other hand, if the corporation wishes to pay out the maximum amount of its earnings and retain nothing, it may pay out $66.67 in dividends and pay tax of $33.33. In this instance, the taxable income at the corporate level is $66.67--$100 less half the $66.67 in dividends paid--and it pays $33.33 in tax. Thus, the dividend deductibility feature of the Administration's proposal provides great flexibility to corporate management in adjusting its financial policy to the overall reduction in corporate tax burden realized by integration.

The dividend deduction provided for the first year, 1978, would be that percentage which produces a net reduction of approximately $2.4 billion in corporate tax liabilities for that year.

Additional dividend deductions required to bring the total deduction up to approximately 50 percent of dividends distributed would be phased in from 1979 through 1983, causing the revenue loss to increase at a rate of about 1 billion per year (at 1978 levels).

<u>The Stockholder Credit</u>

The balance of the double tax on dividends would be eliminated by a stockholder credit to be phased in equally over the five-year period from 1979 to 1983 inclusive. This would cause a revenue loss in each of those years, increasing at the rate of about $1.5 to $2.0 billion a year (at 1978 levels).

The credit mechanism would be quite simple. The taxpayer would "gross-up" his dividend by adding to his taxable income an amount equal to 50 percent of the dividends he receives and would then take a tax credit equal to the gross-up. This is precisely the same procedure as the taxpayer follows with labor income subject to withholding. The taxpayer adds the withheld income tax to his "take-home" pay, calculates the tax on the gross amount, then subtracts the taxes withheld. In the case of the proposed stockholder credit, the taxpayer adds to his "take-home dividends" corporate taxes paid by the corporation on his behalf, calculates his tax liability on the gross amount, and then takes a credit for the tax "withheld" for him by the corporation.

We may illustrate the operation of this portion of the proposal by extending the prior example to the cases of stockholders subject to personal tax at 20 to 50 percent in the following table.

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Illustrative Computation of 50% Individual Dividend Gross-up and Credit

	(1)	(2)	(3)	(4)	(5)	(6)
	Case I - Taxpayer in 20% Marginal Tax Bracket			Case II - Taxpayer in 50% Marginal Tax Bracket		
		Proposed Law			Proposed Law	
	Present Law	with $50 Dividend	with Maximum Dividend	Present Law	with $50 Dividend	with Maximum Dividend
A. Dividend Income Received	$50	$50	$66.67	$50	$50	$66.67
B. Gross-up of Dividend (50% of Line A)	-	25	33.33	-	25	33.33
C. Dividend Income Plus Gross-up (Line A + Line B)	-	75	100	-	75	100
D. Tentative Tax (Tax Rate x Line C)	10	15	20	25	37.50	50
E. Dividend Tax Credit (Equals Line B)	-	25	33.33	-	25	33.33
F. Tax Liability or Refund (-) (Line D - Line E)	10	-10	-13.33	25	12.50	16.67
G. Total Income After Tax (Line A - Line F)	40	60	80	25	37.50	50

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Office of Tax Analysis

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Under present law, the 20 percent stockholder receives $50 in dividends, pays $10 in tax and retains $40. In effect, the combined corporate and personal tax rate he has paid is 60 percent. If the corporation still pays out $50 under the proposed integration procedure, the stockholder would add $25 to the $50--that is, he could gross-up for the 50 percent corporation income tax--and compute a $15 tax liability on the entire $75. He would then be permitted to take a tax credit for $25, receiving a net refund of $10. Altogether, this stockholder would net $60 after tax, 50 percent more than under present law, and additionally have a claim to $12.50 of retained earnings. And if the corporation maintains its policy of paying out all income possible, the 20 percent stockholder would receive a dividend of $66.67 which he would gross-up to $100 to include the $33.33 tax paid by the corporation, and compute his tax at $20 which would entitle him to a refund of $13.33. This refund, plus the $66.67 in dividends received yield the 20 percent taxpayer a total return of $80. This is exactly what he should net from a $100 income, given that he is subject to a 20 percent tax rate: and this is twice his yield from such an income under present law. In effect, this taxpayer's burden on income earned by the corporate enterprise has been reduced from 60 to 20 percent, and his return has doubled.

The table shows similar results for the stockholder who is a 50 percent taxpayer. Under present law, he nets $25 of the original $100 income, a tax rate of 75 percent. Under integration, with the same $50 dividend payment, he nets $37.50 plus retaining a claim to the $12.50 of retained earnings; and with maximum payout, he nets $50 after taxes. Again, the proposal imposes only the stockholder's own tax rate on the income of the corporation he owns, so that with full payout of corporate income the reduction in his tax rate is from 75 to 50 percent, and his return is also doubled.

As a matter of arithmetic, a 50 percent dividends paid deduction and a 50 percent gross-up and credit, when combined with a 50 percent corporate rate, exactly eliminates the double tax. With a 46 or 48 percent corporate tax rate, either the 50 percent dividends paid deduction or the 50 percent gross-up and credit must be adjusted slightly. In terms of tax return simplicity, it is obviously very desirable for tens of millions of shareholders to use a gross-up and credit of 50 percent rather than an odd percentage which requires more complicated arithmetic. Therefore, we recommend that the required compensating adjustment be made by reducing somewhat the percentage of dividends which are deductible. It is for that reason that I suggested earlier that the dividend deduction might ultimately be for slightly less than 50 percent of the deduction.

The combination of the dividend deduction and the stockholder gross-up and credit has two major advantages:

First, use of the dividend deduction will initially create additional cash flow at the corporate level, which provides an immediate increase in funds available for investment.

Second, use of the stockholder credit mechanism permits flexibility with respect to tax-exempt organizations and foreign stockholders in U.S. corporations. We do not believe the stockholder credit should be extended automatically to them. Like other stockholders, they will receive indirectly the benefits of the dividend deduction at the corporate level. Thus, the tax burden on income going to such stockholders will be reduced, but will not be totally eliminated. That seems an appropriate way to deal generally with such stockholders and it significantly reduces the revenue loss. Of course, it may be appropriate in particular cases to extend the benefit of the stockholder credit to foreign stockholders by means of an income tax treaty.

Answering the Critics

Four major arguments have been mounted against the integration plan. Let me answer these arguments.

1. Plan Favors Big Business

The first argument is that the plan is heavily weighted toward big business and high-income individuals at the expense of the "little guy."

This argument first ignores the fact that all Americans would benefit from the plan as higher levels of real income are generated by higher levels of productivity. As indicated earlier, our experience has been that we achieve greater productivity through increased capital investment. Greater productivity means more jobs, greater price stability, and more goods and services to fill rising demands. In short, it means a higher standard of living for all.

Second, the ownership of corporate capital is much more widespread than many may realize. In addition to the gains to direct owners of corporate stock, benefits will flow to people who receive corporate income indirectly through participation in pension funds, insurance companies, and other financial institutions. These institutions have been increasing their ownership of stock and now own about a quarter of all outstanding corporate shares.

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About half of our work force is now covered by private pension plans. Eighty-four percent of American adults are covered by some type of life insurance policy, according to the Institute of Life Insurance. Other Americans have other types of insurance or participate in mutual funds, trust funds, and other types of dividend income. Thus, most American families have some direct or indirect dividend income, and they all would benefit from our program.

Third, the integrated nature of our nation's capital markets assures that benefits will spread to people who receive all types of capital income, from bonds, notes and savings accounts, as well as from stocks. Because in our competitive economic system investment flows to those opportunities with the highest after-tax returns, after-tax returns tend to be equalized. As more investment flows to the corporate sector, and corporate earnings before-tax will be reduced, the rates of return on other assets will rise until stock holding will again confer no differential advantage relative to other forms of capital people own. Thus, an initial buoyant effect of integration on rates of return to stockholders will be dispersed to all capital ownership, to higher money wages, and to higher real incomes for all, not just rich stockholders as the critics assert.

If corporations had it in their power to make their rates of return higher than others, they would now be exercising that power. If they do not have that power under present tax law, I am at a loss to see how the proposal I have outlined for you will confer that power.

Finally, I should like to note that the lengthy period which is proposed for phasing in this fundamental change in the tax law is calculated to mesh the changes in rates of return to feasible adjustment rates in the structure of the economy. There will be no sharp increases in rates of return, no stimulation of speculative activities in the capital markets. By 1983, when the plan is fully phased in, no financial evidence of full integration will be apparent. The economic gains of a more efficient use of our capital stock will, in fact, be realized, although since we always wish we had more, we may not then recognize how much better off we will have become.

2. Cost of Program

The second argument is that the cost of the program is too high in proportion to the benefits.

This argument fails to note that the whole thrust of the program will be to encourage people to save and invest more now as well as to make new capital more productive so that we will have more real output in the future to meet our economic needs. We can effect this reform by restraining growth in Federal expenditures. The cost, in this event, is merely the marginal programs which are abandoned. Or, if we regard these expenditure programs as more worthy than the benefits to be gained from this necessary reform of the tax system, we might consider moderate increases in other taxes which have less deleterious effects on our productivity and welfare.

But this program would be a good investment even if we had to increase other taxes to cover the revenue loss. For if efforts to improve capital formation and increase the efficiency of capital use are not undertaken, Americans will pay in the future through lower standards of living and poorer employment opportunities.

In either case, I fail to see how retaining a tax system which incurs for us a current loss of economic welfare and consigns us to a lower growth rate can be less costly than reforming it.

3. The Plan Favors Dividend-Paying Corporations

Plainly, the present unintegrated corporation income tax favors corporate retentions over dividend distributions, particularly for wealthy stockholders in tax brackets substantially above the corporate tax rate. For such stockholders, retained earnings are translated into enhanced stock values which may be cashed at favorable capital gains rates at some distant time, or never. This makes retention for them preferable to current receipt of dividend income. As I noted before, this has two consequences, both harmful to efficient use of our resources: corporate managers are induced to retain more than they otherwise might, leading them to make poorer investment decisions and those classes of stockholders who need to hold securities which yield them current income flow have fewer opportunities left to them to invest in stocks.

If we were to propose to so distort private choices by some tax scheme, we justifiably would be criticized. I am, therefore, puzzled when critics chastise me for proposing to neutralize the present distorting affect of tax policy on corporate financial management policies.

As to the correlary argument that integration penalizes growth companies, it should be noted that true growth companies have unusually good investment opportunities. Such companies will still find it easier to raise capital than nongrowth companies, for stockholders will always prefer shares which promise higher future earnings to those with stable or declining earnings.

4. Reduction of Corporate Tax Rates as an Alternative

The fourth argument is that reducing the corporate income tax would be simpler and just as effective a means to stimulate capital formation.

I agree that this alternative is sound and would help achieve the overall objective. However, simply reducing corporate rates would fail to confront the inherent inequity and inefficiency of maintaining higher tax rates against income from corporate as compared to noncorporate capital. To make most productive use of savings available for investment, we must assure that all investment opportunities meet the same test for profitability before taxes. This requires that, as nearly as practicable, tax rates on capital income be equalized regardless of the form of business organization or method of financing.

Reducing the corporate tax rate by itself would also do nothing about the grave problem of tax bias in favor of debt financing. The corporate debt-equity ratio has risen dramatically in the past decade. Together with higher interest rates resulting from inflation, lower corporate profitability, and a serious recession, we have created a situation where suppliers of capital are increasingly concerned with the safety of their investments. New companies and new enterprises particularly are experiencing difficulties attracting venture capital.

Finally, reductions in the corporate rate unaccompanied by integration serve only to increase the effective tax differential favoring corporate retention of profits rather than payment of dividends. This encourages corporations to use retained earnings for projects which may be less profitable than the investments shareholders would make for themselves. Also, potential stockholders who prefer income will choose investments other than stocks.

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Lowering corporate tax rates would lead to increased capital formation, but integration will improve corporate financial structures and bring about more effective use of that capital as well.

Benefits of the Proposed Change

First, the net tax reductions on the income from saving will increase the rewards for saving and will thus increase the total amount which people and institutions will be willing and able to save. That will produce benefits not just for savers, but for everybody in the form of increased growth, higher paying jobs and greater prosperity generally.

Second, it would ultimately eliminate a double tax which is unfair and inefficient.

Third, it will eliminate the existing tax discrimination in favor of debt as compared with equity financing and strike at the heart of the debt-equity problem.

Fourth, American businesses will be better able to compete against foreign companies for whom the cost of capital has already been reduced by elimination of the double tax. At the same time, increased returns on saving in the United States will help attract additional foreign capital. Both of these consequences will help to maintain the stability of U.S. exports and employment and the strength of the dollar abroad.

Fifth, it will greatly improve the efficiency of the process by which capital is allocated and produce the equivalent of an increase of at least 0.5 percent in our national income.

Sixth, it will make the capital markets more competitive. Corporate managers will have to demonstrate to stockholders that they can do a better job of investing profits than the shareholders can do for themselves. It would eliminate the tax penalty which presently induces corporate managers to "lock-in" corporate capital and keep it out of the capital markets.

Seventh, it will be an immediate and major assist for equity financing. Businesses which have lost access to equity markets will again be able to compete.

Eighth, it will be a great help to utilities and to other industries whose investors rely upon steady dividends.

CAPITAL GAINS AND LOSSES

I would like to turn now to capital gains and losses.

H.R. 10612 contains two relevant provisions dealing with the taxation of capital gains. The first provides for an extension of the holding period requirement to qualify for long-term capital gains. Under this provision, the holding period requirement is increased from six months to 12 months over a three-year period (1976--eight months; 1977--10 months; 1978 and thereafter--12 months). The second provision increases from $1,000 to $4,000 the amount of net capital losses which may be used to offset ordinary income, also over a three-year period (1976--$2,000; 1977--$3,000; 1978 and thereafter--$4,000).

We support both provisions of the House Bill. The increase of the holding period requirement is warranted because the reasons for distinguishing between long-term and short-term capital gains--"bunching" and distinguishing between assets held for investment and those held for speculative profits--suggest that the holding period should be one full year. The increase in the amount of losses allowable as an offset against ordinary income is also warranted because the present law $1,000 limitation has not been changed since 1942 despite substantial increases in the consumer price index.

Further, we are today proposing the adoption of a sliding scale approach for the taxation of capital gains and losses. Under our proposal, the tax burdens on capital gains will be reduced the longer the asset has been held by a taxpayer. This will promote capital formation and the efficient allocation of investments. The proposal is a sensible rule-of-thumb to avoid converting the income tax into a capital levy on shifts in investments. In addition, we believe the sliding scale mechanism will reduce the unwarranted taxation of inflationary gains.

The principal features of our proposal are:

-- The amount of capital gain which may be deducted in computing adjusted gross income will be based on the holding period of the asset, as follows

Holding Period	Deduction
Up to 1 year (phased in)	None
1 year to 5 years	50 percent
5 years to 25 years	50-70 percent (additional deduction of 1 percent for each year)

-- Capital losses will also be subject to the sliding scale proposal.

-- All transactions which presently generate capital gains and losses will be subject to the sliding scale.

-- The 25 percent alternative tax on the first $50,000 of the excess of net long-term capital gains over net short-term capital losses will be repealed.

-- The portion of any capital gain which is deductible under this proposal will be added back to a taxpayer's taxable income in order to compute his minimum taxable income.

-- The House-adopted capital gains provisions are effective January 1, 1976. For reasons spelled out below, we recommend the following effective dates:

House provisions: January 1, 1977
Sliding scale for gains: January 1, 1976
Sliding scale for losses: January 1, 1977
Repeal of alternative tax: January 1, 1976
Effect on minimum taxable income: January 1, 1976

Let me elaborate:

Sliding Scale Period

We propose that the sliding scale period commence after the taxpayer has held a capital asset for five years and that the percentage increase in the amount deductible be set at 1 percent for each additional year through the 25th year.

In the short run, adoption of a sliding scale approach will cause a burst of unlocking; in the long run, it may result in a new lock-in, at least insofar as appreciated assets are concerned. To soften the impact of this potential lock-in effect, the sliding scale intervals have been pegged at one year, rather than at longer intervals.

Treatment of Capital Losses

Under present law, a net long-term capital loss may first offset short-term capital gains on a 1 for 1 basis and then offset ordinary income (up to $1,000) on a 2 for 1 basis. Thus, under present law it takes a $2 net long-term capital loss to offset $1 of ordinary income. An elaborate carryover system is provided to preserve the character (long-term or short-term) of carryover losses.

Under our recommended proposal, capital losses as well as gains will be subject to the sliding scale. Thus, for example, a $100 realized gain on a capital asset held for 15 years will result in a taxable gain of $40. A $100 realized loss on a capital asset held for 15 years will result in a $40 deductible loss, which may be offset against other capital gains, or against ordinary income (subject to the dollar limitation previously discussed).

The symmetrical treatment of gains and losses generally accords with the trend set by the Tax Reform Act of 1969 which introduced the 2 for 1 rule. A further advantage of applying a symmetrical rule for gains and losses, and computing reportable gain or loss on an asset-by-asset basis, is that the present law complex loss carryover system would be simplified considerably.

Qualifying Assets

The sliding scale proposal will apply to all assets which are presently accorded capital asset status. Thus, all transactions which presently generate capital gains and losses will be treated in the same fashion without arbitrary distinctions.

Repeal of Alternative Tax

We propose repeal of the 25 percent alternative capital gains tax on the first $50,000 of the excess of net long-term capital gains over net short-term capital losses. Repeal of the alternative tax is a necessary first step in enacting a sliding scale. Coupling a sliding scale with the alternative tax would require complex "stacking" and allocation rules.

Relationship to Minimum Taxable Income

Under our minimum taxable income (MTI) proposal, a taxpayer will be required to pay a tax at the regular rates of 14 to 70 percent on the greater of his minimum taxable income or his regular taxable income. We propose that the amount of the entire capital gain deduction be included in computing a taxpayer's MTI base thus assuring that each taxpayer will bear a "fair share" of the tax burden.

Effective Dates and Revenue Estimates

As noted above, we propose the following effective dates:

House provisions: January 1, 1977
Sliding scale for gains: January 1, 1976
Sliding scale for losses: January 1, 1977
Repeal of alternative tax: January 1, 1976
Effect on MTI: January 1, 1976

The effective dates of January 1, 1976 for gains and January 1, 1977 for losses will have a maximum impact on unlocking both gains and losses in calendar year 1976. Gains will be unlocked because of the lower tax rates on realized gains. Losses will be unlocked because of the desire to realize losses in the current year rather than in 1977 when the sliding scale begins to impact on losses. The net effect will be that gain and loss transactions will, to a considerable degree, offset each other in calendar 1976.

Personally, I believe that the unlocking will be substantial and generate significant revenue increases in Fiscal 1977. However, we are assuming that the sliding scale proposal will produce no material change for budget purposes in Fiscal 1977 receipts.

In the long run, when fully effective, the four capital gains provisions--(1) a sliding scale on gains and losses: (2) a holding period requirement of one year to qualify for long-term capital gain treatment; (3) an annual limitation of $4,000 on capital losses which may offset ordinary income; and (4) repeal of the 25 percent alternative tax--will generate revenue losses of about $800-$900 million per year.

ESTATE AND GIFT TAX PROPOSALS

I would like to turn now to gift taxes. As you know, the House Ways and Means Committee is now holding hearings on the major issues of estate and gift tax revisions, and, Treasury Department officials will be testifying on that subject next Monday, March 22. We believe that a complete reexamination of estate and gift taxes is long overdue and we look forward to cooperating with the tax-writing committees in this undertaking. As you also know, the President has already recommended an increase of the estate tax exemption from $60,000 to $150,000.

Estate Tax Exemptions and Rates

The basic structure of the estate and gift tax has remained fundamentally unchanged since 1932, and the estate and gift tax exemptions were last changed in 1942. Since that time, the ravages of inflation have substantially eroded the value of the $60,000 estate tax exemption. No longer does the tax impact principally on the relatively larger estates. Rather the estate tax now has shifted to a more broadly-based tax on the private capital accumulations of more moderate estates.

Let me elaborate on these two points. First, adjusting the $60,000 estate tax exemption for inflation since 1942 would require an estate tax exemption of $210,000. Moreover, while a person with a $60,000 estate in 1942 could leave it to his family without tax, today an individual must have an estate of $260,000, on which an estate tax of $50,700 will be levied, in order to leave the equivalent amount, $210,000, to his family.

Second, during the 1920s, 1930s and 1940s, the estate tax reached about 1 to 2 percent of all estates. Thus, in 1950 there were 27,144 estate tax returns filed (1.9 percent of estates) and 18,697 taxable returns (1.3 percent of estates) By 1973 the number of estates filing tax returns had reached 174,899 (8.9 percent of all estates), of which 120,761 (6.1 percent) were taxable. And in the Fiscal Year ending June 30, 1974, there was 211,540 estates filing returns (10.7 percent of all estates) and 146,000 taxable estates (7.6 percent).

We believe that an increase in the estate tax exemption is clearly warranted. Indeed, such an increase is essential if the estate tax is to be returned to its historic role as an excise on the transfer of relatively larger wealth accumulations.

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At the same time, we cannot ignore the significant revenue consequences that would result from increasing the estate tax exemption. Thus, we recommend that the estate tax exemption be increased to $150,000 over a five-year transition period and that the lower bracket estate tax rates on the first $90,000 of taxable estate be eliminated. Limiting the increase to $150,000 (with the proposed restructuring of rates) will permit the revenue loss to be held to an acceptable amount, which can be absorbed gradually during the phase in period.

Our specific recommendations regarding the estate tax rates and exemptions are:

-- Increase the estate tax exemption to $150,000 in equal $18,000 increments over five years.

-- Eliminate the lower estate tax rate brackets so that the beginning estate tax rate would be 30 percent. The estate tax rate changes would be phased in over five years along with the increased exemption.

We estimate that the combination of the increased estate tax exemption and the restructuring of estate tax rates will result in a revenue loss of $1.1 to $1.2 billion when fully effective and a revenue loss of less than $100 million in Fiscal Year 1977. At the same time, much needed relief will be provided for moderate estates.

Liberalized Payment Provisions for Family Farms and Businesses.

Inflation has had a particularly serious impact upon the family farm or business. Property values have risen dramatically with the result that owners have been faced with higher estate taxes. This has created a greater liquidity need than faced by many other taxpayers, because family farms or businesses generally tend to represent a significant portion of the owners' estates in terms of dollar values. Therefore, many families have found it necessary to sell the family farm or business to obtain cash to pay Federal estate taxes.

To meet these problems, the Administration has proposed a change in the Federal estate tax laws to make it easier to continue the family ownership of a small farm or business following a substantial owner's death. In summary fashion, the details are as follows:

-- At the estate's option, a five-year moratorium will apply to payment of that portion of the tax liability attributable to an ownership interest in a family farm or other closely-held business qualifying for ten-year installment payments under present section 6166 of the Internal Revenue Code. No interest will accrue during the five-year moratorium period and no principal or interest payments will be required during that period.

-- At the end of the five-year period, the deferred tax will, at the estate's option, be payable in equal annual installments over the next 20 years.

-- Interest on the installments will be reduced to 4 percent per annum from the 7 percent rate generally applicable to deferred tax payments.

-- The five-year moratorium and twenty-year extended payment provisions will apply only to the estate tax liability attributable to the first $300,000 in value of the family farm or business. Between $300,000 and $600,000 there will be a dollar for dollar reduction in the value of the farm or business qualifying for the moratorium and extended payment provisions. That portion of the tax not qualifying will continue to be subject to ten-year installment payments with the 7 percent interest rate.

We believe that enactment of the Administration's proposal would be a positive and essential step toward ensuring the survival of smaller farms and businesses for future generations.

FOREIGN WITHHOLDING

Let me turn briefly to the subject of foreign withholding. The Administration strongly supports the elimination of the existing withholding taxes on dividends and interest paid by United States persons to nonresident aliens and foreign corporations.

Under present law, and subject to numerous exceptions, a 30 percent withholding tax is imposed on the gross amount of dividends and interest paid to foreign investors. This tax should be eliminated and it should be done now. Elimination of this tax is desirable because:

--Removal of the tax will increase investment by foreigners in the United States. It will make investing more profitable and less difficult for investors, and will make it easier for U.S. companies to seek funds in international capital markets.

--It will improve the relative attractiveness of long term securities and reduce the present imbalance favoring short term securities and bank deposits (which are presently exempt from withholding). Access to foreign funds will permit the United States to continue its role as a capital exporter, including the recycling of funds flowing into and out of the oil producing countries.

--It will put the United States financial community back in the center of international capital markets and help them to regain competitive ground lost.

--It is consistent with principles of tax equity and other rules relative to source of income.

--It will eliminate what has become a complex patchwork of legislative and treaty provisions and simplify one area of tax law.

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The basic point is that the many benefits of eliminating the tax outweigh the small revenue loss.

The Desirability of Increased Foreign Investment

Increased investment by foreigners in the United States is desirable anytime. Proposals to remove impediments to investment have been under consideration for several years. Increased investment is especially important today when we are faced with a massive outflow of funds to pay for very expensive oil.

To the extent that dollars piling up abroad are used to buy goods and services produced in the United States --say, wheat for example-- we are exporting real wealth from our economy and are the poorer for it. Further, as dollars simply pile up abroad, their value falls in the foreign exchange market. The increased number of dollars that we must then pay for imports becomes a potential claim on an even larger part of our national production. For example, as the value of the U.S. dollar falls, every Mercedes we buy gives some German a potential claim on more bushels of our wheat than previously.

In contrast, dollars which are reinvested in the United States stay here and do not involve exporting our real wealth --at least initially. Furthermore, increased foreign investment here keeps dollars from simply piling up abroad and helps forestall further devaluation.

We have for years preached to other countries the value to them of foreign investment in their countries. It is time we took our own preaching seriously. Investment in the United States by foreigners provides capital needed by this country.

The existence of additional investment here is desirable for three reasons: First, it increases the productivity of labor within our country, which in turn increases the real income of our residents. That increased productivity is critical in the battle against inflation. Second, as capital investment located here wears out and depreciates, it tends to be replaced by machinery and equipment and other assets that are manufactured here; and that too helps our economy. Third, as the investment generates income here, we get the tax on that income. This happens whether the corporation is directly controlled by foreigners, or the corporation simply sells bonds and other securities to foreign investors.

It is true that the after-tax profits on investments by foreigners may eventually be removed from our economy and repatriated by the foreign investor. But repatriation of income is usually only partial. And even when it is total, it usually occurs gradually over time.

In sum, we are much better off to have the investment, even if the after-tax profits are ultimately lost to us, than not to have the investment at all.

Enhanced Market Efficiency

The statutory elimination of withholding will greatly increase market efficiency for investments in the United States.

There have been so many ways --all complicated-- around the United States withholding tax that the tax is as imaginary as it is real. However, even an imaginary tax can have detrimental effects. While certain foreign investors enjoy exemption or reduced rates by statute or treaty, the tax remains an impediment to broader foreign ownership of United States investments.

The present withholding tax system handicaps U.S. companies seeking foreign capital by narrowing the market in which potential foreign investors operate. Those who are unable or unwilling to deal with the complexities are discouraged from investing. Since most of the exemptions depend on the status or residence of the investor, the investor cannot freely market this investment. Securities which are not freely marketable throughout the world are not competitively attractive investments.

U. S. borrowers seeking long-term funds are at a competitive disadvantage compared to borrowers of other major countries which do not impose withholding taxes on investments by nonresidents. U.S. withholding taxes increase the capital costs of American companies. They either deter borrowing abroad or cause the U.S. company to bear the burden of the tax. For example, an

American borrower who would otherwise borrow at 9 percent may be required to pay a nonresident as much as 13 percent to secure the same loan.

Other countries that have recently taken legislative action to eliminate their withholding on long term international bonds in order to give their borrowers greater access to international capital markets include Australia in 1973, Japan in 1975 and Canada in 1975. They have thus joined other countries, such as Austria, France, the Scandinavian countries, and the United Kingdom, that provide exemption of international issues from withholding tax.

Short-term debt investments rather than long-term debt or equity investments are favored by the present withholding tax system. This bias arises as a result of the present exemptions from withholding for interest on bank deposits and certain other short-term obligations.

We urge elimination of withholding not only with respect to interest income, where a 30 percent tax on gross payments of interest is a clear impediment, but also for dividend payments. There is no reason to perpetuate favorable tax treatment for debt investment over equity investment. Many foreign investors are interested not solely in capital appreciation, which we do not tax in the case of a foreign investor, but in yield. The 30 percent tax on portfolio dividends is clearly a deterrent to those relying on the investment yield. This deprives many of our businesses of access to a form of capital they urgently require.

Free capital markets and free capital flows are in the best interests of everyone. In early 1974, capital controls were eliminated, and it again became possible for American capital to move abroad. The repeal of withholding taxes on dividends and interest would be a further move toward unimpeded flows of capital.

The Question of Tax Equity

The repeal of these taxes is consistent with generally accepted tax principles, and is a part of tax reform. Jurisdiction to tax dividend and interest income was considered more than 50 years ago by a commission of tax experts established by the League of Nations. They concluded, back in 1923, that the right to tax investment income properly belongs to the state of the taxpayer's residence. This principle has been reaffirmed in the commentaries to the OECD Model Convention, while recognizing that some states may wish to maintain some minimal withholding tax solely on revenue grounds.

Revenue

The present withholding tax system does not raise significant revenue, due to a patchwork of statutory and treaty provisions. For 1973, the withholding taxes collected on dividends and non-bank interest were less than 10 percent of the gross payments, despite a basic statutory rate of 30 percent. In 1973, only $210 million of withholding tax was collected, $20 million with respect to interest and $190 million with respect to dividends.

The House Bill

H.R. 10612 as reported by the House Ways and Means Committee, repealed the withholding tax on portfolio dividends and interest, but a floor amendment struck the provision. This floor action was an unfortunate error which should be corrected. At the time, the House seemed to be focusing on the immediate revenue loss and to be ignoring the large potential benefits from the proposal, including the fact that increased foreign investment will produce increased domestic revenues to offset any immediate loss. In fact, the Administration strongly believes that the repeal should be broader than the Ways and Means Committee provision, that is, withholding taxes on direct as well as portfolio investments should be repealed. In the case of direct investments the United States would continue to collect the corporate tax on the underlying profits.

H.R. 10612 as passed by the House contains a provision which makes permanent the "temporary" provision removing the tax on bank deposit interest until December 31, 1976. While we are very pleased that this provision was adopted by the House, there is a particular timing problem which requires your Committee's attention. Foreign investors have already begun to withdraw their funds, or switch to shorter term investments, to remove any risk of withholding taxes being imposed next year. It is, therefore, essential that that particular provision be passed immediately.

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To summarize, our present withholding system is counter-productive. It hampers our economy, denies access to foreign capital markets, favors short-term foreign debt investment, and needlessly complicates our tax law, in order to raise an insignificant amount of revenue. It should be repealed promptly.

TAXABLE BOND OPTION

The efficiency of the municipal bond market is a matter of major importance to the Nation and to government at all levels. While the municipal market is basically sound, there is an artificial and unnecessary constraint on its efficient operation--state and local borrowers are limited to only one group of potential lenders, those who can use tax-exempt income. This means that the interest rates for municipal debt are critically influenced by changes in the tax and financial situation of such lenders. In addition, the municipal market is experiencing important changes in supply/demand patterns. On average, commercial banks are absorbing smaller percentages of new municipal issues, particularly in the longer maturities. Consequently, other sources of financing must be found if the volume of municipal borrowing is to be maintained.

In order to broaden the municipal market, Treasury strongly recommends legislation giving state and local issuers the option to borrow on a taxable basis and obtain a Federal subsidy of 30 percent of the borrowing cost. For electing issuers of longer-term debt, a 30 percent subsidy will restore the customary "spread" in interest rates between municipal bonds and other debt issues.

The taxable bond option will introduce a much needed element of flexibility by permitting state and local borrowers to tap the investment resources of foundations, pension funds and other tax-exempt institutions. The Federal subsidy will enable municipal borrowers to go to the taxable market to secure lower net interest costs. As municipal bonds are issued on a taxable basis, the borrowing costs for governments which continue to issue tax-exempts will also be reduced, since there will be a smaller supply of tax-exempt bonds to be absorbed. State and local governments can thus achieve lower interest costs regardless of whether they choose to issue debt on a taxable or a tax-exempt basis.

In making this proposal, we are not suggesting that state and local governments have need for higher subsidies from the Federal government. Our objective is not to provide more in the way of a direct subsidy but rather to make the tax-exempt market itself more effective. The taxable bond option will ensure that all municpal borrowers receive a subsidy of at least 30 percent below taxable rates regardless of underlying credit conditions or the needs of particular institutions for tax-exempt income; and it will do this in a manner which maintains the viability of the tax-exempt market.

We are working to devise procedures that will minimize Federal involvement in the subsidy process. We firmly believe that state and local governments should retain their traditional rights to determine whether and when to borrow and the terms of the borrowing.

As shown in Table 23, we estimate that the cost of the 30 percent subsidy, after allowance for estimated revenue gains, will be $7 million for the first full year of operation. This net cost will rise to about $80 million by the 10th year.

SOCIAL SECURITY AND UNEMPLOYMENT TAXES

To assist in protecting the financial integrity of the Social Security System, the President has proposed a slight increase in the payroll tax effective in January, 1977.

The Old Age, Survivors and Disability Insurance trust funds are paying out more in benefits than their current payroll tax receipts. This is largely due to increased benefits in the past few years and payroll tax receipts which have lagged because of unemployment and slowed wage growth.

Presently the amount of trust funds is equal to about 7 months of expenditures. Under present law, the question is not whether the trust fund will be depleted; rather, it is a question of when it will be depleted. Recent estimates by the Social Security System show that if the recovery should proceed more slowly than expected, the combined trust fund would be depleted by 1981. If a recession were to develop, it would be depleted even sooner. I am not suggesting that I expect a recession, or a slow recovery. I am suggesting, however, that the rapidly diminishing trust fund affords us precious little cushion for adverse events.

To prevent the rapid decline of the Social Security trust funds over the next few years, the choices are either to restrain increases in retirement and disability benefits or to increase revenues. It is clear that we need to increase Social Security receipts.

The President has included a full cost of living increase in Social Security benefits in his Fiscal 1977 budget. To assure the future financial stability of the Social Security system, the President proposed, effective January 1, 1977, a payroll tax increase of 0.3 percent of covered wages for employees and employers.

The current Social Security tax rate is 5.85 percent for each employee and employer of covered wages. Under this proposal, in 1977 the tax rate would be 6.15 percent on a maximum wage base of $16,500. This increase will cost workers with the maximum taxable income less than $1 a week and will help stabilize the trust funds so that current and future recipients can be assured of the benefits that they have earned.

The increase is in the form of a modest rate increase as opposed to a further increase in the maximum wage base. The base is already scheduled to rise in progressive steps. Increasing the base even further to solve our short-run financial problem will lead to greater complications because of the increased benefits to which the Social Security system will be committed. Consequently, an increase in the tax rate is the responsible course of action.

Let me turn briefly to unemployment taxes.

The unemployment compensation program is no longer self-supported and the financial structure of the system at both the State and Federal levels is seriously threatened: As of March 15, 1976, 20 States have depleted their unemployment compensation funds and as many as 10 additional States will be forced to borrow from the Federal Government by the end of calendar year 1976. Also, as of March 15, $2 billion has been borrowed from the Federal Loan Fund. The Department of Labor estimates that under the present financing provisions, the State Unemployment Compensation Trust Fund will have deficits amounting to $16.5 billion in 1978, $19.3 billion in 1982, and $24.1 billion in 1984.

The Federal Unemployment Account (from which the States with depleted trust funds borrow money) and the Extended Unemployment Compensation Account (which finances the

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Federal share of the extended benefits program) are both depleted and borrowing Federal general revenues. The Department of Labor also projects that under the existing tax base and net Federal tax rate, the Federal Unemployment Compensation Trust Funds will have a deficit of $6.2 billion in 1978 increasing to $8.2 billion in 1982 and $9.6 billion in 1984.

To alleviate the urgent problem before us, the Administration has proposed an increase to $6,000 in the amount of wages subject to the Federal Unemployment Tax, beginning calendar year 1977. We also propose to increase the net Federal tax rate from 0.5 percent to 0.65 percent as of January 1, 1977, and reduce it to 0.45 percent in the calendar year following the year in which all advances to the Extended Unemployment Compensation Account have been repaid. Since many States tie their State unemployment taxes to the Federal rate base, State unemployment tax receipts will increase as well.

III. ENERGY POLICY AND TAX POLICY

I would like to turn now to the topic of energy and the relationship of energy policy with tax policy. Let me note at the very outset that there are four provisions in H.R. 10612 which relate to oil and gas which we believe will have a negative impact on our efforts to deal with the Nation's energy problem. It is just as important to avoid programs that aggravate the problem as it is to implement programs to resolve the problem. This bill seems to assume that we have solved the problem of declining oil production in this country. It signals a return to the complacency that prevailed before 1973. Have we forgotten so quickly the effects of the embargo on the American people or the effects of OPEC's price increases on our economy?

NATURE OF THE PROBLEM

Let's be clear about what the problem is. Forty out of every 100 barrels of oil we consume in the United States are imported from foreign sources. Unless we take actions to increase the portion of our consumption from domestic sources, the number of imported barrels will increase as a result of increasing demand and declining domestic production.

The price of foreign oil paid by consumers is nominally about $12.50 per barrel. However, we must recognize that there are additional costs involved in each barrel of foreign oil; for we increase our dependence and vulnerability to OPEC and hurt our balance of payments.

Therefore, each barrel of domestic oil which could be produced for $12.50 is worth a premium to this Nation if it replaces a barrel of foreign oil. Tax measures which encourage domestic exploration, in effect, pay for this premium and are justifiable to the extent they make it possible to replace imported oil with domestic oil. Any provisions of the House Bill which reduce the effectiveness of those tax measures would, along with other recent actions, discourage domestic production. The cost of the resulting increased dependence on imported oil outweighs any revenue gain from those provisions.

ADMINISTRATION EFFORTS

Let's review what we've done that affects our dependence on imports since the embargo. In January, 1975, the President sent to Congress a comprehensive energy program. The thrust of that program was to limit our dependence on foreign oil by seeking both an increased domestic oil and gas supply and an elimination of wasteful demand. If the free market were permitted to work, without obstruction by government interference, these goals could be achieved.

The major aspects of the President's package included

--immediate decontrol of oil and gas prices;

--an import fee on foreign crude oil;

--a windfall profits tax on domestic producers;

--a residential insulation credit; and

--return of the revenue from the new taxes to consumers to compensate them for higher prices.

Under this program, energy would cost more, but consumers would have no reduction in their spendable income. Oil producers would have an incentive to find and produce the more costly domestic reserves that, under current world market conditions, would be competitive with expensive foreign oil. However, they would realize no windfall profits on the lower cost oil produced from pre-existing capacity.

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The President's program was not accepted by the Congress. What have we achieved instead in terms of either conservation or increasing our supply of oil and gas?

PRICE DECONTROL

In the case of natural gas, interstate sales remain subject to price regulation. Some initial steps in the right direction have been taken by the Congress with respect to small producers. Unfortunately, however, the House has voted to extend controls for large producers to cover intrastate, as well as interstate, sales. I urge the Congress to avoid this backward step and recognize the high priority of full decontrol of new natural gas.

In the case of crude oil prices, Congress agreed to a decontrol program after numerous compromise offers by the President. Last December, the President signed the Energy Policy and Conservation Act under which controls will be removed after 40 months. It is expected that such action will increase domestic production by a million barrels a day by 1985. However, production of new reserves will occur only after a 5 year lead-time for exploration and development. This means that the industry needs capital today to search for and develop the higher cost, harder to find domestic reserves that we expect to be produced 40 months from now.

Delay in decontrol will certainly have an impact on the ability of the industry to generate the needed revenues. Further, we must not forget that in March 1975, the Congress repealed percentage depletion for that sector of the oil industry which accounts for 75 to 80 percent of expenditures made to discover, develop and produce from new reserves. For the small producers, percentage depletion was retained for a small, and declining, amount of production. What remains is subject to rules which are so complex that the uncertainty and confusion in some cases may outweigh the tax benefit. In any event, the repeal of percentage depletion took from the industry $1.6 billion of after-tax revenues for 1976 that could have been reinvested in exploration and development of new reserves.

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H.R. 10612 OIL AND GAS PROVISIONS

Now, we have before us the proposals of H.R. 10612 which would further jeopardize sources of capital needed for exploration and development. Under this Bill, the limitations on artificial losses would be applied to all but exploratory wells on every oil and gas property. Intangible drilling cost deductions would be included as a tax preference for minimum tax purposes, along with percentage depletion which is already included under present law. The deduction for intangible drilling costs would be denied where nonrecourse loans are used to finance drilling. Finally, the tax burden would be increased on dispositions of oil and gas properties with respect to which intangible drilling costs have been deducted.

The combined effect of these measures would be a further reduction of the after-tax revenues from oil investment by almost $300 million in 1976. The problem will be compounded if outside investors, an important source of capital, become disenchanted by these actions and redirect their investments to other businesses. With the reduction of net revenues available for internal financing, the dependence on sources of outside financing becomes more acute. This is not the time to create more uncertainty or eliminate those incentives which influence potential investors in oil and gas ventures. Potential investors in a business which is inherently very risky can certainly be expected to turn to other investments if we continue to make oil investment less attractive.

We believe that your Committee should take affirmative steps to eliminate these measures from H.R. 10612, as well as the present treatment of percentage depletion as an item of tax preference, if we are to fully achieve the objectives of increased domestic oil supply and reduced dependence on imports. It was this mutual objective which, after months of give and take by the Congress and the President, led to a decontrol program. To enact these measures and dry up a significant source of capital needed today to start finding and producing those additional reserves would be patently counterproductive. Almost as detrimental is the uncertainty created by the existence of such proposals. They should be disposed of quickly.

H.R. 6860

Your Committee is now considering H.R. 6860, the energy tax bill, a product of an effort by the House to solve the

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energy problem with oil import quotas and tax measures to encourage conservation of oil and gas and conversion to alternative sources of energy. Although the effort was well intentioned, the result is a list of provisions which would have only a modest energy savings at the cost of significant economic distortion induced by discriminatory excise taxes, amortization, and investment credit provisions. Let me give you just a few illustrations of the problems we perceive with H.R. 6860:

The Bill includes a proposed excise tax on business use of oil and gas which is objectionable on several grounds. First it imposes the conservation burden selectively on a few members of one economic sector and only on certain kinds of uses of energy. We all need to conserve the whole barrel of oil. Second, it would produce an undesirable distortion in petroleum usage by tilting prices of products in favor of non-business uses. Third, it will be extremely difficult to administer because of the multitude of exceptions, even within the business sector.

The Bill would repeal excise taxes on radial tires and buses. This would be an unwise reshaping of the sole function of such user taxes which is to raise revenue for highway maintenance uniformly from highway users.

It also would allow tax credits for installation of insulation and solar energy equipment and the purchase of electric cars. Such credits would make some sense in the case of residential insulation, the energy saving facilities of which have been proven for use on a broad scale. However, solar energy and electric cards, early in their development, are available and useful for only a few taxpayers for whom such credits would be a windfall. Little, if any, additional use of solar energy equipment or electric cars would result from such credits at this time.

Finally, the Bill includes several provisions which employ rapid amortization or a selective increase or denial of the investment credit to induce the business sector to either conserve oil and gas or convert to alternative sources. Wherever economics are favorable, there is no need for special public subsidies to induce private business decisions. When oil is sold at a given price, energy users will convert to alternative sources which are competitive at that given price. It is wasteful to subsidize conversion to alternative sources which are not competitive at that price.

Thus, there are very few provisions of H.R. 6860 that we could support.

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IV. TAX REFORM--H.R. 10612

As I stated earlier, another major item before your Committee is H.R. 10612--the Tax Reform Bill. In 1973 the Administration presented to the House Ways and Means Committee specific proposals to improve significantly the fairness, equity, simplicity and efficiency of our tax system. Our three principal proposals were:

- -- LAL (Limitation on Artificial Losses) to deal effectively with the problems associated with tax shelters by a solution which reaches their most common feature: Bad tax accounting rules which mismatch expenses and revenues and thereby produce artificial accounting losses.

- -- MTI (Minimum Taxable Income) which, in combination with LAL, deals with the problem of taxpayers with high economic income who pay little or no Federal income tax.

- -- A simplification package designed to alleviate the intolerable reporting burden imposed upon the average taxpayer.

After nearly three years of labor on the House side, you now have before you H.R. 10612. In broad outline, the Bill deals with the same problems we identified in 1973. Overall, it is clearly a step in the right direction. However, in a limited number of cases, we believe that certain features should be strengthened or deleted.

Because of our crowded agenda this morning, I will limit my comments only to certain aspects of the Bill. With your permission, we will submit shortly a technical memorandum of Treasury position on the Bill. The specific areas I will address are:

- -- The limitation on artificial losses and other tax shelter amendments,

- -- The minimum taxable income proposal,

- -- The simplification provisions,

- -- The provisions affecting the taxation of foreign income and DISC; and

- -- Certain administrative provisions.

LIMITATION ON ARTIFICIAL LOSSES AND OTHER SHELTER PROVISIONS OF THE HOUSE BILL

LAL Background

LAL was first proposed by the Administration in 1973. It was designed to eliminate "tax shelters " which introduce substantial distortions into the income tax system. Under the proposal, tax accounting rules would no longer be permitted to create from a profitable enterprise an artificial tax loss to be deducted against (and shelter from tax) other unrelated income. Under present law, such losses reduce adjusted gross income and make tax shelters possible.

Artificial accounting losses limited by LAL would neither be permanently disallowed nor capitalized. Instead, they would be suspended and carried forward to be deducted in full against net related income in a future taxable year, thus more correctly matching income with the expense of earning it.

Because LAL was carefully directed at a narrow, but significant, problem under present law, it would affect relatively few taxpayers. LAL would apply only where there are artificial "losses." While such losses are frequently generated in the real estate and agricultural industries, LAL would normally not affect either the ordinary farmer or the ordinary real estate developer, but rather the outsider who buys into those industries in search of tax "losses." Artificial "losses" from such sources as accelerated depreciation, the current deduction of pre-opening costs, and prepaid feed deals, would no longer be permitted to shelter unrelated income.

LAL would apply to individuals but not to corporations. In combination with the proposal for a Minimum Taxable Income (MTI) provision, LAL would be substituted for the present minimum tax on individuals.

The House Bill contains a modified version of the Administration's 1973 LAL proposal. In addition, the Bill also contains other provisions dealing with tax shelters. I will comment briefly on LAL and the other tax shelter provisions.

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Real Estate

With respect to real estate, the House Bill applies LAL to commercial and residential real estate. The accelerated deductions subject to LAL are limited to the deductions for (1) construction period interest and taxes, and (2) accelerated depreciation in excess of straight-line depreciation. A taxpayer may aggregate all income from real estate activities in determining the accelerated deductions on real property which are currently allowable.

Although our 1973 proposals would have allowed aggregation of all income from residential real estate, and applied a property-by-property rule for commercial real estate, we favor the provision of the House Bill. Aggregation will lessen the impact of LAL on the professional real estate developer and thereby have no significant adverse effect on new construction. It will also tend to isolate the impact of LAL to the one-time passive investor. Moreover, the aggregation rule will simplify the LAL computations.

Farming Activities

Under the House Bill, LAL applies to losses generated by accelerated deductions attributable to farm operations. Subject to numerous exceptions, LAL applies to (1) preproductive period expenses attributable to any property having a crop or yield, (2) prepaid feed, seed, fertilizer and similar farm supply expenses, and (3) accelerated depreciation on any property having a crop or yield (which may be taken after the property begins to be productive). LAL should have little impact on the ordinary farmer who works during the off season to supplement his income since farmers are permitted to deduct up to $20,000 of farm losses against nonfarm income.

Although aggregation is generally permitted for farming activities, LAL applies separately to each farm interest in the case of farming syndicates.

We generally support the application of LAL to farming activities but do not favor the application of more stringent rules to farm syndicates. Instead, we propose that syndicates be required to use the accrual and inventory method of accounting. In this way, the tax shelter abuses resulting from the cash method of accounting are dealt with directly. These syndicates should be treated in the same manner as farm corporations (other than family corporations) which, under the House Bill, are required to use the accrual method of accounting. Existing income tax regulations have long exempted farmers from the accrual method of accounting because of the difficulty of maintaining the books and records required for accrual accounting. However, today's nonfamily farm corporations and syndicates are sophisticated business ventures with ready access to the necessary expertise to maintain these records.

Oil and Gas

Under the House Bill, LAL does not apply to exploratory wells but it does apply to development wells. The House Bill also provides that gain on the disposition of oil and gas interests will be treated as ordinary income to the extent of the excess intangible drilling cost deductions over the amount that would be allowed had the costs been capitalized.

We strongly oppose the application of LAL to any oil and gas activities. We also strongly oppose the recapture of intangible drilling cost deductions. Admittedly, our position on LAL is a change from our 1973 proposal. However, the situation has changed markedly. We have witnessed a sharp decline in domestic sources of oil and gas. We have experienced the painful dislocations caused by our dependence on foreign sources for oil. Energy exploration and development activities have already been severely hampered by the repeal of percentage depletion, the limitations on the foreign tax credit, and the continuation of price controls. For reasons I spelled out earlier, the existence of government-imposed controls will prevent the market incentives from increasing domestic energy supplies. Surely, now is not the time to erect further impediments by increasing the tax burden on oil and gas.

Sports Franchises

The House Bill applies LAL to sports franchises. While LAL is a sound concept, this is an unwarranted extension of the rules the Administration proposed in 1973. These rules did not contemplate that LAL would apply to sports franchises.

The Internal Revenue Code contains no special tax benefits for sports franchises. In this area, abuses arise only when too high a value is placed on player contracts, or when they are written off over too short a period of time. However, abuses of this type are possible in the case of any business property which may be amortized or depreciated. These abuses can be dealt with adequately by the Internal Revenue Service. Although the disputes surrounding the value and life of player contracts are the subject of litigation, resolution of these disputes should eliminate the tax controversies in this area.

The House Bill also applies special rules for the allocation of the purchase price on the purchase and sale of sports franchises. It also provides that single sale of a player contract will trigger depreciation recapture on previously unrecaptured depreciation and abandonment losses taken on all other player contracts.

These proposals are arbitrary since they apply only to sports franchises. Allocating the purchase price among the assets of a sports franchise is no different from allocating the purchase price among the assets of any other business. Applying special rules to sports franchises to deal with a problem that the Internal Revenue Service can handle adequately is not warranted. Further, the unique depreciation recapture rule goes far beyond the usual asset-by-asset depreciation recapture rules in the Code. Here, too, there is no apparent reason to isolate sports franchises for special treatment.

Limitation on Nonbusiness Interest

The House Bill imposes a $12,000 a year limitation on the amount of personal interest, and investment interest in excess of investment income, that an individual may deduct. Unused investment interest, but not unused personal interest, would be available as a carryforward and be deductible in future years to the extent of related investment income in those years.

We oppose the $12,000 limitation since it is an arbitrary limit on the interest deduction. It would deter individuals from purchasing assets with borrowed funds. Moreover, the $12,000 limitation can have the effect of disallowing permanently deductions for home mortgage interest. This is a fundamental change from current law since home mortgage interest will be subject for the first time to a dollar limitation, and in some cases, will be disallowed permanently. The permanent disallowance can occur because of the absence of a carryover for unused personal interest.

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We believe that the problem presented by taxpayers who use the interest deduction and other itemized deductions to reduce their tax liability will be handled adequately by treating the amount of itemized deductions in excess of 70 percent of adjusted gross income as an item of tax preference includable in the minimum taxable income base. I will discuss this point in detail shortly.

"At Risk" Limitation

The House Bill limits deductions to the amount of capital which a taxpayer has "at risk" in a venture in the case of motion picture films, livestock, certain one-year crops (grain, oil seed, fiber and others) and oil and gas wells. The "at risk" limitation is intended to prevent a taxpayer from deducting losses where the deductions are attributable to property acquired with borrowed funds for which he has no personal liability, that is, nonrecourse financing. The losses would be suspended and become deductible only in the future as the taxpayer increases his "at risk" capital.

The "at risk" limitation is premised on the assumption that the present tax treatment of nonrecourse financing is unsound. The present law is based on the Supreme Court's decision in Crane v. United States, 331 U.S. 1 (1947), which held that nonrecourse financing is treated in the same manner, for tax purposes, as financing for which taxpayers are personally liable. The Supreme Court's decision in Crane recognizes that nonrecourse financing is an accepted financing medium in many industries. It is a valuable method of encouraging individuals to invest in ventures with a high degree of risk. An "at risk" limitation would overturn more than 20 years of established commercial practice, and adversely affect the general business community as well as passive investors.

We believe that LAL is a better remedy to the tax shelter problem than the "at risk" limitation. The limitation--applicable to corporations as well as to individuals--can result in distortions of income. Taxpayers would include income from ventures but would not have the benefit of offsetting deductions. Moreover, taxpayers will be able to control the timing of their deductions merely by electing to increase their capital "at risk" in those years in which the deductions yield the greatest tax benefit. Further, the scope of the definition of "at risk" is not clear. The House Ways and Means Committee

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Report accompanying H.R. 10612 adopted an expansive definition of the term which would include within its scope many types of insurance arrangements obtained in the normal course of business. Thus, the reach of "at risk" may be far greater and affect far more transactions than necessary or desirable to cure the potential abuse of nonrecourse financing.

MINIMUM TAXABLE INCOME

In 1973 the Administration recommended a proposal which would require each individual to pay tax at regular rates on a minimum amount of taxable income. Last July, in testimony before the House Ways and Means Committee, I recommended that the House follow our 1973 proposal with some modifications. Today, I am renewing our MTI proposal.

MTI was formulated with a view to balancing two competing considerations. First, Congress has provided various tax incentives designed to encourage specific economic activities. Second, excessive use of these tax incnetives by some taxpayers with large economic incomes enables them to avoid paying a reasonable amount of tax, or in some cases, any tax at all. This conflicts directly with the basic tenets of equity and fairness--the income tax should be based on ability to pay; the income tax should be fair and should be perceived as such by all taxpayers.

The House did not adopt MTI. Instead, it perpetuates the minimum tax. Let me review briefly the defects of the minimum tax.

Defects of Present Minimum Tax

The minimum tax is a flat 10 percent tax on certain preference items, such as the excluded portion of capital gains, accelerated depreciation on real property, and the excess of percentage over cost depletion. An exemption for the first $30,000 of preferences and a full offset for regular income taxes paid are applied to reduce the smount subject to the minimum tax.

The minimum tax is defective in two critical respects:

First, since it is an additional tax, it penalizes the use of preferences, or incentives, even where an individual has paid significant amounts of regular tax. By contrast, MTI comes into play only if the taxpayer's taxable income is not sufficiently large, in relation to his economic income, to assure that he is paying his fair share of taxes.

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Second, because minimum tax is imposed at a flat rate, it serves merely to "slap the wrist" of those taxpayers who are able to shelter large amounts of income from regular tax. By contrast MTI is predicated on the proposition that taxpayers should not be permitted to avoid the graduated rates through exclusion preferences, itemized deductions or the payment of a 10 percent surcharge.

Previous Proposals

Because of the deficiencies of the current minimum tax, the Administration proposed in 1973, and again in 1975, repeal of the minimum tax and the substitution of MTI and LAL. MTI would prevent individuals from avoiding tax on high economic income by the use of exclusions or large itemized deductions. LAL would prevent individuals from deducting artificial losses against unrelated salary or investment income.

The prior MTI proposal called for taxing an individual at regular rates on one-half of an expanded income base if the expanded base exceeded his regular taxable income. The expanded base consisted of adjusted gross income plus the excluded half of net long-term capital gains, the bargain element in stock options, the excess of percentage over cost depletion, and excludible income earned abroad. The expanded income base was then reduced by personal exemptions, certain deductions, and a $10,000 exemption.

House Action

Instead of adopting MTI, the House merely restructured the minimum tax. The rate of tax is increased from 10 to 14 percent, the $30,000 exemption is reduced to $20,000 and is subject to a phase-out. Moreover, new items of tax preference are added. A most serious consequence of the House action is the denial of any offset for regular income taxes paid. This means that individuals who have paid significant amounts of regular tax will now be subject for the first time to an additional minimum tax.

The House Bill also treats as preferences certain accelerated deductions which result in deferral of tax rather than a permanent exemption from tax. To illustrate, as an

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incentive for real estate development, taxpayers may elect to deduct taxes and interest during the construction period. To prevent the mismatching of income and deductions the House adopted the Administration's LAL proposal, which allows these deductions only to the extent of related real estate income. Having closed the potential abuse, the House proceeded to treat construction period interest and taxes not limited by LAL as items of tax preference for minimum tax purposes. We believe this action is conceptually unsound since the deductions, when allowed, are offsetting income from a related activity. Furthermore, HUD and Treasury are convinced that this treatment can have an adverse affect on real estate development.

Revised MTI Proposal

We are convinced that neither the current minimum tax nor the amendments made by the House Bill properly deal with the problem of high economic income taxpayers who pay little or no income tax. We propose that your Committee repeal the minimum tax and adopt an alternative tax along the lines of our prior MTI proposal. We have modified our MTI proposal somewhat in light of concerns expressed since it was first proposed in 1973.

Adjusted gross income was the starting point for computations under the original MTI proposal. A taxpayer with large, but legitimate, itemized deductions and little taxable income might have been taxable under MTI. We have reconsidered this aspect of the proposal and have concluded that this result is not warranted. We recommend, therefore, that the starting point for MTI calculations should be taxable income.

Permit me to review how MTI will work. MTI will be an alternative tax. Under MTI, a taxpayer will pay tax at the regular rates on the larger of his taxable income or on his MTI base. The MTI base is calculated by (1) adding items of tax preference to a taxpayer's taxable income, and (2) taking 60 percent of that expanded base. A $10,000 exclusion is allowed (before applying the 60 percent factor) to assure that MTI does not affect either low income taxpayers or taxpayers with only a small amount of tax preferences. For MTI purposes, there are only two tax preferences: (1) the excluded portion of net long-term capital gains, and (2) itemized deductions (other than charitable contributions) to the extent that they exceed 70 percent of the taxpayer's adjusted gross income (AGI).

There are several preference items which are included under the present minimum tax which are not included as preference items under our MTI proposal. Our tax shelter program consists of two parts: LAL takes care of some shelters; MTI will take care of others. Thus, to the extent that LAL deals with an item of preference, there is no reason to include it under MTI. Most of the preference items under the minimum tax are handled under LAL. We have not included percentage depletion in excess of basis as an item of tax preference since percentage depletion has been virtually eliminated. The remaining preferences are excessive itemized deductions and capital gains. Therefore, they are the only two included under MTI.

Under our present proposal, the alternative tax will be computed on 60 percent of the MTI base instead of the 50 percent which the Administration recommended in 1973. The increase from 50 to 60 percent will make MTI more effective in insuring that individuals with large economic incomes pay a tax which is significant in relation to that income.

Charitable Contributions Under MTI

In 1974, when the House Ways and Means Committee in its tentative decisions adopted the MTI concept one of the controversial issues was the impact of MTI on charitable contributions. After considerable discussion, the Committee decided to put charitable deductions entirely outside the scope of MTI. In view of the dire financial position in which inflation has left so many private charities, we became persuaded that the Committee decision was appropriate and we supported it in our July 1975 testimony.

Accordingly, we have carefully structured our present MTI proposal to avoid completely all impact on charitable contributions. Under our proposal, charitable contributions, no matter how large, will not be an item of preference. We will exclude contributions in computing the extent to which itemized deductions will be a preference item.

In short, we have treated charitable contributions very generously. Under no circumstances can MTI adversely affect contributions.

Overall, we believe that MTI is superior to the minimum tax as a way of dealing with the problem of taxpayers who make excessive use of tax preferences. MTI will not affect taxpayers who use tax preferences--which the Congress has provided to encourage various economic activities--and who otherwise pay substantial ordinary tax. At the same time MTI will assure that every taxpayer bears a fair share of the tax burden. The idea of "fair share" is related to the taxpayer's ability to pay. Whereas the minimum tax is an additional tax at a flat rate, our minimum taxable income proposal involves an alternative tax, at progressive rates, based directly on a measure of ability to pay. Not only is this in itself a desirable feature, it is compatible with long-term tax reform in the direction of a more inclusive definition of income, taxed at a lower structure of rates.

SIMPLIFICATION PROVISIONS

As I mentioned earlier, simplification of the tax law must be a major objective of any meaningful tax reform.

Much of the complexity faced by the average taxpayer is in itemizing deductions. Expansion and revision of the standard deduction under the Administration's current tax proposal will result in substantial tax simplification by increasing the number of taxpayers who will use the standard deduction. However, it is also necessary to simplify the tax law directly, and thereby enhance its fairness, through the elimination or restructuring of certain provisions which require complex recordkeeping by taxpayers.

In 1973, the Administration made specific proposals to achieve simplification. H.R. 10612 generally follows our proposals by expanding the optional tax tables and by revising the sick pay exclusion, the retirement income credit and the child care deduction. Overall, the changes are in the right direction. However, the House did not adopt the Miscellaneous Deduction Allowance proposal recommended by the Administration in 1973. We believe that further action is required and that certain aspects of H.R. 10612 relating to simplification should be revised.

Miscellaneous Deduction Allowance

The Administration recommends the adoption of a Miscellaneous Deduction Allowance of $400 ($200 in the case of a married individual filing a separate return) for taxpayers who itemize their deductions. This "simplification" deduction will replace or modify the following hard-to-itemize deductions:

-- The deduction for state and local gasoline taxes,

-- Medical expenses and casualty losses,

-- Certain miscellaneous investment expenses and employee business expenses.

These deductions are sources of complexity in the present tax law. While they are used by many taxpayers, they generally do not significantly affect a taxpayer's ability to pay or provide substantial incentives. They require taxpayers to keep track of numerous small bills and receipts which are difficult to classify, summarize, and correctly reflect on the tax return. These items also cause substantial problems on the administrative side at the audit level.

Let me discuss briefly some of the specific deductions which will be affected by our proposal.

First, we propose repeal of the deduction for state and local gasoline taxes. The gasoline tax deduction involves complications out of proportion to any benefit to the taxpayer. There is a substantial amount of guessing in the computation of the deduction (where the tax tables are not utilized) and the amount of the tax saving to the average taxpayer is generally small.

In addition, state and local gasoline taxes, like the nondeductible federal gasoline tax, are in essence charged by the state for the use of its highways. They are in the nature of personal expenses for automobile travel rather than a tax, and therefore, like such expenses they should not be deductible. Further, their deductibility is inconsistent with the character of the taxes as use charges since they serve to shift part of the cost of the highway user to the general taxpayer.

The gasoline tax deduction is also inconsistent with our current national energy policy. The deduction lowers the price of gasoline to taxpayers who itemize deductions. Repeal of this provision should result in the reduction of gasoline consumption.

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Second, we propose to revise the medical expense and casualty loss deductions. Under current law, there is a complex three-tier system for determining allowable medical expense deductions. First, a medical expense deduction is allowed for one-half of medical insurance premiums (up to $150) without regard to a 3 percent floor applicable to other medical expenses. Second, a taxpayer must compute amounts paid for medicine and drugs to the extent they exceed 1 percent of his adjusted gross income. This excess is then added to the remainder of the cost of his medical insurance (which was not deductible in the manner described above) and to general medical expenses not otherwise compendated by insurance. If the total of these items exceeds 3 percent of the taxpayer's adjusted gross income, then that excess is deductible as a medical expense.

Nonbusiness casualty and theft losses are deductible under present law only to the extent that the loss in each case exceeds $100.

We propose to apply a floor of 5 percent of adjusted gross income on medical expenses and casualty losses. Further, we propose repeal of the deduction for one-half of medical insurance premiums (up to $150) allowable without regard to the current 3 percent floor. The 1 percent floor with respect to medicine and drugs would also be eliminated. Expenses for drugs would be covered under the proposed 5 percent floor, but the deduction would apply only to prescription drugs.

Aggregation of medical and casualty deductions is desirable because they are quite similar. Both are based on the theory that they reduce a taxpayer's ability to pay because of unfortunate circumstances generally beyond his control. The 5 percent level is where these expenses become extraordinary and affect substantially a taxpayer's ability to pay taxes.

Third, we propose a $200 floor on the deduction of the following expenses:

-- Employee business expenses such as union dues, work clothes, small tools, educational expenses and home office expenses; and,

-- Expenses such as tax return preparation expenses, and investment expenses such as the cost of financial newspapers, financial periodicals, investment advisory services and safe deposit boxes.

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We propose a $200 floor on these expenses because of the considerable difficulty experienced by taxpayers in keeping records of a number of relatively small items. By limiting these deductions to cases where a taxpayer incurs a significant amount of such expenditures, some difficulty in completing tax returns will be eliminated for many taxpayers.

We propose the adoption of a "Miscellaneous Deduction Allowance" of $400 ($200 in the case of a married individual filing a separate return) for taxpayers who itemize their deductions to replace the itemized deductions eliminated or restructured by our proposal. This deduction would be in addition to a taxpayer's other itemized deductions which are unaffected by this proposal.

Child Care Provision

The child care provision of H.R. 10612 converts the current treatment of household and dependent care expenses from an itemized deduction to a nonrefundable tax credit. The revenue loss from adoption of a credit is estimated to be $325 million for 1976, $355 million for 1977, and $393 million for 1978, with the amounts projected to increase substantially for the years 1979-1981. Such high cost for the child care credit is entirely unjustified in terms of the resultant benefits.

Simplification and expansion of the provision can be provided adequately by retaining the existing deduction without substantial revenue loss. We continue to emphasize that the child care deduction should be made available only to low and moderate income taxpayers whose economic situation is such that it compels both spouses to work and who thus have no spouse at home to care for dependents. There can be no justification for allowing the tax system to subsidize high-income taxpayers in discharging a personal obligation to care for dependents and thereby depart from what is the proper basis for the provision.

We generally support the other revisions of the child care deduction made by H.R. 10612. Thus, we support those measures which make it fairer and simpler such as its extension to married couples where the husband or wife, or both, work part time, or where one is a full-time student and the other works. Similarly, we support elimination of the monthly limitation on the deduction in favor of an annual deduction.

We also support elimination of the current distinction between care outside the home and care in the home, making the deduction available to a divorced or separated parent with custody of a child, and to a deserted spouse.

Sick Pay Exclusion

Another prime candidate for simplification is the sick pay exclusion provisions of the Code. Under present law, sick pay is excluded from gross income and, therefore, not subject to tax. However, these provisions are complicated by special rules turning on the amount of the weekly sick pay, the number of days the employee has been absent from work, the relationship between the sick pay and the employee's regular wages, and whether the taxpayer has been hospitalized.

H.R. 10612 repeals the present sick pay exclusion and the complicated time and percentage rules. A maximum annual exclusion of $5,200 ($100 a week) is provided only for taxpayers under age 65 who are permanently and totally disabled. After age 65, these individuals are eligible for a retirement income credit. The provision requires a reduction of the exclusion on a dollar-for-dollar basis by the amount of the taxpayer's income, including disability income, in excess of $15,000.

While the House modifications of the sick pay provisions are a step in the right direction, we believe that complete repeal of these provisions is essential to the goal of simplification and equity. The sick pay provisions were enacted with worthwhile objectives in mind. However, limitations, conditions, and exceptions had to be grafted onto them to prevent abuses and substantial revenue losses. As a result, these provisions are now incomprehensible to the average taxpayer. More fundamentally, no justification exists for treating sick pay any differently than other wages. Taxpayers who have comparable ability to pay should be taxed in a similar manner.

Retirement Income Credit

There is a need to redesign the present retirement income credit for several basic reasons:

First, the complexity of the present retirement income credit prevents it from providing the full measure of relief it was intended to grant to elderly people. Individuals who receive little or no social security benefits should be subject to a tax treatment roughly comparable to that accorded those who receive tax-exempt social security benefits. However, difficult compliance burdens have been imposed on large numbers of elderly people, many of whom are not skillful in preparing tax returns. These individuals must now compute their retirement income credit on a separate schedule which involves 19 separate items, some of which require computations in three separate columns. Further, the special provisions for public retirees under age 65 also add substantially to this complexity.

It is these complexities which undoubtedly account for the fact that some of the organizations representing retired people have estimated that as many as one-half of all elderly individuals eligible to use the retirement income credit do not claim this credit on their tax returns.

Second, the credit needs revision because most of its basic features have not been revised since 1962 when the maximum level of income and the current earnings limits were established. Since that time, social security benefits have been substantially liberalized. As a result, the present maximum amount of income eligible for the credit is considerably below the average annual social security primary and supplementary benefits received by retired workers.

Third, the present credit discriminates among individuals with modest incomes, depending on the source of their income. The credit is available only to those with retirement income--that is, some form of investment or pension income in the taxable year. Elderly individuals who must support themselves by earning modest wages, and who have no investment or pension income, are not eligible for any relief under the present credit.

This feature of present law is unfair. Elderly individuals who rely on earned income should be allowed the same retirement income credit as those who live on investment income.

In 1973, we recommended a revision of the retirement income credit. With one exception, H.R. 10612 follows our recommendations. The retirement credit is converted to an age credit, available to all taxpayers age 65 or over regardless of whether they have retirement income or earned income. Further, the maximum amount on which the credit is computed was increased and much of the complexity reduced or eliminated.

One further step is necessary. The separate treatment of the retirement income of public employees under age 65 should be eliminated. The continuation of this treatment perpetuates the extraordinary complexity of this provision. This would be contrary to the goal of simplification and fairness which was the major purpose of amending the existing retirement income credit in the first instance.

FOREIGN INCOME PROVISIONS

The House Bill has several provisions dealing with the taxation of foreign income. I would like to comment briefly on a few of these provisions.

Foreign Tax Credit

The United States employs a foreign tax credit to avoid double taxation of income. The basic concept of a foreign tax credit system is that, when an enterprise of one country does business in another country, the country in which the business is carried on has the first right to tax the income of the business. The home country also taxes the income, but only to the extent that the home tax does not duplicate the tax of the country where the income is earned. The duplication is eliminated by the foreign tax credit.

The basic concept of the foreign tax credit is sound, and has the full support of the Administration. The foreign tax credit is neither a tax loophole nor an incentive to invest abroad. It is merely part of a system of allocating primary taxing jurisdiction to the country within whose borders the income is earned. U.S. companies are taxable on their worldwide income. Our tax credit system does not reduce the total tax bill of U.S. companies below the amount they would have paid if the income had been earned here. The effect is that the total tax is limited to the higher of the U.S. tax or the foreign tax.

Despite the basic soundness of the foreign tax credit, there are technical problems with our present system. H.R. 10612 contains several provisions which deal with these problems.

At present, taxpayers may compute their foreign tax credit under either the per-country limitation or the overall limitation. Under the per-country limitation, the foreign tax credit is applied to the taxes and the income of each country separately. Where taxes in a given foreign country exceed the U.S. tax on the income from that country, that excess is not creditable. Where another foreign country's taxes are less than the U.S. tax on the foreign income from that other country, the taxpayer will have additional tax to pay to the United States. When there is a loss in a particular country, that loss can reduce U.S. taxes on U.S. income, even if there is income in other countries with respect to which no U.S. tax is payable because of the foreign tax credit.

Under the overall limitation, the taxpayer aggregates all his foreign income and all his foreign taxes. If the foreign taxes do not exceed the U.S. tax on the foreign income, then the entire amount of foreign tax may be taken as a credit. The overall limitation permits the taxpayer to average out high foreign taxes with low foreign taxes, but does not allow foreign losses to reduce U.S. taxes on U.S. income, unless there is an overall foreign loss.

The opportunity that taxpayers now have either to offset foreign losses against domestic income or to average high and low foreign taxes has given rise to demands for revision of our foreign tax credit system. In response to these demands, the House bill eliminates the per-country limitation.

The Ways and Means Committee Report explains that the elimination of the per-country limitation is necessary to prevent foreign losses from offsetting domestic income, except in the case of an overall foreign loss. In addition, the per-country limitation creates difficult administrative problems. The primary problem is the difficulty of providing adequate source rules. Because of these problems with the per-country limitation, the Administration has not objected to its repeal.

The House Bill also includes a foreign loss recapture provision. This provision was proposed by Treasury in slightly different form in 1973, but we support it in its present form. We view this as a technical change to eliminate an unintended benefit. Under present law, a U.S. taxpayer can use foreign start-up losses to reduce U.S. tax and then pay no U.S. tax on subsequent foreign gains because of the foreign tax credit. In such a case it is only fair for the U.S. to recapture the tax lost during the start-up period.

The House Bill provides a capital gain adjustment to the foreign tax credit. We view this as a technical improvement, and we support it. Capital gains are subject to lower U.S. tax, and it is logical that foreign capital gains should receive a correspondingly lower foreign tax credit limitation. Similarly, we view the full gross-up for less developed country dividends as a desirable simplification, eliminating an inefficient preference in our tax laws.

DISC

The House Bill has introduced an incremental export rule for United States exporters through DISC and has provided that certain goods are not eligible for DISC benefits. The Administration supports DISC and opposes the House cut-backs in the program.

DISC stimulates exports. During the time DISC has been in existence, United States exports have grown from $44 billion in 1971 to some $118 billion in 1975. Obviously, all of this growth cannot be attributed to DISC. The growth reflects worldwide trade expansion, exchange rate adjustments, varying inflationary movements, and so on. But part of the growth is due to the incentive of DISC. Most estimates of the DISC part of the growth range between $4 billion and $6 billion per year.

DISC creates jobs. With more goods exported, more goods must be produced, and more people are employed to produce them. DISC tends to neutralize the provisions in foreign tax laws which encourage United States businesses to establish plants abroad or encourage foreign export efforts in competition with U.S. exports.

Any curtailment of DISC would be particularly unfortunate at this time, when the economy is in the midst of a recovery. It would increase our present problem of capital formation by raising the taxes on capital at a time when they should be lowered. It would hit hardest those companies who have been doing the most to help our export efforts. We shouldn't alter DISC until there is agreement in the multilateral trade negotiations concerning uniform rules for taxation of exports.

The House moved to restrict DISC benefits in two ways:

First, the bill takes away DISC benefits for the export of certain goods. The Tax Reduction Act of 1975 has already made natural resources ineligible for DISC. The current bill would add to the disqualified list agricultural products not in excess supply and military equipment.

Second, for companies with profits in excess of $100,000, the House Bill restricts DISC benefits to income on sales in excess of 75 percent of average sales during a base period.

The first change, the disqualification of certain items from DISC, reflects a desire to remove the export stimulus from the export of goods believed to be undeserving of stimulus. This effort produces hardship for companies exporting those items. The hardship is made particularly difficult by the lack of adequate transitional rules for those companies previously exporting the now-disqualified items.

The second change, the incremental approach, was considered seriously during the development of the DISC legislation in 1971, at a time when income on incremental DISC sales would have been 100 percent deferred, rather than 50 percent deferred. This Committee judged an incremental approach unsatisfactory and the legislation emerged with an alternative of a 50 percent deferral. The reasons valid in 1971 for rejecting an incremental approach remain valid today. The problem is similar to that posed by excess profits tax legislation. Inevitably, any base period will lead to unfairness. The new entrant will have an undue advantage, and the company with declining sales will have no incentive to slow the trend. An already complex statute will be rendered increasingly unworkable to the detriment of U.S. exports and jobs.

DISC has been in place for only a short time. And, it is working. Many companies have made significant investments in reliance on it, but the legislative tinkering with the DISC can only weaken the program. DISC, like the investment credit, should not be turned on and off depending on the whim of the moment. We must resist the temptation to adopt stop and go policies, which create a climate of great uncertainty for business planning.

Other Foreign Income Items

The House Bill contains a number of other changes in the tax treatment of foreign income. In general, we either support, or do not oppose, these changes. I would like to mention in particular only two of these items.

First the foreign trust provision. The House Bill would end the tax loophole whereby many wealthy individuals avoid U.S. tax through the creation of foreign trusts. We strongly support this provision and, in particular, would oppose any attempt to weaken the provision or to postpone its effective date.

Second, the changes in the ruling requirements with respect to tax-free reorganizations of foreign corporations. These changes are very technical, but in general would allow taxpayers either to determine the effects of a transaction from the regulations rather than applying for a ruling or to apply for a ruling after the event takes place rather than being required, as under present law, to obtain an advance ruling. We strongly support this provision.

ADMINISTRATIVE PROVISIONS

The House Bill contains numerous changes affecting the administrative provisions of the Code. Most of these provisions would directly benefit the cause of sound tax administration and the Treasury welcomes their enactment. For example, the provisions dealing with income tax return preparers, declaratory judgments in section 501(c)(3) cases, assessments in the cases of mathematical or clerical errors, and minimum exemptions from levy for wages, etc., would all have the effect of improving our tax system and we hope these provisions, with certain minor drafting changes, will be enacted into law.

Jeopardy and Termination Assessments; Administrative Summons

We believe, however, that extensive revisions are required in two provisions of the House Bill, those dealing with jeopardy and termination assessments and with administrative summons. Whenever the Congress makes changes in the area of the capability of the Service to perform its tax administration responsibilities, great care must be taken to provide that such changes do not diminish the ability of the Service to effectively and fairly carry out these responsibilities. While we share fully the concern underlying the House Bill for the protection of taxpayers' rights, we believe these provisions go too far in imposing burdensome administrative procedures on the Service that unduly handicap its ability to collect taxes.

For example, the Internal Revenue Service uses administrative summons to obtain needed information from third parties concerning the tax liability of taxpayers.

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This important investigatory tool, which has been provided by modern revenue laws since at least 1926, is essential to investigating cases in which there is a substantial probability of serious noncompliance with the revenue laws. Although the Department believes that legislative review of the entire administrative summons procedure is desirable at this time, it opposes the particular amendments passed by the House. If enacted, they would enable a taxpayer, by simple notice, to prevent a third party from giving the IRS information from the third party's records relevant to the liability of the taxpayer and compel the government to institute a court action (to which the taxpayer will be a party) for the release of that information. This will mean that in every case in which there is a high probability of noncompliance with the tax laws, IRS investigations will, from their inception, be frequently tied up for extended periods of time without any investigatory progress.

As regards jeopardy and termination assessments, the Laing case, decided by the Supreme Court after the House Bill was passed, will plainly alter procedures which the Service must follow in termination assessment cases, and the effect of this decision should be taken into account when your Committee considers these provisions.

Employment Taxes

There are two important areas affecting tax administration which are not dealt with in the House Bill that we would hope the Committee will give its serious consideration. The first deals with the Service's administration of the employment tax area. Despite vigorous actions by the Internal Revenue Service, the tools available under present law are simply not adequate to cope with mounting delinquencies in unpaid employment taxes. Our experience shows that this overall deterioration in compliance requires a thorough revision of the basic definition of the employer-employee relationship and the penalty structure for failures to file, collect, withhold, account for, and pay over employment taxes. Accordingly, we would like to work with your Committee in developing clearer and more uniform statutory guidelines with respect to when an employer-employee relationship exists. Such guidelines would have the beneficial effect of making clear the types of relationships that would be subject to the various employment taxes. This would provide greater certainty for taxpayers and eliminate the necessity for the Service to devote a vast amount of administrative time and resources to determining responsibility for payment of employment taxes.

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Interest on Delinquent Taxes

The second area relates to the amount of interest charged and paid by the Service on underpayments and overpayments of tax. Under present law (enacted last year), the rate of interest for tax purposes is to be fixed, not more frequently than every two years, at 90 percent of the average predominant prime rate quoted by commercial banks as determined by the Board of Governors of the Federal Reserve System. To make the tax rate of interest more realistic when compared with interest rates in the money markets, we recommend that it be raised from 90 percent to 125 percent of the prime interest rate charged by commercial banks. With this revision, the interest rate on underpayments and overpayments of tax would conform more nearly to the interest rates that the average taxpayer could obtain in the money markets and, thus, make it less attractive for taxpayers to "borrow" from the Government by being delinquent in their tax payments. In addition, we recommend that provision be made for an annual, rather than a biennial, adjustment in the tax interest rate.

I would like to comment, now, on two other administrative provisions in more detail.

Disclosure of Private Letter Rulings

The House Bill contains a detailed set of rules providing for public disclosure of the substance of private letter rulings issued by the Internal Revenue Service to taxpayers and of National Office technical advice memoranda issued to district directors, if disclosed to the taxpayer involved. We enthusiastically endorse this basic concept of making public what has come to be considered a body of "secret law."

While the structure of the section is elaborate in describing what must be disclosed under its terms, it fails to provide sufficient safeguards for the legitimate confidentiality of materials involved. This deficiency results from the fact that the section does not provide that it is the exclusive means of public access to the material encompassed in its scope. Thus, the section leaves unresolved the basic issue as to what information contained in a ruling or a technical advice memorandum, or the related background file, is subject to public disclosure under other provisions of the law, principally the Freedom of Information Act. Nor does the section resolve the issue of what portions of such information are protected from disclosure by the confidentiality principles underlying our self-assessment tax system.

The section also provides that, in general, the identity of the recipient of a private letter ruling will be made public as part of the ruling itself. As a result, it is likely that a complicated and cumbersome procedure will have to be established by the Service to insure that other significant information will be deleted from the public text of the ruling in order to protect the confidential affairs of the taxpayer.

We believe that the "secret law" is best understood when disclosure includes as many of the relevant facts as possible and, moreover, that broadscale disclosure of the identity of ruling recipients serves no useful public function particularly when compared to the potential damage it may do to the basic confidentiality of the tax system. We urge the Committee, therefore, to attempt to find a method under which identities of ruling recipients would be disclosed when there is compelling cause for the disclosure but under which, as a general rule, such identities would remain confidential. If a successful solution to this problem is found, the need to delete other information from the ruling in order to protect a taxpayer's personal or financial privacy would be reduced.

Certainly it will remain necessary for a procedure to exist to permit the taxpayer and the Internal Revenue Service to agree, before the issuance of a ruling, as to what information may be disclosed. The taxpayer should be entitled to protect trade secrets and other sensitive material, even if his identity will not be disclosed, by withdrawing his ruling request. But so long as his identity will not be disclosed, this agreement procedure should be facilitated; and public disclosure should not interfere with the basic ruling and technical advice issuance programs.

I do want to emphasize, amid these comments, our basic support of many concepts embodied in the House Bill. It preserves the confidentiality principles of the Freedom of Information Act; it recognizes the repetitiveness of certain rulings by permitting disclosures of certain rulings in summary form; it acknowledges the need of the Service for judicial uniformity on the scope of disclosure by limiting disclosure and confidentiality actions to the Tax Court and the District Court for the District of Columbia with appeal to the Court of Appeals for the District of Columbia Circuit; and it permits delay of disclosure when premature disclosure would interfere with a pending transaction.

We also believe it critical to have an effective date for disclosure of future rulings to commence upon the expiration of a reasonable time, say 90 days, after enactment of the precise statutory rules governing disclosure. The taxpayer has a right to know, at the time he requests his ruling, the degree of publicity to which his affairs may be subject; and the Internal Revenue Service will have a massive gearing-up task to face.

In addition, consideration should be given as to the best manner in which to make public rulings requested in the past. First, we think that the most recent rulings are likely to be the most informative to the public so that a last-in-first-out (LIFO) order should be used. And, second, we believe that the rulings already designated by the Service for its own internal purposes as important, or "reference," rulings will be the most useful and should be disclosed prior to any past "routine" rulings.

Most important in your consideration of this issue is the preservation of the concept in the House Bill that the process of disclosure of past rulings is expensive and should not be required without additional appropriation of funds by Congress for this specific purpose.

Confidentiality of Tax Returns

As you are well aware, another matter related to the confidentiality of our tax system has been the subject of recent Congressional concern, that is, the degree to which tax returns and tax return information are made available to governmental agencies outside the Treasury Department. Several members of Congress, including Senators Weicker, Bentsen, Montoya, and Dole, have introduced legislation to make section 6103, the section governing tax return confidentiality, more specific and restrictive--replacing the present broad grant of authority to the President to authorize disclosure by Executive Order.

In this Congress and the last, the Administration sent to the Congress a bill which, in our view, constitutes an appropriate statutory balancing of the need for confidentiality in the self-assessment tax system and privacy for the taxpayer with the legitimate needs of relevant governmental agencies for access to a data source of unparalleled detail and completeness. At the end of January of this year, the General Counsel of the Treasury, Mr. Albrecht, and the Commissioner of Internal Revenue, Mr. Alexander, presented the Treasury Department's and the Service's views on this subject to the House Ways and Means Committee. Such a complete discussion would be inappropriate in the general context of my remarks and this hearing; but we are ready and eager to meet with your Committee to review in detail the factors which we believe must be taken into consideration in the legislative resolution of this complex issue.

Let me, nonetheless, raise a few of the most pressing issues for your review.

First, there is substantial similarity among the majority of the proposals presently before the Congress on the basic issues. There must be a comprehensive set of statutory rules to replace the open ended Executive Order system of present law. This system should cover not only the tax return itself but also other tax data concerning a taxpayer gathered by the Service.

There are entities outside the Treasury Department which most proposals agree have legitimate need for access to tax return information. These include the Justice Department when it acts as the Internal Revenue Service's attorney in litigating tax cases; the staff of the Congressional Joint Committee on Internal Revenue Taxation and the tax-writing committees of the Congress, themselves, when considering changes in the tax laws or performing their oversight function; the President and his specifically designated assistants when he is acting in his capacity as the Constitutional Chief Executive; and state tax administrators when trying to verify the correctness of income reported on a state income tax return. On most of these issues, there is almost unanimous agreement.

Second, the principal area of contention seems to relate to the use of tax data in nontax law enforcement investigations and court proceedings. We believe that the Internal Revenue Service has all the necessary incentive to protect the confidentiality of returns if given a set of statutory rules permitting it to resist demands for disclosure. The Administration's Bill requires that the Service be satisfied that the information sought for nontax law enforcement use "cannot reasonably be obtained from another source" and that the disclosure of the information will not "seriously impair the administration of the Federal tax law."

A further requirement that the information have a "direct bearing" on the investigation or proceeding applies in the case of so-called "third party" returns. We strongly feel that such a system of administrative control should be tested in use before a cumbersome court order or search warrant procedure is established to govern access by non-Treasury personnel to tax returns.

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<u>Third</u>, we believe that analysis of the degree of publicity involved in a disclosure and t‘ . relationship of the taxpayer to the matter under investigation or litigation is necessary to determine the standards for disclosure. Thus, a public courtroom disclosure must be justified by a stronger showing of necessity or relevance than must a disclosure within the federal government. And the disclosure of a third-party's return should be permitted only on a showing of a degree of directness of relevance specified in the statute.

<u>Fourth</u>, we have concluded, based primarily on the absence of past abuse and on convincing claims of need, that the statistical agencies of the Federal Government--specifically the Census Bureau, the Bureau of Economic Affairs, and the Federal Trade Commission's Bureau of Economics--should have access to individualized tax data for statistical purposes under strict confidentiality controls.

<u>Fifth</u>, any amendment should permit the taxpayer to designate agents to inspect his own tax information and to consent to any otherwise unauthorized disclosure of information by the Internal Revenue Service.

<u>Finally</u>, we believe that nontax-writing Congressional committees should have access to returns if authorized by a specific resolution of the appropriate house and that the President, similarly, should not be limited to "tax-administration-only" access to tax data. There should, however, be a written record of accountability for each disclosure (in the form of the resolution on one hand and a personally signed request on the other), and a specification of the staff assistants who are to be entitled to act as agents for the President and the Congress in carrying out their constitutional functions.

Clearly, there are many detailed provisions to be worked out. But we are optimistic that there is a solid foundation of agreement on which a final and practical structure can be erected which will protect the privacy of taxpayers and enable the government to function effectively.

CONCLUSION

In this testimony I have addressed long and seemingly disparate list of tax provisions. As the members of this Committee well know, when we attempt to embody policy in concrete provisions of the law, it is difficult to avoid becoming entangled in a web of complexity. But let us keep before us the long-term objectives of this Administration and, I believe, of all of you. The tax system should be fair. The tax system should be simple. The tax system should promote efficient use of resources.

Inevitably we are going to take some steps backward as we take other steps forward and often we are going to move sideways. I believe that the positions I have urged upon you today represent the direction of improvement. However, I must candidly say to you that I see a vast potential for further improvement. As I have said earlier and as I have said many times elsewhere, I believe that the extraordinary complexity of our tax system has begun to threaten public confidence in it, and I do not believe that this complexity is required to serve the objectives of fairness and efficiency. Quite to the contrary.

Let us then, by all means, take the steps I have urged upon you in the direction of a better income tax Code, but let us not stop there. Let us have these steps represent a part of a process of continuing true tax reform which will take us eventually to a tax system which looks as though someone had constructed it on purpose, a simple progressive tax on a broad base which adequately reflects individual taxpayer's ability to pay. That is the tax break all Americans are waiting for.

Thank you.

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Table 1

Real Gross National Product

Billions of 1972 dollars, seasonally adjusted at annual rates

Period		Real GNP
1970		1075.3
1971		1107.5
1972		1171.1
1973	I	1227.7
	II	1228.4
	III	1236.5
	IV	1240.9
1974	I	1228.7
	II	1217.2
	III	1210.2
	IV	1186.8
1975	I	1158.6
	II	1168.1
	III	1201.5
	IV	1215.9

Office of the Secretary of the Treasury
Office of Tax Analysis

March 11, 1976

Table 2

Consumer Price Index

Seasonally Adjusted

Period	Level (1967=100)	Percent Change From Last Period (Annual Rates)
1970	116.3	5.9
1971	121.3	4.3
1972	125.3	3.3
1973 I	128.8	6.0
II	131.6	8.7
III	134.3	8.2
IV	137.5	9.5
1974 I	141.6	11.9
II	145.5	11.0
III	149.7	11.5
IV	154.1	11.8
1975 I	157.2	8.0
II	159.6	6.1
III	162.8	8.0
IV	165.5	6.6
October	164.5	7.3
November	165.5	7.3
December	166.4	6.5
1976 January	167.1	5.0

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Table 3

Productivity Growth, 1960-1973
(Average Annual Rate)

	Gross Domestic Product per employed person	Manufacturing output per manhour
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	6.4
United Kingdom	2.8	4.0
11 OECD Nations	5.2*	6.1

*Average for 6 OECD countries listed.

Source: Department of the Treasury

Table 4

ACTUAL AND PROJECTED INVESTMENT AS A PERCENT OF GNP

	Average 1965-1974	NYSE 1/	Bosworth Duesenberry Carron 2/	Friedman 3/	G.E. 4/	DRI 5/	Chase Econometrics 6/
Gross private domestic investment	15.1	16.4	15.5	15.8	15.8	15.7	15.9
Non-residential fixed	10.4	12.1	11.3	11.5	11.4	11.0	11.8
Inventory	1.0	0.3	0.8	0.8	0.4	0.8	0.8
Residential	3.8	3.9	3.5	3.5	4.0	3.8	3.3

1/ The New York Stock Exchange, The Capital Needs and Savings Potential of the U.S. Economy: Projections Through 1985, September 1974. Figures shown are based on cumulative projections in current dollars, 1974-1985.

2/ Barry Bosworth, James S. Duesenberry, and Andrew S. Carron, Capital Needs in the Seventies, The Brookings Institution, 1975. Figures shown are based on estimates for 1980 in current dollars from Table 2-12, p. 39 (note the constant dollar 1980 figures in Table 2-11 project gross private domestic investment as 15.8 percent of GNP).

3/ Benjamin M. Friedman, "Financing the Next Five Years of Fixed Investment" in President's Authority to Adjust Imports of Petroleum, Public Debt Ceiling Increase; and Emergency Tax Proposals; Hearings before the Committee on Ways and Means, House of Representatives, January 1975, pp. 710-726. Figures shown are based on 1975-79 averages of current dollar projections.

4/ Reginald H. Jones, "Capital Requirements of Business, 1974-85," Testimony submitted to Subcommittee on Economic Growth, Joint Economic Committee, May 8, 1974. Figures shown are based on cumulative projections in current dollars, 1974-1985.

5/ Data Resources, Inc., Summer 1975, "Special Study: The Capital Shortage." Summary table on inside cover. 1985 data only, current dollars, standard forecast.

6/ Chase Econometrics August 1975. "The Next Ten Years: Inflation, Recession and Capital Shortage." 1984 data only, current dollars. Table, page #1 of 14. No recession

Table 5

Debt-Equity Ratios for Selected Industries 1/

Fourth Quarter of Year	All Manufacturing	Durable Goods	Motor Vehicles & Equipment	Electrical & Electronics Equipment	Primary Iron & Steel	Non-Durable Goods	Textile Mill Products	Industrial Chemicals	Petroleum and Coal Products
1956	.249	.224	.147	.316	.191	.254	.243	.263	.200
1957	.242	.233	.150	.290	.188	.251	.251	.276	.197
1958	.239	.233	.136	.260	.208	.246	.236	.306	.198
1959	.237	.235	.132	.284	.216	.239	.237	.289	.180
1960	.246	.248	.126	.282	.231	.244	.242	.283	.178
1961	.250	.255	.135	.273	.272	.245	.257	.280	.172
1962	.253	.256	.122	.299	.257	.248	.270	.299	.166
1963	.253	.253	.113	.296	.239	.253	.313	.338	.168
1964	.258	.253	.110	.293	.249	.262	.310	.368	.165
1965	.282	.275	.120	.330	.262	.289	.337	.426	.186
1966	.321	.321	.141	.403	.309	.319	.364	.426	.211
1967	.350	.353	.155	.446	.330	.347	.392	.452	.233
1968	.377	.375	.158	.444	.358	.382	.408	.465	.268
1969	.412	.420	.194	.498	.407	.403	.448	.474	.271
1970	.444	.463	.215	.546	.472	.427	.463	.505	.287
1971	.444	.459	.255	.518	.498	.429	.457	.495	.309
1972	.431	.442	.232	.505	.500	.420	.526	.485	.292
1973	.437	.455	.264	.549	.500	.417	.559	.463	.282
1974	.433	.448	.230	.508	.370	.415	.556	.446	.221
1975	.431	.450	.287	.467	.422	.412	.535	.503	.238

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1/ Total stockholder equity divided by total short-term bank loans, installments due on one-year or less on long-term debt and long-term debt due in more than one year.

Source: Federal Trade Commission "Quarterly Financial Report for Manufacturing Corporations," Fourth Quarter of Year. Not adjusted for changes in sample or methods of reporting.

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Table 6

The President's Tax Cut Proposals

(1975 Levels of Income)

($ billions)

	President's Tax Cut Proposals
Individual	21.2
Increase personal exemption	10.1
Standard deduction changes	4.0
Tax rate reductions	6.6
Investment tax credit 1/	0.5
Corporate	6.7
Surtax exemption and normal rates	1.5
Surtax rate	2.2
Investment tax credit 1/	2.5
Utility relief	0.6
Total	27.9

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1/ The investment tax credit changes do not affect tax liabilities until 1977, since these exact changes were already included in the Tax Reduction Act of 1975 and extended through 1976.

Note: Figures may not add to totals due to rounding.

Table 7

Tax Rate Schedule for President's
Tax Reduction Proposals
(Single Taxpayers)

Taxable income bracket		Present rates	Proposed rates for 1976	Proposed rates for 1977
$ 0	$ 500	14 %	13 %	12 %
500	1,000	15	14	13
1,000	1,500	16	15.5	15
1,500	2,000	17	16	15
2,000	3,000	19	17.5	16
3,000	4,000	19	18	17
4,000	5,000	21	19.5	18
5,000	6,000	21	20	19
6,000	8,000	24	22.5	21
8,000	10,000	25	24.5	24
10,000	12,000	27	27	27
12,000	14,000	29	29	29
14,000	16,000	31	31	31
16,000	18,000	34	34	34
18,000	20,000	36	36	36
20,000	22,000	38	38	38
22,000	26,000	40	40	40
26,000	32,000	45	45	45
32,000	38,000	50	50	50
38,000	44,000	55	55	55
44,000	50,000	60	60	60
50,000	60,000	62	62	62
60,000	70,000	64	64	64
70,000	80,000	66	66	66
80,000	90,000	68	68	68
90,000	100,000	69	69	69
100,000	--	70	70	70

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Table 9

Tax Liabilities Under Various Tax Laws for Single Person Without Dependents, With Itemized Deductions of 16 Percent of Adjusted Gross Income 1/

Adjusted gross income class	Tax Liability: 1972-74 law	1975 law 2/	Revenue Adjustment Act	Revenue Adjustment Act extended	Proposed 1976 law	Proposed 1977 law
$ 5,000	$ 490	$ 404	$ 425	$ 364	$ 334	$ 307
7,000	889	796	800	715	677	641
10,000	1,506	1,476	1,430	1,331	1,278	1,227
15,000	2,589	2,559	2,500	2,410	2,358	2,307
20,000	3,847	3,817	3,757	3,667	3,609	3,553
25,000	5,325	5,295	5,235	5,145	5,080	5,015
30,000	6,970	6,940	6,880	6,790	6,722	6,655
40,000	10,715	10,685	10,625	10,535	10,455	10,375
50,000	15,078	15,048	14,988	14,898	14,811	14,725

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1/ If standard deduction exceeds itemized deduction, uses standard deduction.

2/ Assumes that taxpayer is not eligible for the Home Purchase Credit.

Table 10

Tax Liabilities Under Various Tax Laws for Family with No Dependents, Filing Jointly with Itemized Deductions of 16 Percent of Adjusted Gross Income 1/
(Dollars)

Adjusted gross income class	Tax Liability					
	1972-74 law	1975 law 2/	Revenue Adjustment Act	Revenue Adjustment Act extended	Proposed 1976 law	Proposed 1977 law
$ 5,000	$ 322	$ 170	$ 225	$ 130	$ 88	60
7,000	658	492	548	448	387	335
10,000	1,171	1,054	1,084	948	872	800
15,000	2,062	2,002	1,972	1,882	1,827	1,750
20,000	3,085	3,025	2,995	2,905	2,842	2,780
25,000	4,240	4,180	4,150	4,060	4,006	3,950
30,000	5,564	5,504	5,474	5,384	5,358	5,328
40,000	8,702	8,642	8,612	8,522	8,481	8,444
50,000	12,380	12,320	12,290	12,200	12,140	12,080

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1/ If standard deduction exceeds itemized deduction, family uses standard deduction

2/ Assumes that taxpayer is not eligible for the Home Purchase Credit.

Table 11

Tax Liabilities Under Various Tax Laws for Family with 1 Dependent, Filing Jointly with Itemized Deductions of 16 Percent of Adjusted Gross Income 1/

(Dollars)

Adjusted gross income class	Tax Liability: 1972-74 law	1975 law 2/	Revenue Adjustment Act	Revenue Adjustment Act extended	Proposed 1976 law	Proposed 1977 law
$ 5,000	$ 208	$ 29	$ 95	$ 0	$ 0	$ 0
7,000	527	336	406	289	234	190
10,000	1,029	882	949	821	726	640
15,000	1,897	1,807	1,807	1,717	1,635	1,535
20,000	2,898	2,808	2,808	2,718	2,624	2,530
25,000	4,030	3,940	3,940	3,850	3,757	3,660
30,000	5,324	5,234	5,234	5,144	5,070	4,938
40,000	8,407	8,317	8,317	8,227	8,140	8,054
50,000	12,028	11,938	11,938	11,848	11,739	11,630

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1/ If standard deduction exceeds itemized deduction, family uses standard deduction.

2/ Assumes that taxpayer is not eligible for the Home Purchase Credit. Also assumes that taxpayer is not eligible for the Earned Income Credit. Taxpayers maintaining a home in the United States for a dependent child are eligible for the Earned Income Credit (EIC) if they earn less than $8,000. If the effects of the EIC were included, the table would have these entries (negative entries represent direct payments to the taxpayer):

AGI	1975 Law	Revenue Adjustment Act	Revenue Adjustment Act Extended	Proposed 1976 Law
$5,000	- $271	-$55	-$300	- $150
$7,000	+ $236	$356	$189	+ $184

Table 12

Tax Liabilities Under Various Tax Laws for Family with 2 Dependents, Filing Jointly with Itemized Deductions of 16 Percent of Adjusted Gross Income 1/
(Dollars)

Adjusted gross income class	Tax Liability					
	1972-74 law	1975 law 2/	Revenue Adjustment Act	Revenue Adjustment Act extended	Proposed 1976 law	Proposed 1977 law
$ 5,000	$ 98	$ 0	0	0	$ 0	$ 0
7,000	402	186	$ 268	$ 135	89	60
10,000	886	709	797	651	555	485
15,000	1,732	1,612	1,642	1,552	1,446	1,325
20,000	2,710	2,590	2,620	2,530	2,405	2,280
25,000	3,820	3,700	3,730	3,640	3,507	3,370
30,000	5,084	4,964	4,994	4,904	4,781	4,648
40,000	8,114	7,994	8,024	7,934	7,799	7,664
50,000	11,690	11,570	11,600	11,510	11,345	11,180

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1/ If standard deduction exceeds itemized deduction, family uses standard deduction.

2/ Assumes that taxpayer is not eligible for the Home Purchase Credit. Also assumes that taxpayer is not eligible for the Earned Income Credit. Taxpayers maintaining a home in the United States for a dependent child are eligible for the Earned Income Credit (EIC) if they earn less than $8,000. If the effects of the EIC were included, the table would have these entries (negative entries represent direct payments to the taxpayer):

AGI	1975 Law	Revenue Adjustment Act	Revenue Adjustment Act Extended	Proposed 1976 Law
$5,000	- $300	-$150	-$300	- $150
$7,000	+ $ 86	$218	$35	+ $ 39

Table 13

Tax Liabilities Under Various Tax Laws for Family with 4 Dependents, Filing Jointly with Itemized Deductions of 16 Percent of Adjusted Gross Income 1/
(Dollars)

Adjusted gross income class	Tax Liability: 1972-74 law	1975 law 2/	Revenue Adjustment Act	Revenue Adjustment Act extended	Proposed 1976 law	Proposed 1977 law
$ 5,000	$ 0	$ 0	0	0	$ 0	$ 0
7,000	170	0	7	0	0	0
10,000	603	372	$ 481	$ 308	240	190
15,000	1,402	1,222	1,297	1,192	1,078	965
20,000	2,335	2,155	2,230	2,125	1,966	1,816
25,000	3,400	3,220	3,295	3,190	3,003	2,830
30,000	4,604	4,424	4,499	4,394	4,191	4,008
40,000	7,529	7,349	7,424	7,319	7,102	6,896
50,000	11,015	10,835	10,910	10,805	10,543	10,280

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1/ **If standard deduction exceeds itemized deduction, family uses standard deduction.**

2/ Assumes that taxpayer is not eligible for the Home Purchase Credit. Also assumes that taxpayer is not eligible for the Earned Income Credit. Taxpayers maintaining a home in the United States for a dependent child are eligible for the Earned Income Credit (EIC) if they earn less than $8,000. If the effects of the EIC were included, the table would have these entries (negative entries represent direct payments to the taxpayer):

AGI	1975 Law	Revenue Adjustment Act	Revenue Adjustment Act Extended	Proposed 1976 Law
$5,000	- $300	-$150	-$300	- $150
$7,000	- $100	-$43	-$100	- $ 50

Table 14

Comparison of Individual Income Tax Provisions

	1974 Law	1975 Law	Revenue Adjustment Act - unextended 1/	Revenue Adjustment Act extended 2/	President's proposal for 1976	President's proposal for 1977
1. Standard Deduction						
(a) Minimum standard						
Single returns	$1,300	$1,600	$1,500	$1,700	$1,750	$1,800
Joint returns	$1,300	$1,900	$1,700	$2,100	$2,300	$2,500
(b) Percentage standard	15%	16%	16%	16%	16%	--
(c) Maximum standard						
Single returns	$2,000	$2,300	$2,200	$2,400	$2,100	$1,800
Joint returns	$2,000	$2,600	$2,400	$2,800	$2,650	$2,500
2. Personal Exemption Deduction	$750	$750	$750	$750	$875	$1,000
3. Tax Credit						
(a) Per capita	None	$30	$17.50	$35	$17.50	None
(b) Percent of taxable income	None	None	1% up to $90	2% up to $180	1% up to $90	None
4. Rate Reductions	None	None	None	None	See Annex	See Annex
5. Earned Income Credit	None	10% up to $400	5% up to $200	10% up to $400	5% up to $200	None
6. Home purchase credit	None	5% of value up to $2,000	None	None	None	None

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1/ Full-year tax liability change enacted by Revenue Adjustment Act of 1975.
2/ [illegible] of Revenue Adjustment Act changes to permit continued use of present withholding tax tables through [illegible]. These provisions are actually contained in the Act but will be inoperative without further legislation.

Table 15

Revenue Losses of Individual Income Tax Reduction Compared to 1974 Law

(1976 Levels of Income)

($ billions)

	Revenue Adjustment Act unextended	Revenue Adjustment Act extended	Combination of President's program and Revenue Adjustment Act for 1976	President's proposal for 1977
1. Standard Deduction	-1.8	-3.9	-3.9	-4.2
2. Personal Exemption Deduction	-	-	-5.4	-10.6
3. Per Capita Exemption/ Taxable Income Tax Credit	-4.9	-9.5	-4.9	-
4. Rate Reductions	-	-	-3.6	-6.8
5. Earned Income Credit 1/ ..	-0.7	-1.4	-0.7	-
Total	-7.4	-14.9	-18.5	-21.6
Total excluding outlay portion of earned income credit 2/	-6.8	-13.8	-17.9	-21.6

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1/ Includes outlay portion.

2/ Revenue loss of tax liability changes that affect withholding tax tables.

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Table 16

Total Tax Liability Under Various Tax Laws

(1975 Levels of Income)

($ millions)

Adjusted gross income class	1974 law	1975 law 1/	Revenue Adjustment Act unextended	Revenue Adjustment Act extended	President's proposed 1976 law	President's proposed 1977 law
($000)						
Up to 0	44	44	44	44	44	44
0 - 5	2,000	1,165	1,430	998	872	775
5 - 10	14,069	11,514	12,247	10,391	9,702	9,102
10 - 15	23,122	21,099	21,536	19,818	18,653	17,609
15 - 20	23,706	21,944	22,381	21,066	20,264	19,520
20 - 30	28,022	26,782	27,148	26,216	25,470	24,714
30 - 50	16,950	16,579	16,696	16,430	16,174	15,913
50 - 100	12,064	11,962	11,995	11,923	11,803	11,681
100 or over	9,445	9,425	9,431	9,416	9,385	9,354
TOTAL	129,422	120,514	122,906	116,303	112,366	108,711

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Note: Estimates exclude net refunds under E.I.C.; they are treated as expenditures.

1/ Includes effect of home purchase credit.

Table 17

Distribution of Tax Liabilities Under President's Proposal
for 1976 Compared with Revenue Adjustment Act Extended
by Size of Adjusted Gross Income

(1975 Levels of Income)

Adjusted gross income class	Total tax liability: Revenue Adjustment Act Extended	Total tax liability: President's proposal for 1976	Tax cut caused by the President's proposal for 1976: Amount	Tax cut: Percent distribution	Tax cut: As percent of tax under Revenue Adjustment Act Extended
($000)	(............... $ billions		...............)	(................. percent	.......................)
Up to 5	1.0	0.9	0.1	3.2%	12.1%
5 - 10	10.4	9.7	0.7	17.5	6.6
10 - 15	19.8	18.7	1.2	29.6	5.9
15 - 20	21.1	20.3	0.8	20.4	3.8
20 - 30	26.2	25.5	0.7	18.9	2.8
30 - 50	16.4	16.2	0.3	6.5	1.6
50 - 100	11.9	11.8	0.1	3.0	1.0
100 +	9.4	9.4	0.03	0.8	0.3
TOTAL	116.3	112.4	3.9	100.0	3.4

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Note: Estimates exclude net refunds under E.I.C.; they are treated as expenditures.

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Table 18

Distribution of Tax Liabilities Under President's Proposal
for 1977 Compared with Revenue Adjustment Act Extended
by Size of Adjusted Gross Income
(1975 Level of Income)

Adjusted gross income class	Total tax liability		Tax cut caused by the President's proposal for 1977		
	Revenue Adjustment Act extended	President's proposal for 1977	Amount	Percent distribution	As percent of tax under Revenue Adjustment Act extended
($000)	(.................$ billions		...............)	(.................. percent	.....................)
Up to 5	1.0	0.8	.2	2.9%	21.4%
5 - 10	10.4	9.1	1.3	17.0	12.4
10 - 15	19.8	17.6	2.2	29.1	11.1
15 - 20	21.1	19.5	1.5	20.4	7.3
20 - 30	26.2	24.7	1.5	19.8	5.7
30 - 50	16.4	15.9	0.5	6.8	3.1
50 - 100	11.9	11.7	0.2	3.2	2.0
100 +	9.4	9.4	0.1	0.8	0.7
TOTAL	116.3	108.7	7.6	100.0	6.5

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Note: Estimates exclude net refunds under E.I.C.; they are treated as expenditures.

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Table 19

Distribution of Tax Liabilities Under President's Proposal for 1976 Compared with Revenue Adjustment Act Unextended by Size of Adjusted Gross Income

(1975 Levels of Income)

Adjusted gross income class	Total tax liability		Tax cut caused by President's proposal for 1976		
	Revenue Adjustment Act-unextended	Proposed 1976 law	Amount	Percent distribution	As percent of tax under Revenue Adjustment Act unextended
($000)	(.......... $ billions	....	)	(... percent	.....................)
Up to 5	1.5	0.9	0.6	5.3%	37.9%
5 - 10	12.2	9.7	2.5	24.1	20.8
10 - 15	21.5	18.7	2.9	27.4	13.4
15 - 20	22.4	20.3	2.1	20.1	9.5
20 - 30	27.1	25.5	1.7	15.9	6.2
30 - 50	16.7	16.2	0.5	5.0	3.1
50 - 100	12.0	11.8	0.2	1.8	1.6
100 +	9.4	9.4	0.05	0.4	0.5
TOTAL	122.9	112.4	10.5	100.0	8.6

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Note: Estimates exclude net refunds of E.I.C.; they are treated as expenditures.

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Table 20

Income Distribution of Liability Under President's Proposal for 1977 Compared with Revenue Adjustment Act Unextended

(1975 Levels of Income)

Adjusted gross income class	Total of tax liability: Revenue Adjustment Act unextended	Total of tax liability: President's proposal for 1977	Tax cut caused by the President's proposal for 1977: Amount	Tax cut caused by the President's proposal for 1977: Percent distribution	Tax cut caused by the President's proposal for 1977: As percent of tax under Revenue Adjustment Act unextended
($000)	(.......... $ billions		............................)	(.percent	............................)
Up to 5	1.5	0.8	0.7	4.6%	44.4%
5 - 10	12.2	9.1	3.1	22.2	25.7
10 - 15	21.5	17.6	3.9	27.7	18.2
15 - 20	22.4	19.5	2.9	20.2	12.8
20 - 30	27.1	24.7	2.4	17.1	9.0
30 - 50	16.7	15.9	0.8	5.5	4.7
50 - 100	12.0	11.7	0.3	2.2	2.6
100 +	9.4	9.4	0.1	0.5	0.8
TOTAL	122.9	108.7	14.2	100.0	11.5

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Note: Estimates exclude net refunds under E.I.C.; they are treated as expenditures.

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Table 21

Income Distribution of Liability Under
President's Proposal for 1977 Compared with
President's Proposal for 1976

(1975 Levels of Income)

AGI class ($000)	Total tax liability: President's Proposal for 1976	Total tax liability: President's Proposal for 1977	Tax cut caused by the President's Proposal for 1977: Amount	Tax cut caused by the President's Proposal for 1977: Percent distribution	Tax cut caused by the President's Proposal for 1977: As percent of tax under President's Proposal for 1976
	(..........$ billions		...........................)	(..percent	.....................)
Up to 5	0.9	0.8	0.1	2.7	10.6
5 - 10	9.7	9.1	0.6	16.4	6.2
10 - 15	18.7	17.6	1.0	28.6	5.6
15 - 20	20.3	19.5	0.7	20.4	3.7
20 - 30	25.5	24.7	0.8	20.7	3.0
30 - 50	16.2	15.9	0.3	7.1	1.6
50 - 100	11.8	11.7	0.1	3.3	1.0
100 +	9.4	9.4	0.03	0.8	0.3
TOTAL	112.4	108.7	3.7	100.0	3.3

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Note: Estimates exclude net refunds under E.I.C; they are treated as expenditures.

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Table 22

Revenue Losses of Corporate Income Tax Reduction Compared to 1974 Law

(1976 Levels of Income)

($ billions)

	Revenue Adjustment Act unextended	Revenue Adjustment Act extended	Combination of President's program and Revenue Adjustment Act for 1976	President's proposal for 1977
1. Reduce basic corporate rate and increase surtax exemption.........	-1.0	-1.9	-1.9	-1.9
2. Reduce corporate surtax rate......	--	--	-1.2	-2.5
3. Six-point utilities program 1/....	--	--	-0.6	-0.6
Total.	-1.0	-1.9	-3.8	-5.0

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1/ Assumes program effective July 1, 1976.

Note: Figures may not add to totals due to rounding.

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Table 23

Annual Costs and Benefits of Taxable Municipal Bond

Plan with 30 Percent Subsidy

(millions of dollars)

Year	1	2	3	4	5	10
Gross subsidy cost	39	79	122	166	213	486
Revenues generated	32	66	102	139	178	405
Net subsidy cost	7	13	20	27	35	81
Reduction in state and local interest costs	69	141	218	297	381	868

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REMARKS OF THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE
THE ROTARY CLUB OF CINCINNATI
CINCINNATI, OHIO
MARCH 18, 1976

Thank you, Ron Roberts, President Dean Gaudin, Rotarians and guests.

It is indeed a pleasure to be in Cincinnati and to enjoy the hospitality of this outstanding organization. Your club is not only one of the oldest Rotaries anywhere but is one of the most active and I sense in this room today the same dynamism and drive that made Cincinnati one of America's great cities and that will assure its continued growth, economic vigor and greatness.

This club has many time-honored traditions, but the one that particularly appeals to me is your prompt closing time. You might say that Rotary is the only place where the speech-making is timed to self destruct at one-thirty sharp. I just wish I could sell the basic idea back in Washington, but since hot air is one of that city's two major industries -- the other is inflation -- I have no illusions about my success.

In my remarks today I would like to do the unthinkable in an election year and look beyond November to the longer-range issues that confront this country. But first, a brief report on the current state of the economy may be in order.

Economists pretty much agree that the recession hit bottom last April. There is also general agreement that the recovery began sooner than expected and has been stronger than expected. For example:

-- The year 1975 opened with inflation raging at more than 12 percent. That rate has been cut nearly in half, to between 6 and 6-1/2 percent.

-- Last spring, unemployment had reached 9 percent. Today is has dropped to 7.6 percent and our forecasts indicate a continuing downward trend.

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-- Other signs show an economy that is regaining its vitality: real G. N. P., the stock market, personal income, industrial output, retail sales -- all are up, and reflect a rising confidence about the economy that contrasts dramatically with the deep pessimism reported by polltakers only a few months ago.

Thus we made considerable headway in 1975 and we expect to make even more in 1976. And yet this is no time for complacency. The jobless rate is far higher than we are willing to tolerate, and inflation is by no means under control. That is why the administration is urging Congress to enact a broad-guaged plan to strengthen the economy further by putting the brakes on the dizzying momentum of federal spending. This will allow us to slow inflation even more, to make additional tax cuts possible and to set the stage for a balanced budget within three years.

Furthermore, the President has proposed elimination of the unfair double taxation of dividends that retards capital formation and has urged other tax measures designed to stimulate job creation generally and to encourage construction of plant and equipment in Cincinnati and other areas where unemployment has topped 7 percent.

These additional steps and the balanced program we have pursued thus far are designed to fight inflation and unemployment simultaneously by strengthening the private sector of our economy, the source for five out of every six jobs in this country. We think it is a course that is working, that is right for the nation, and that is leading us back to the position of robust growth and expanding opportunities that has made us a beacon of hope and inspiration for peoples everywhere.

And yet you will hear a chorus of rhetoric out of Washington as the elections draw closer that we are failing to spend enough, to press hard enough, to push enough panic buttons to solve our problems. Many of these critics assume there must be a basic flaw in the system and cast about for other remedies -- national economic planning... guaranteed government jobs for everybody... a new round of wage and price controls. But they fail to see that efforts to strengthen the public sector at the expense of the private sector are a large part of the problem, not part of the solution. They fail to perceive that excessive government fiscal, monetary and regulatory policies led to abuses of our economy and helped trigger, first, the storm of inflation of the early 1970s and then the severe recession resulting from it.

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I further suggest that those who advocate more spending and more control as solutions to our economic problems also fail to understand a gathering mood in this country against the further expansion of big government. As President Eisenhower once remarked, "there are a number of things wrong with Washington, and one of them is that everybody has been too long away from home."

However, public disenchantment with big government does not mean that all Americans are necessarily immune from the superficial appeal of quick-fix spending programs whose short-term benefits are well publicized but whose long-term impact in terms of inflation and economic stagnation is masked from view.

It may seem strange, and it is certainly ironic, but at a time when Americans are enjoying such great abundance and such great opportunity, too many of us have lost sight of the principles and institutions that have made our way of life possible. Somewhere along the line, there has been a dangerous breakdown in communications.

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Too many Americans -- especially those born into an affluent society which seemed to have no beginning or end, no cause and no effect -- have lost sight, or have never been taught, the dynamics of prosperity in a free society.

Today, when nearly everyone takes the fruits of the free enterprise system for granted -- the abundance, the opportunity, the freedom of choice, the unprecedented opportunities for learning, travel, and general upward mobility -- not everyone understands the basic economic facts of life that create all these benefits.

Small wonder then, that when economic difficulties like the recession hit, millions of otherwise reasonable people fall for the quack nostrums of politicians who are more interested in promising than performing, and for quick-fix government spending programs.

Because of this, I believe that the time is ripe for an economic heart-to-heart talk with the American people. And I believe that organizations like the Rotary must do even more than they are now if such a national dialogue is to succeed.

What is at stake is not just the future of this or that industry. At stake is the survival of the private sector, and the individual liberties which have never long survived the collapse of a society's free enterprise system.

Unless we get the facts across today, the America of tomorrow -- of our children and grandchildren -- will be doomed to a system of economic and political bondage that is the very opposite of all that we hold dear.

The problem already exists, as I have had ample opportunity to observe in my job as Secretary of the Treasury. And it is getting worse, not better. It is a question of both policy and perception for faulty perception of the economy makes faulty economic policy almost inevitable.

And I am firmly convinced that, taken together, misunderstanding and misdirection of the American economy have become the central, underlying problem of our times.

Part of it is a matter of image. Frequently, and especially to youthful idealists, those who support bigger government spending and more government domination of the private sector are preceived as concerned, socially progressive men and women who "care" -- in a nutshell, they are seen as the humane champions of the persecuted underdog.

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On the other hand, those who warn that the government should not -- and cannot -- effectively solve every new problem that comes down the pike, and who advocate instead the strengthening of the free enterprise system are seen as either outdated theorists or a new generation of economic exploiters, indifferent to human suffering and only out to make a fast buck for themselves and their companies.

To make matters worse, surface appearances often tend to confirm this inaccurate impression. Advocates of big government are able to wax eloquent for hours about the ills they imagine they can cure by cranking out more currency and soaking up more credit through massive deficit spending. They have as many arguments as there are social, economic and political problems -- even though the spending they advocate,as we have seen with the "Great Society's" war on poverty, is often part of the problem rather than part of the solution.

Those of us who recognize the fallacy of the big government approach have only one argument. It's the right one, but by dint of repetition, people are getting tired of hearing about it. For we constantly invoke the free enterprise system, too often without defining the freedoms and the opportunities that it, and it alone, provides. We chant a slogan, a label, without defining it in comprehensible, human terms.

We can talk about the free enterprise system until we are blue in the face, but it still won't mean anything to those who do not understand what it really is and what makes it work. It's like trying to sensibly discuss the birds and the bees with someone who is unshakable in his belief that babies are delivered by the stork.

People who have never seen what happens to countries with state-controlled economies simply have no standard for comparison.

They have never witnessed the long lines of workers and housewives who have to cue up for hours outside state-owned food and department stores in order to buy a poor selection of over-priced food staples and state-manufactured clothing and merchandise.

They don't realize what a miracle of variety, economy and productive competition the average American shopping center would represent to nine-tenths of the earth's people.

They have never asked themselves why a country like the Sovet Union, with some of the largest, richest tracts of grain-land in the world, but with a government-owned and run agricultural system, cannot even feed its people without turning to American farmers who own their own land, make their own decisions and feed not only our own people, but millions of others as well.

Too often they have been taught to scoff at the very profit and property motives which make our prosperity possible.

They have never had the opportunity to compare the miraculous economic recovery of a free enterprise country like West Germany, to state-controlled East Germany.

They have never lived in countries where the seemingly idealistic dream of a non-profit, propertyless society has turned into a nightmare reality -- where the state and the state alone dictates what kind of education you will receive; whether or not you will be allowed to travel; what kind of job you can have; what you will be paid; what merchandise you can buy with your earnings; where you will live;where you will receive medical treatment; and, ultimately, where you will be buried.

They have not seen first-hand the political and social aftermath in societies where the government has destroyed free enterprise. For the personal rights all Americans cherish -- freedom of worship, freedom of speech and freedom of association -- have never long endured once economic freedom has been destroyed. As Alexander Hamilton warned so long ago, "power over a man's substance amounts to power over his will."

Without the individual profit motive, people simply do not work as hard, produce as much, or bother to come up with as many new improvements. Whether we like it or not, it is an immutable law of human nature.

Unfortunately, like clean air, economic freedom is something most people don't really appreciate until it begins to run out -- and then it is often too late.

So we have reached the point where, although the free enterprise system works, and works better than any other economic system in effect anywhere in the world -- and although it feeds, clothes and houses more people more affluently than any other while serving as the underpinning of our free society -- it is somehow losing the semantic war to an alien philosophy of government control and economic irresponsibility that has never worked but has somehow managed to preserve an aura of idealism and altruism that attracts many young idealists.

Now don't get me wrong. I am not anti-semantic. What I am simply saying is that those of us who believe in the free enterprise system have got to do a better job of getting our story across -- especially to young Americans.

All of these misconceptions would be unimportant if they were not so misleading -- so blatantly phoney. My experience in Washington has convinced me that almost every man and woman in a position of high public trust cares deeply about the well being of our people, especially those who are impoverished or face disadvantages because of their sex or the color of their skin.

The central question is not who cares the most, but rather how we broaden prosperity and reduce human hardship without sacrificing our freedom or destroying the most successful economic system that man has ever known.

I submit to you today that if America continues down the road toward greater governmental spending and greater governmental control over our economy and our lives -- a road that we have been moving steadily down for several decades -- then our children will be robbed of their personal and economic freedoms. And, in the meantime, all of us will be condemned to an economy riddled by chronic inflation and incurable unemployment.

That is really what is at issue underneath the semantics and the misleading labels, and of course young Americans have an even greater stake in the outcome than the rest of us.

Let's look at a few facts about government spending. For most of our history, the Federal Budget stayed somewhere below the $100 billion mark -- usually way below it.

Then, in 1962, we finally hit $100 billion -- and that was only the beginning. Seven years later, the budget broke the $200 billion barrier and then, only four years after that, we hit the $300 billion mark. And now, in our bicentennial year, we have reached the point where the Federal Government is spending $1 billion a day.

The very size of such numbers makes them almost meaningless to the average American. But there are ways of getting the message across. For example: Suppose that on the day Christ was born, a man had been given $1 billion on the condition that he or his heirs spent $1,000 every day, seven days a week. How long would that $1 billion last? Adding it up, I think you'll find that today, almost 2000 years later, the grandchildren would still not have spent the full billion dollars.

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Yet our Federal government is spending $1 billion every single day, and going into debt another $1 billion every week.

And as the Budget grows, the government comes to occupy a more and more dominant role within our society.

In 1930, government spending at all levels -- Federal, state and local -- amounted to about 12 percent of the Gross National Product. Today, because budgets have mushroomed, government accounts for a third of our entire national output. And if recent trends prevail, the government's share of the total economy could reach 60 percent before the end of the century.

For taxpayers, the burden of paying the Government's bills has become so heavy that many are now in open rebellion. In the 1974 general elections, for example, voters across the country turned down some three quarters of all bond issues on the ballot. But we get around this public opposition by voting more Federal spending without increasing taxes.

The result has been a string of Federal Budget deficits that are unparalleled in our history. In 16 of the last 17 years, the budget has been in the red. And now, just when a balanced, healthy economic recovery has begun, the advocates of big spending would have us launch another round of reckless spending and runaway inflation.

It is up to us to stop them.

I wish that there was some way for television cameras to portray this story as vividly as they did the war in Vietnam or the race riots of earlier years. For, while the visual images are less dramatic, the problem is every bit as pressing and important.

But, as the greath 19th century historian Thomas Carlyle once said, political economics is the "dismal science." On the surface, it seems nothing more than a pile of charts and a jumble of numbers so large as to be incomprehensible in everyday terms. To put it mildly, economics seldom makes "sexy" news stories. And yet the economy is the one thing that affects every other aspect of American life -- the food we eat, the quality of our education, our mobility, our freedom of choice in careers, services and merchandise, and our material and personal sense of pride and independence.

The smallest shock to the economy is felt in every limb of the body politic. And that is a big story, if only a graphic, gripping way of telling it could be found.

Consider the case of the Federal debt and its impact. As the debt climbs rapidly upwards, we have to pay higher and higher interest costs on it. But the end of fiscal year 1976 we will have spent $36 billion in interest payments alone.

That's more than we spent in any single year on the war in Vietnam. It's more than a third of our national defense budget. And it is money that could be better spent on needs such as public transportation, health care or any of a dozen worthy purposes.

This heavy borrowing by the government has also aggravated inflation and increased interest rates, creating strains in money and capital markets. This, in turn, affects everyone from the businessman interested in expanding his plant to create new jobs, to the young couple trying to buy their first home without paying an arm and a leg in mortgage interest.

Reckless government spending is the basic cause of inflation, and inflation was the underlying cause of the worst recession our country has experienced in a generation -- a recession we are only now recovering from.

It was inflation that caused a loss in real income and the confidence of consumers, prompting the sharpest drop in consumer spending since World War II. And it was inflation that helped dry up the flow of savings into our thrift institutions, driving up interest rates and causing the housing industry to collapse.

So one of our prime concerns as we proceed with the economic recovery is to avoid another dose of the poison that brought the recession on in the first place -- rampant inflation fed by runaway Federal spending.

But spending isn't the whole problem. There is also the matter of government controls and regulation for, as government spending has grown by leaps and bounds, so too has federal red tape.

Did you realize that government regulatory agencies now exercise direct control over 10 percent of everything bought and sold in the United States and indirect control over almost every other sector of the private economy?

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Did you know that it costs private industry -- and that means each one of us as consumers -- an estimated $18 billion a year just to do the paper work demanded by Federal bureaucrats? Why, the army of regulators on government payrolls -- 100,000 of them -- could fill Cincinnati Gardens, and Union Terminal, three times over.

Some of these regulations are, of course, necessary. But many of them are counter-productive, wasteful, and obsolete, And as President Ford has repeatedly stated, those regulations and regulatory bodies that no longer serve a useful purpose should be abolished before we strangle in our own red tape.

Speaking in 1865, Lincoln said, "I have faith in the people... the danger is in their being misled. Let them know the Truth and the country is safe."

That is what I have been trying to stress here today -- the need to get the truth, the economic facts of life, across to the American people, especially the young American who will lead us in the years ahead.

Given the truth, I am confident that, as always, Americans will rise to the challenge.

And let us never forget this Basic Truth: The source of the vitality of our economy is its private sector. That means individuals like yourselves from many businesses and professions, united in a fellowship of service to your neighbors and your community. It means the "Fortune 500" company and the one-man shop. It means workers, engineers, architects and lawyers and countless others who by their independent efforts and independent decisions cause their great and powerful country to move forward, to prosper and to work wonders.

Those who are part of our mighty private enterprise economy have a crucial role in getting this message across to our fellow Americans. Once given the truth, I am confident that the people of this nation, as always, will rise to the challenge.

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STATEMENT OF JOHN A. BUSHNELL
DEPUTY ASSISTANT SECRETARY FOR DEVELOPING NATIONS
BEFORE THE SUBCOMMITTEE ON OILSEEDS AND RICE
OF THE HOUSE AGRICULTURE COMMITTEE
MARCH 18, 1976 AT 10:00 A.M. EST

Mr. Chairman and members of the Subcommittee, I appreciate this opportunity to testify before you today on international development bank lending for palm oil projects.

The role of the international development banks is to assist the poorer countries to increase efficient, economical production. The banks do not assist new production of items for which market conditions are difficult or are estimated to be difficult at the time of full production. Only economical production for which there are good markets can meet the twin objectives of the banks -- promoting expanded output and incomes and establishing a project which can easily pay the interest and amortization on the loan.

The U.S. Government reviews carefully the potential implications of development bank projects for U.S. producers as well as for U.S. consumers. Of course we suffer from the limitation that no one has a perfect crystal-ball for predicting the future. We supported considerable development bank financing of palm oil -- particularly in the 1971-74 period when fats and oils prices were high. Given the long lead times for these projects, it now appears that they are just coming into production when fats and oil prices are falling. Recently we have been advising the development banks to proceed very cautiously, if at all, with projects which will result in palm oil exports pending the completion of studies which we hope will project accurately the market situation a decade into the future.

I shall divide my presentation into four parts:

-- palm oil in the context of the world market for fats and oils;

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-- the activities of the international development banks in lending for palm oil production;

-- the status of market studies being undertaken within the U.S. Government;

-- the role of the Treasury Department and the National Advisory Council on International Monetary and Financial Policies (NAC) in approving loans of the international development banks.

Palm Oil

The Administration is well aware that increases in foreign palm oil production, partly financed by the international development banks, are causing increasing concern for U.S. producers of competing oils, particularly in the light of recent market developments for fats and oils in general.

In the developing countries that grow palm oil for export , particularly Malaysia and Indonesia, -- countries incidentally with per capita incomes of about $400 and $130, respectively -- an increase in palm oil production was seen in the 1960s and early 1970s' as a primary way to diversify their agricultural economies and to help small landholders who were eking out miserably low incomes on subsistence farms. Rapid increases in demand for palm oil were projected, particularly to meet the need for improved diets in developing countries. Improving economic stability and particularly helping improve rural incomes in Malaysia and Indonesia were high priorities for the U.S. Government because of the political importance of these Asian countries.

In the early 1970s, world demand for fats and oils was increasing and prices were rising. In the 1972-75 period soybean prices increased, on the average, to a level which was 130 percent above the average for the 1960-70 period. In 1975, world market conditions for fats and oils, and most other non-fuel agricultural and mineral commodities, changed markedly and suddenly. The worldwide recession adversely affected the rate of consumption growth. At the same time, the world supply of fats and oils from all sources was increasing rapidly responding to the unusually high prices of the preceding few years.

U.S. palm oil usage in 1975/1976 is expected to increase to 900 million pounds, or 7 percent of domestic U.S. fats and oils consumption. Treasury's preliminary estimate is that imports of palm oil have contributed three to four cents of the 12-15 cent drop in soybean oil prices from the 1974-1975 level of about 31 cents per pound. Most of the remaining price decline is due to a nearly one billion pound increase in availability of soybean oil from 1974/75 levels. The increase in U.S. palm oil imports reflects the tight soybean oil situation in recent years and a change in the historical price relationship between soybean oil and palm oil. For the years 1973-75, the spread between soybean oil and palm oil prices was significantly greater than in previous years. This price spread has now lessened and the substitution of palm oil for soybean oil should be less rapid with a resulting slower growth of imports. As indicated in the attached graph, current soybean oil prices are well below the record highs of the last two years, but they are substantially above prices prevailing in the late 1960's.

We are very acutely aware of the problem of world supply and demand for fats and oils and any new palm oil projects proposed by the international development banks.

The World Bank justified its lending for palm oil projects on the basis of a comprehensive study issued in September, 1973, ("Palm Oil Review and Outlook for Bank Lending"). This study considered the palm oil situation in the context of trends and future prospects of world demand and supply for fats and oils. The study concluded that world demand for fats and oils in general was expected to grow rapidly enough to absorb the prospective increase in output of these commodities as a group in the decade ahead without significant downward pressure on their market prices. It concluded further that demand for all vegetable oils would grow faster than for other fats and oils; the Bank experts felt that a larger share of this demand than in the past would have to be met from palm oil and soybean oil as a result of the slower expected growth in supply of most competing oils. They also concluded that some downward adjustment of the real price of palm oil might be needed because it is not a perfect substitute for other oils. However, as the overall world supply and demand situation for fats and oils in 1980 was expected to be in balance, the fall in the price of palm oil relative to other oils was expected to be moderate, particularly since palm oil accounted for a relatively small share of world production of fats and oils.

According to the World Bank study, the increase in the share of vegetable oils compared with other fats and oils was due to a number of factors which were likely to be felt more in developed than in developing countries. However, future demand for vegetable oils in developing countries was also expected to increase considerably faster in this decade, reflecting the rise in incomes in these countries and the fact that the income elasticity of demand for the oils tend to be relatively high at low income levels. For instance, as a result of the projected slow growth of production in the hitherto main producing countries of Africa, some of these countries were expected to become major importers of palm oil.

Moreover, the World Bank study concluded that due to the gradual shift of consumption in the developed countries away from animal oils and fats and toward products based on vegetable oils, including palm oil, the export demand prospects would remain favorable in the period to 1980 and also in the next decade.

Though prospects of demand for palm oil after 1980 were not analyzed in detail in the World Bank study, if the trends projected to 1980 continue in the first half of the next decade, world demand for vegetable oils will rise faster than demand for all fats and oils combined until 1985.

The World Bank study indicated that, although physical yields were highest in the major producing countries of Asia (Malaysia and Indonesia), investment in palm oil production still remained attractive in some other countries, notably in Africa, given the alternative investment opportunities available to these countries. By investing in palm oil production, the Bank felt it could therefore make a positive contribution to economic development of some African countries.

The Bank study reports that the Food and Agriculture Organization of the United Nations (FAO) generally concurred with the views expressed in World Bank study. The FAO was of the view that there was scope for investment in palm oil projects both to produce limited additional supplies for export and, particularly, to increase supplies for domestic consumption.

Loans for Palm Oil Projects

Over the past decade -- 1965-1975 -- the World Bank (IBRD), the Inter-American Development Bank (IDB), and the Asian Development Bank (ADB) have made 32 loans totaling over $300 million for palm oil production in developing countries. Twenty of these loans have been approved since 1970. A list of the palm oil projects financed by the international development banks is shown in Annex 1. Of course, these development banks make loans for a great many development projects -- in industry, power, transportation and other sectors -- besides agriculture. Since 1970, the amount of loans by these banks for palm oil accounts for only about one percent of their total commitments.

Palm oil is one of the most difficult products to assess in terms of development bank lending because of the very long lead times involved. For most bank projects two or three years are needed to develop the project before bank approval. It then takes about two years from the time a project is approved by the Executive Board until a palm tree is planted. Thereafter, it takes three to five years for the palm trees to begin producing oil. The peak yield period of palm trees occurs around the tenth year following planting. Thus projections of market conditions are needed for many years into the future to deal with such projects. As we have seen over the past five years, the fats and oils market can change very rapidly.

In this connection I would note that projects coming to the boards of the banks last year and this year were generally initiated in 1973 and 1974 when prices for edible oils were unusually high. Moreover, the projects approved in 1974 and 1975 will probably not have an impact on the market until the 1980s. Incidentally only one of the palm oil projects approved in 1975 is expected to result in any substantial exports of palm oil; the projects in Africa will provide palm oil mainly for consumption in the producing country. This is not the case, however, for the projects approved by the international development banks in 1974.

Let me say a word now about the terms of the loans made by the international development banks. In general concessional terms have been extended to support production for the domestic market -- with export production generally financed at close to commercial terms. Half of the loans were made on "soft" terms. The remaining 15 projects were made on "hard" terms. Of the 16 soft loans made, 10 were from IDA with terms of 50 years, including 10 years grace, and a service charge of 0.75 of 1 percent. These loans were made primarily to the African countries. The four loans from the Inter-American Development Bank (IDB) were at interest rates between 1 and 3 percent with terms from 16 to 40 years. These loans were to Ecuador (2), Honduras and Peru, all for domestic consumption. In 1969 and 1971, the Asian Development Bank (ADB) made two loans to Indonesia at 2.5 and 3.0 percent, repayable in 30 and 24-1/2 years, respectively. The remaining 15 loans -- 11 of which were made since 1970 -- were extended on near market terms, mostly by IBRD. Specifically, the rates ranged from 6.25 percent in the mid-to-late 1960s to the present rates of 8.5 percent for IBRD and 8.75 for the ADB with terms of 20 to 25 years.

The most recent palm oil loan, the Gohor Lama Processing Plant in Indonesia, was made for 20 years, with 4 years grace, at 8.75 percent, and the last IBRD loan to Malaysia in 1974, carried an interest rate of 8 percent with repayment over 23 years.

If we use the estimated maximum annual production for each bank-financed project, the total is 1.1 million tons, or about 23 percent of estimated world production in 1980. Approximately one-third, or 11 of the projects, are for domestic consumption. Nevertheless, 72 percent of the production from total bank-financed projects is for export.

At this point, I would like to say a few words about the Administration's general position towards U.S. assistance to the developing countries through the international development banks. The United States is committed to assisting developing countries in their efforts to increase their food production and to raise the standard of living for the very poor in these countries. Palm oil is one of the best crops for some of these countries to produce efficiently for domestic food uses and for earning the foreign exchange to buy goods from us that they need for development. The United States supports assistance to developing countries on both humanitarian and self-interest grounds since we are convinced that increased production is the only long-term solution to the serious food and income problems faced by these countries. Moreover, as countries prosper and their

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effective demand increases, their commercial import requirements rise. The consequent growth of developing countries, we believe, is the best way to increase demand for traditional U.S. exports in a magnitude far greater than any potential initial displacement.

It is with this global view of world supply and demand for edible fats and oils that the palm oil problem should be viewed. We seek open markets in which flows of trade are determined by competitive efficiencies. The importance of this open trading system is crucial to U.S. agriculture, particularly in view of our "full production" policy. In 1974/75, agricultural exports amounted to over $21 billion. More to the point, soybeans and other U.S. oilseeds have been among the largest of our agricultural exports. In FY 1975 soybeans and products surpassed feed grains in total value of exports, amounting to $4.9 billion or nearly 22 percent of total agricultural exports.

Our estimates indicate that bank-financed projects involving palm oil accounted for about 20 percent of the increase in world production from 1970 to 1975 and 16 percent of the export increase for the same period. Palm oil currently accounts for not quite 7 percent of world output of fats and oils and is projected to rise to about 9 percent in 1980. Thus, involvement by these banks in palm oil production represents only a small part -- less than one percent -- of total world production of fats and oils. Palm oil trade sources in Malaysia indicate that the development of the palm oil industry in that country has been accomplished principally with private funds and the World Bank has provided only 7 percent of the required capital.

Future Fats and Oils Prospects and Palm Oil Loans

Forecasting over the medium and long-term, in the case of most commodities including fats and oils, is at best uncertain. Difficult as these forecasts are, however, they are necessary to support objective decisions in the U.S. interest. For this reason we are counting on the USDA study concerning fats and oils now underway to help us in formulating a definitive U.S. position toward palm oil project financing by the international development banks.

Also the Food and Agriculture Organization (FAO) is undertaking a long-term study of the world fats and oils situation. Completion of this study is not expected until early 1977. When completed, the FAO study should be helpful in providing the banks with another appraisal of the demand and supply outlook for fats and oils well into the 1980's. The World Bank, on its part, is updating its study on the outlook for fats and oils. This study will be completed in July.

The current World Bank list of prospective projects includes six proposals involving palm oil, and the Asian Development Bank (ADB) is now considering two. Of these, eight projects only one or two are likely to be ready for consideration by the IBRD or ADB Boards before the USDA's report and the interagency review have been completed.

The USDA's report and conclusions will be the basis for a thorough interagency review of the U.S. Government position on any palm oil projects proposed by the international development banks. A working group of the National Advisory Council has already been established to consider such projects. As President Ford mentioned in his recent visit to Illinois, this is also a matter tnat is being considered at the very highest level in the Executive Branch.

I believe that there is substantial evidence that there will be oversupply in the fats and oils market through 1980, despite growing demand, and for this reason the development banks should back away from new projects for palm oil exports. I have asked our Executive Directors in the banks to work with their managements to find alternative products and alternative projects for development bank financing. In one case a development bank has already substituted other products for palm oil in an agriculture development project. If alternatives are not possible, we are asking the banks to delay consideration of new palm oil projects until the long-term market studies are completed.

We would of course examine carefully any palm oil project that might come to the board of a development bank before these studies are completed. At this point, we in Treasury would tend to go along with projects which are solely or principally to supply a domestic market, particularly if increased availability of palm oil would raise nutrition levels. We would not support projects that were principally for export.

The development banks are multilateral institutions and do not necessarily respond to the wishes of a single member - even the largest single member. Thus, on issues such as the advisability of financing additional palm oil production we proceed largely by convincing the staffs of the banks and experts of other countries that our position is correct. No organization in the world has a better reputation for its ability to analyze commodity markets than the U.S. Department of Agriculture and all the banks pay very close attention to the Department's views. However, they have their own commodity experts, they maintain close contact with the FAO, and they consult with commodity experts of other governments. Thus, it is important for us to lay out clearly our analysis and our projections in order to make a case.

As you have heard, Agriculture is now preparing such a study. I am sure we shall convince these banks to halt lending for palm oil if our analytical case is strong. Some time is usually needed to develop a worldwide consensus on such issues, but such a consensus does develop. I would note that it is not in the interest of present palm oil producers to have the banks lend for substantial additional export production unless the market is strong. Nor is it in the interest of the banks to make new loans that might convert old loans into bad projects by reducing the price of the export product.

As we look further ahead, there are a number of questions which we have not yet analyzed in detail in Treasury which are relevant to the palm oil question. I do not know the relative economies of production of palm oil as compared with soybean oil production. This is a very complicated question depending in considerable part on the market for other soybean products as well as on such things as the exchange rate systems of the palm oil producing countries. There is a school of thought that, because palm oil can be produced economically in some parts of the world, its production will continue growing and it will take an increasing share of the fats and oils market. The basic issue will require a great deal more analysis and consideration before a convincing argument -- one way or the other -- can be made. I can assure you that we shall be devoting considerable attention to this analysis in the U.S. Government.

Role of Treasury and the NAC

I want to emphasize that all resources of the U.S. Government are coordinated in taking a position on development policies of loans. The National Advisory Council on International Monetary and Financial Policies (NAC) is the interagency group responsibile for coordinating U.S. participation in the international financial institutions.

I have attached as Annex II a description of the role of the NAC in reviewing the proposed loans of the international development banks. I want to stress that in reviewing agricultural loan projects the NAC draws heavily on the Department of Agriculture for advice on the world demand and supply situation and the impact of proposed loans on U.S. producers. I want to reiterate that the NAC does not support projects aimed at increasing production of commodities where the outlook is for surpluses and depressed prices. But it does encourage loans for agricultural projects that assist small farmers and those that increase production of food for domestic consumption in the developing countries.

In summary, Mr. Chairman, we fully recognize that the international development banks have financed a considerable expansion of palm oil production. However, the major issue is not what has already been financed but what will be financed in the future. We are very much aware that estimates of the future supply and demand situation for palm oil, soybean oil and other fats and oils require careful attention. We will make our studies available to the development banks as soon as they are completed. In the meantime, we are discouraging new loans for palm oil production destined for export.

Thank you, Mr. Chairman.

U.S. SOYBEAN OIL PRICES

Production and Exports of Palm Oil
Financed by IFI Projects
1965 - 1975

ANNEX I

Date	Country	IFI	Purpose	Loan ($ Millions)	Loan Amount for Palm Oil ($ Millions)	Peak Annual Oil Production (MT) 1/	Oil Exports (MT)	Peak Annual Kernel Production (MT) 1/	Kernel Exports (MT)
11/6/75	Indonesia	ADB (OC)	Processing	11.3	11.3	25000	25000	5000	--
6/17/75	Nigeria	IBRD	Smallholder Development	17.0	17.0	25300	--	5800	5800
6/17/75	Nigeria	IBRD	Smallholder Development	19.0	19.0	35200	--	8000	8000
6/17/75	Nigeria	IBRD	Smallholder Development and Estates	29.5	29.5	38400	--	8700	8700
4/29/75	Sierra Leone	IBRD/ IDA	Groundnuts, Cocoa, Palm Oil	5.0 5.0	2.5	3200	--	800	800
2/18/75	Ghana	IDA	Plantation & Mill	13.6	13.6	14000	--	3000	3000
9/17/74	Malaysia	IBRD	Planting & 2 Mills	36.0	32.4	90000	90000	17000	--
8/1/74	Malaysia	ADB (OC)	Production, Mills & Storage	14.0	14.0	120000	120000	--	--
6/27/74	Ivory Coast	IBRD	Plantations & Estates	2.6	2.6	30800	30800	6300	6300
2/5/74	Malaysia	IBRD	Production & 5 Mills	40.0	34.8	123500	123500	24800	24800
12/1/73	Ecuador	IDB (FSO)	Livestock & Palm Oil	15.0	3.3	18800	--	3800	--
3/13/73	Malaysia	IBRD	Planting & Mill, Rubber, Cocoa	25.0	14.5	49000	49000	10000	10000
2/6/73	Indonesia	IDA	Oil Palms, Rice & Rubber	5.0	0.4	5400	5400	1100	1100
6/22/72	Indonesia	IDA	Oil Palms, Processing, & Rubber	11.0	8.3	38500	2/	7200	2/
6/20/72	Sierra Leone	IDA	Oil Palms, Rice & Cocoa	4.3	1.9	4300	--	900	900
6/1/72	Ivory Coast	IBRD	Oil Palms, Mill & Coconut	7.0	2.6	9900	9900	2400	2400
3/25/71	Indonesia	ADB (SF)	Oil Palm & Rubber	7.4	2.8	29900	29900	6000	6000
5/20/70	Malaysia	IBRD	Production & Processing	13.0	8.6	33000	33000	8200	8200
6/15/70	Indonesia	IDA	Oil Palms & Rubber	17.0	13.2	42000	32600	10200	7900
1/30/70	Papua New Guinea	IDA	Palm Oil, Beef & Coconuts	5.0	2.2	14400	14400	2200	2200
10/21/69	Indonesia	ADB (SF)	Production & Mills	2.4	2.4	26800	21400	5100	4100
6/20/69	Indonesia	IDA	Planting	16.0	12.7	68500	53100	17800	13800
6/13/69	Ivory Coast	IBRD	Oil Palms, Mill & Coconuts	17.1	14.1	39000	21500	9400	5200
4/15/69	Cameroon 3/	IBRD	Production & 2 Mills	9.6	9.6	25500	--	6000	--
3/27/69	Honduras	IDB (FSO)	Production	7.7	1.5	3000	--	--	--
3/20/69	Ecuador	IDB (FSO)	Production	6.0	2.4	11000	--	--	--
3/5/69	Benin 3/	IDA	Production & Forestry	5.2	4.2	10100	10100	2400	2400
2/11/69	Malaysia	ADB (OC)	2 Mills	2.8	2.8	77000	77000	19300	19300
1/21/69	Papua New Guinea	IDA	Production	1.5	1.5	8500	8500	1400	1400
4/17/68	Malaysia	IBRD	Oil Palms & Resettlement	14.0	9.5	57000	57000	14000	14000
3/28/67	Cameroon	IDA	Production	11.0	9.0	22400	6700	7100	2100
5/26/66	Peru	IDB (FSO)	Production	15.0	0.8	2000	--	--	--
	TOTALS			411.0	305.0	1101400	788900	207900	152400

1/ Production during year of maximum production

2/ Not estimated separately

3/ Includes supplemental loans

Source : OIDB: Department of Treasury

ROLE OF THE NATIONAL ADVISORY COUNCIL ON INTERNATIONAL MONETARY AND FINANCIAL POLICIES VIS-A-VIS THE INTERNATIONAL DEVELOPMENT BANKS

The National Advisory Council on International Monetary and Financial Policies (NAC), which was established by the Bretton Woods Agreements Act July 31, 1945, is responsible for coordinating U.S. participation in the international financial institutions, as well as the policies and practices of all agencies of the Government which make, or participate in making, foreign loans, or which engage in foreign financial, exchange, or monetary transactions. In fulfilling these responsibilities the NAC reviews proposed loans and credits of the World Bank Group, the Asian Development Bank (ADB) and the Inter-American Development Bank (IDB) with a view to recommending to the Secretary of the Treasury instructions to the U.S. Executive Directors in those institutions which the NAC member agencies consider appropriate. This process of coordinated review is followed in connection with all of the proposed transactions of these institutions, whether these involve construction of power plants, highway improvements or the financing of projects designed to develop, or increase the production and processing of agricultural products, including palm oil.

NAC review is initiated, generally speaking, upon receipt of a detailed proposal from the World Bank or one of the other international development financing institutions. These proposals are then carefully reviewed as to their merits and consistency with both U.S. and Board policies, by the NAC Staff Committee, which meets regularly every Tuesday afternoon. Representatives of the NAC member agencies and other interested agencies of the U.S. Government bring to bear economic, political, financial and other technical expertise during the Staff Committee meeting. Specifically, in the case of agricultural projects, representatives of the Agriculture Department regularly participated in the NAC Staff Committee meetings and are given full opportunity to present that Department's views on such projects for the consideration of the NAC.

The recommendations of the NAC on loan proposals are, after Staff Committee review and subsequent reference to policy level officials of the NAC member agencies, embodied in documents known as Actions. The member agencies, votes for each proposal are cast on the basis of those agencies' evaluations of all of the relevant factors pertaining to the proposal being considered, including such elements as foreign policy considerations, consistency with international institution lending policies, and the economic viability and intrinsic merits of the proposal. NAC Actions approved as a consequence of this review and voting process typically state "The NAC advises the Secretary of the Treasury that it recommends the U.S. Executive Director in the World Bank (or other institution) take affirmative (negative or abstaining) action on the proposal to finance a project involving..."

Upon receipt of the NAC's advice on given transactions, the Secretary of the Treasury then instructs the U.S. Executive Director in the International Financial Institution as to how he should deal with a proposal in that institution's board. In this connection, I would like to mention that authority to instruct the U.S. representatives in the international institutions, which was previously vested in the National Advisory Council under the Bretton Woods Agreement Act, was delegated to the Secretary of the Treasury under the provisions of Executive Order 11269 of February 14, 1966, which was the Executive Order reconstituting the NAC after its abolition as a statutory body in 1965.

Members of the Committee may find it useful to refer, in this connection, to Appendix A of the fiscal 1975 Annual Report of the NAC to the President and to the Congress (House Document 94-348) for fiscal 1975, where the activities of the Council are described in more detail.

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FOR IMMEDIATE RELEASE March 18, 1976

PATRICIA ANN METZER
APPOINTED ASSOCIATE TAX LEGISLATIVE COUNSEL

Secretary of the Treasury William E. Simon today announced the appointment of Patricia Ann Metzer as Associate Tax Legislative Counsel for the Treasury Department.

Miss Metzer, 35, will work with the Tax Legislative Counsel, Dale S. Collinson, in providing assistance and advice on matters of tax policy to the Assistant Secretary of the Treasury for Tax Policy, Charles M. Walker. Miss Metzer's appointment became effective on January 21, 1976.

Prior to joining the Treasury Department, Miss Metzer was a partner in the Boston law firm of Mintz, Levin, Cohn, Glovsky, and Popeo, where she was an associate from 1966 to 1972.

Miss Metzer is a graduate of the University of Pennsylvania College for Women (B.A. with distinction, 1962) and the University of Pennsylvania Law School (LL.B., cum laude, 1966). She is a member of the sections on taxation of the American Bar Association and the Boston Bar Association, and has lectured at numerous programs on the subject of taxation, including programs sponsored by the American Law Institute, the New York University Institute on Federal Taxation, the Federal Tax Institute of New England, the New England Law Institute, and the Boston University Institute on Federal Taxation. She has also taught at Boston College Law School on the subject of tax problems in general practice.

Miss Metzer's articles have appeared in the University of Pennsylvania Law Review, Tax Law Review, Taxes and the Journal of Taxation. She has also published numerous outlines in connection with her appearances on continuing legal education programs.

Miss Metzer currently resides in Washington, D.C.

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FOR IMMEDIATE RELEASE March 18, 1976

RESULTS OF AUCTION OF 2-YEAR TREASURY NOTES

The Treasury has accepted $3.0 billion, including $0.1 billion from Government accounts and Federal Reserve Banks for their own account, of the $4.9 billion of tenders received for the 2-year notes, Series K-1978, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	6.71% 1/
Highest yield	6.80%
Average yield	6.76%

The interest rate on the notes will be 6-3/4%. At the 6-3/4% rate, the above yields result in the following prices:

Low-yield price	100.074
High-yield price	99.908
Average-yield price	99.982

The $3.0 billion of accepted tenders includes 10% of the amount of notes bid for at the highest yield and $0.7 billion of noncompetitive tenders from the public accepted at the average yield.

In addition, $0.1 billion of tenders were accepted at the average-yield price from foreign and international monetary authorities.

1/Excepting 3 tenders totaling $290,000

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federal financing bank NEWS
WASHINGTON, D.C. 20220
Press inquiries: 202-964-2615

FOR IMMEDIATE RELEASE

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SUMMARY OF LENDING ACTIVITY

March 1 - March 15, 1976

Federal Financing Bank lending activity for the period March 1 through March 15, 1976 was announced by Roland H. Cook, Secretary:

The Federal Financing Bank made the following advances to borrowers guaranteed by the Department of Defense under the Foreign Military Sales Act:

Date	Borrower	Amount	Maturity	Interest Rate
3/1	Government of Brazil	$ 1,445,804.34	10/1/83	7.629%
3/10	Government of Argentina	1,250,243.66	4/30/83	7.662%
3/11	Government of Israel	20,173,963.13	6/10/85	7.727%
3/11	Government of Morocco	1,245,450.00	6/30/83	7.606%
3/12	Government of Morocco	1,105,480.00	6/30/83	7.663%
3/12	Government of Uruguay	800,000.00	6/30/83	7.698%

The FFB purchased from the Secretary of the Treasury the following loans made to New York City under the New York City Seasonal Financing Act of 1975:

Date	Face Amount (Millions)	Face Rate	Maturity	Purchase Price	Rate of Return to FFB
3/1	$250	6.39%	6/30/76	$250,712,151.26	5.515%
3/15	70	6.33%	6/30/76	70,176,728.66	5.455%

The notes were purchased with the right of recourse against the Secretary of the Treasury.

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The FFB made the following loans to utility companies guaranteed by the Rural Electrification Administration:

Date	Borrower	Amount	Maturity	Interest Rate
3/1	East Ascension Telephone Co.	$ 300,000	3/1/78	6.945%
3/1	Arizona Electric Power Coop, Inc.	3,625,000	12/31/10	8.147%
3/2	Oglethorpe Electric Membership Corp.	2,518,000	12/31/10	8.228%
3/4	Alabama Electric Coop, Inc.	4,463,000	12/31/10	8.195%
3/5	North West Telephone Co.	802,284	12/31/10	8.213%
3/5	Tri-State Generation & Transmission Association	5,625,000	12/31/10	8.213%
3/10	Colorado-Ute Electric Association	4,000,000	12/31/10	8.153%
3/15	United Power Association	3,500,000	12/31/10	8.119%

Interest payments are made quarterly on the above REA loans.

On March 5, the General Services Administration borrowed $154,515 under the Series M $279 million commitment with the Bank. The interest rate is 8.324%. The loan matures July 31, 2003.

On March 11, GSA borrowed $660,743.28 under the Series L $107 million commitment with the Bank. The interest rate is 8.247%. The loan matures November 15, 2004.

On March 8, the U.S. Railway Association borrowed $15 million against its $91 million line of credit with the Bank. The interest rate is 5.381%. The loan matures April 1, 1976.

The U.S. Railway Association made the following drawings against Note No. 3, a $296.5 million renewable line of credit with the Bank:

Date	Amount	Maturity	Interest Rate
3/10	$3,000,000	4/1/76	5.259%
3/15	1,000,000	4/1/76	5.142%

On March 15, the U.S. Railway Association signed Note #6 with the Bank. The note allows USRA to borrow up to $23 million in calendar year 1976. The Association will loan the funds to the Delaware and Hudson River Railway Company under section 211 (a) of the Regional Rail Reorganization Act of 1973. Principal is payable in semiannual installments of $1,150,000 on June 26 and December 26 of each year commencing on June 26, 1981. The final maturity of the loan is December 26, 1990. The interest rate for all advances under this note is 8.055%. USRA borrowed $4.2 million on March 15.

USRA borrowings from the FFB are guaranteed by the Department of Transportation.

On March 9, the Bank purchased $7,439,000 of notes from the Department of Health, Education and Welfare. The Department had previously acquired the notes which were issued by various public agencies under the Medical Facilities Loan Program. The notes purchased by the FFB are guaranteed by HEW and mature on July 1, 2000. The interest rate is 8.104%.

On March 12, the Tennessee Valley Authority borrowed $30 million at an interest rate of 5.39%. The note matures on June 30, 1976.

On March 15, the National Railroad Passenger Corporation (Amtrak) made the following drawings from the FFB:

Note No.	Amount	Maturity	Interest Rate
4	$ 250,000	3/31/76	5.183%
6	3,000,000	3/30/76	5.183%
7	16,000,000	6/14/76	5.183%

Amtrak borrowings from the FFB are guaranteed by the Department of Transportation.

On March 1 the Export Import Bank borrowed $568 million from the FFB at an interest rate of 7.515%. The loan matures June 1, 1979. Proceeds of the loan were used to pay $337 million in principal and $88 million in interest to the FFB and to repay borrowings from the Secretary of the Treasury.

Federal Financing Bank loans outstanding on March 15, 1976 totalled $20.9 billion.

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FOR IMMEDIATE RELEASE
MARCH 19, 1976
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A report by the U. S. Treasury Department's Office of Revenue Sharing on fiscal year 1975 expenditures of general revenue sharing funds, released today, shows that 35,128 states and local governments spent or otherwise obligated a total of $7.185 billion in shared revenues between July 1, 1974 and June 30, 1975.

This amount included some money from revenue sharing payments received earlier, plus accumulated interest. Interest earned on revenue sharing funds during the year amounted to approximately $367 million.

Revenue sharing law (The State and Local Fiscal Assistance Act of 1972, P.L. 92-512) requires that general revenue sharing funds be obligated or expended within two years from the end of the period for which the funds were received. The law specifies the dates of the periods for which funds are to be allocated and paid.

Of each revenue sharing dollar spent during fiscal year 1975,

-- 24 cents were spent for public safety (especially police and fire protection)
-- 22 cents were spent in support of public education. (State governments, alone, spent 60%, or $1.51 billion of their revenue sharing funds for education.)

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-- 13 cents were spent for public transportation facilities and systems
-- 9 cents were devoted to general government expenditures
-- 7 cents were earmarked for environmental protection (pollution control and sanitation services, especially)
-- 7 cents went to support health programs and facilities
-- 5 cents were spent for recreation and cultural programs (acquisition of park land, construction of public recreation facilities and similar projects, for example)
-- 2 cents went directly into programs which provided social services exclusively for the poor or aged. Money spent in other categories often directly benefits the aged and poor, as well. For example, provision of special bus services or subsidy of public transportation fares for the elderly may be considered by some recipient governments as "public transportation" expenditures.
-- 2 cents were spent in financial administration
-- and the remainder supported a variety of programs and activities relating to housing, provision of library services, social and economic development and others.

More money was spent during fiscal year 1975 to operate and maintain programs than was spent on capital projects, continuing a trend which began during fiscal year 1974.

Most governments reported that general revenue sharing money had helped to prevent tax increases or new taxes or to maintain taxes at their current levels. Fewer recipient governments indicated that the money had enabled them to reduce taxes during fiscal year 1975 than had so indicated for the previous year.

Revenue sharing law authorizes the distribution of $30.2 billion from 1972 through December 31, 1976. President Ford has asked the Congress to extend general revenue sharing.

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STATEMENT OF THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE THE HOUSE WAYS AND MEANS COMMITTEE
MONDAY, MARCH 22, 1976 at 9:30 a.m.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to present to you the Administration's position on the major issues of estate and gift tax revision you will be addressing during the coming weeks.

Except for the introduction of the marital deduction in 1948, the basic structure of the estate and gift taxes has remained fundamentally unchanged since 1932. The present estate and gift tax rates were adopted in 1941, and the estate and gift tax exemptions were last changed in 1942. A complete reexamination of the estate and gift taxes is, thus, long overdue, and we look forward to cooperating with you in this undertaking.

Objectives of estate and gift taxation.

Before discussing specific issues, I would like to set forth some general considerations underlying the estate and gift taxes.

Historically, the estate and gift taxes were prompted primarily by a desire to raise revenue. They were raised in wartime or periods of economic depression, when governmental needs for revenue were most intense. Once the immediate emergency was past, estate and gift taxes were lowered again or were eliminated. And even the maximum rates were relatively low by present standards; the top estate tax rate during the 1920's was 25 percent (a 40 percent top rate was enacted in 1924 but was retroactively repealed in 1926).

But the emphasis of estate and gift taxation gradually shifted during the 20's and 30's amid increasing social concern over unreasonable accumulations of wealth. This development culminated in 1941, with the enactment of the present estate tax rate structure that rises from three percent on the first $5,000 of taxable estate to 77 percent

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on taxable estate in excess of $10,000,000. Since then, a major effect of the estate and gift taxes has been to prevent or moderate the unreasonable accumulation of wealth and its transmission from generation to generation. At the same time, the importance of estate and gift taxes to Federal revenues has progressively diminished, so that these taxes now produce less than 2 percent of Federal revenues.

Until recent years, the estate and gift taxes did not affect a large segment of taxpayers. The limited impact of the taxes was consistent with their role as devices to restrain the undue accumulation of wealth. Thus, the annual number of estate tax returns filed during the period 1923-1945 never exceeded 18,000. 1938 was the peak year, with 17,642 returns; and 1932 was the low point, with 8,507 returns. This meant that the percentage of estates filing estate tax returns during the period varied between approximately two thirds of one percent and one and one quarter percent (0.65-1.25%).

During the thirty years since 1945, the situation has changed dramatically. In 1975, approximately 216,000 estates, or 11.2 percent of all estates, filed estate tax returns. Approximately 150,000 estates, or 7.7 percent of estates, paid estate tax. This development is summarized in the following table:

Year	Deaths in Preceding Year	Estate Tax Returns Filed	Percentage of Estates Filing	Taxable Returns	Percentage of Estates Taxable
1945	1,411,338	16,550	1.2	14,521	1.0
1950	1,443,607	27,144	1.9	18,697	1.3
1955	1,481,091	36,595	2.5	25,143	1.7
1959	1,647,886	55,685	3.4	38,515	2.3
1963	1,756,720	78,393	4.5	55,207	3.1
1966	1,828,136	97,339	5.3	67,404	3.7
1970	1,922,000	133,944	7.0	93,424	4.9
1973	1,964,000	174,899	8.9	120,761	6.1
1975	1,936,000	215,918	11.2	150,000**	7.7

* Fiscal year ending June 30, 1975.
** Estimated.

In brief, the past 30 years have seen a ten-fold increase in the impact of the estate tax in terms of the percentage of estates affected. No longer does the tax impact principally on the relatively larger estates. Rather the estate tax has shifted to a more broadly-based tax on the private capital accumulations of more moderate estates. It is, thus, time to reexamine whether the existing estate tax structure is harmonious with the basic objectives of the estate tax.

It should be emphasized that the question is not whether the wealthy should pay taxes. Obviously, an individual should surely count himself fortunate to be among the 8 or 10 percent most wealthy. And such individuals are rightly held accountable by our progressive tax system for defraying a greater share of the costs of government.

Rather, the question is what combination of income taxes and estate and gift taxes is most appropriate for ensuring the desired degree of progressivity in our tax system. From this standpoint, I would urge the Committee to emphasize that the estate tax has the limited function of restraining the undue accummulation of wealth. It should not be viewed as a device to raise revenue nor to achieve progressivity in the tax system, per se. Rather we should rely primarily on the progressive income tax for the orderly collection of revenues from the income stream as it is generated. It is inappropriate, therefore, to continue down the present path to a broad-based estate tax that imposes heavy burdens on moderate estates at a time when financial demands on the widow and children of a decedent may be most heavy and when the chief revenue producer has been lost to the family.

Estate and Gift Tax Exemptions and Rates

As should be evident from the preceding discussion, the most pressing single issue of estate and gift taxation today is whether, and how much, to increase the estate tax exemption.

The estate tax has reached out to more and more estates in part because of an increase in average real family wealth. But the widening impact of the estate tax is also attributable in large part to inflation. Adjusting the $60,000 estate tax exemption for inflation since 1942 would require an estate tax exemption of $210,000. While a person with a $60,000 estate in 1942 could leave it to his family without tax, today an individual must have an estate of $260,000, on which an estate tax of $50,700 will be levied, in order to leave the equivalent amount, $210,000, to his family.

We believe that an increase in the estate tax exemption is clearly warranted. Indeed, such an increase is essential if the estate tax is to be returned to its historic role as an excise on the transfer of relatively larger wealth accumulations. At the same time we cannot ignore the significant revenue consequences that would result from increasing the estate tax exemption. Thus, we recommend that the estate tax exemption be increased to $150,000 over a 5-year transition period and that the lower bracket estate tax rates on the first $90,000 of taxable estate be eliminated. Limiting the increase to $150,000 (with the proposed rate changes) will permit the revenue loss to be held to an acceptable amount, which can be absorbed gradually during the phase in period.

We are not recommending any change in the gift tax exemption or rates. In general, it is only those persons with relatively large estates who make substantial lifetime gifts. Individuals with an estate of $250,000 to $500,000 are unlikely to exceed the present $30,000 lifetime exemption and there is less pressing need for an increased gift tax exemption than for an increased estate tax exemption.

While the proposal to eliminate the lower estate tax rate brackets is prompted in part by revenue considerations, it will also achieve a needed simplification and restructuring of the present estate tax rates, which are set out in Table I below.

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TABLE I

Estate Tax Rates

Taxable net estate (or taxable gifts):	Present Estate Tax Rates (percent)
0 to $5,000	3
$5,000 to $10,000	7
$10,000 to $20,000	11
$20,000 to $30,000	14
$30,000 to $40,000	18
$40,000 to $50,000	22
$50,000 to $60,000	25
$60,000 to $100,000	28
$100,000 to $250,000	30
$250,000 to $500,000	32
$500,000 to $750,000	35
$750,000 to $1,000,000	37
$1,000,000 to $1,250,000	39
$1,250,000 to $1,500,000	42
$1,500,000 to $2,000,000	45
$2,000,000 to $2,500,000	49
$2,500,000 to $3,000,000	53
$3,000,000 to $3,500,000	56
$3,500,000 to $4,000,000	59
$4,000,000 to $5,000,000	63
$5,000,000 to $6,000,000	67
$6,000,000 to $7,000,000	70
$7,000,000 to $8,000,000	73
$8,000,000 to $10,000,000	76
$10,000,000 and over	77

As can readily be observed, the lower estate tax rates are in a sense illusory. Thus, the beginning rate is 3 percent for the first $5,000 of taxable estate, but the lower rate brackets are so narrow that the marginal rate quickly reaches 25 percent at $50-$60,000 of taxable estate.

Thereafter, the rate progression slows dramatically. Once an adequate exemption is provided, the lower rate brackets should simply be eliminated. This will mean a higher initial rate but a smoother rate progression. The proposed estate tax rates are set out in Table II below. Table III illustrates the effect of the exemption and rate changes on estates of varying sizes.

TABLE II

	Proposed Estate Tax Rates (percent)
$0 to $100,000	30
$100,000 to $250,000	32
$250,000 to $500,000	34
$500,000 to $750,000	36
$750,000 to $,000,000	38
$1,000,000 to $1,250,000	41
$1,250,000 to $1,500,000	44
$1,500,000 to $2,000,000	47
$2,000,000 to $2,500,000	50
$2,500,000 to $3,000,000	54
$3,000,000 to $3,500,000	57
$3,500,000 to $4,000,000	60
$4,000,000 to $5,000,000	64
$5,000,000 to $6,000,000	67
$6,000,000 to $7,000,000	70
$7,000,000 to $8,000,000	73
$8,000,000 to $10,000,000	76
$10,000,000 & over	77

Table III

ESTATE TAX BURDENS

(Exemption Only; No Credits Or Deductions From Adjusted Gross Estate)

Adjusted Gross Estate	Current Law: Taxable Estate	Current Law: Tax Burden	Proposed Law: Taxable Estate	Proposed Law: Tax Burden	Change in Tax Burden	Percentage Change in Tax Burden
$ 60,000.	$ 0.	$ 0.	$ 0.	$ 0.	$ 0	----
100,000.	40,000.	4,800.	0.	0.	- 4,800	-100.0
250,000.	190,000.	47,700.	100,000.	30,000.	- 17,700	- 37.1
500,000.	440,000.	126,500.	350,000.	112,000.	- 14,500	- 11.5
750,000.	690,000.	212,200.	600,000.	199,000.	- 13,200	- 6.2
1,000,000.	940,000.	303,500.	850,000.	291,000.	- 12,500	- 4.1
1,250,000.	1,190,000.	399,800.	1,100,000.	389,000.	- 10,800	- 2.7
1,500,000.	1,440,000.	503,000.	1,350,000.	494,500.	- 8,500	- 1.7
2,000,000.	1,940,000.	726,200.	1,850,000.	725,000.	- 1,200	- 0.2
2,500,000.	2,440,000.	968,800.	2,350,000.	970,500.	+ 1,700	+ 0.2
3,000,000.	2,940,000.	1,231,400.	2,850,000.	1,234,500.	+ 3,100	+ 0.3
3,500,000.	3,440,000.	1,509,600.	3,350,000.	1,515,000.	+ 5,400	+ 0.4
4,000,000.	3,940,000.	1,802,800.	3,850,000.	1,810,500.	+ 7,700	+ 0.4
5,000,000.	4,940,000.	2,430,400.	4,850,000.	2,444,500.	+ 14,100	+ 0.6
6,000,000.	5,940,000.	3,098,000.	5,850,000.	3,110,000.	+ 12,000	+ 0.4
7,000,000.	6,940,000.	3,796,200.	6,850,000.	3,805,500.	+ 9,300	+ 0.2
8,000,000.	7,940,000.	4,524,400.	7,850,000.	4,531,000.	+ 6,600	+ 0.1
10,000,000.	9,940,000.	6,042,600.	9,850,000.	6,046,500.	+ 3,900	+ 0.1

Office of the Secretary of the Treasury
Office of Tax Analysis

March 16, 1976

Liberalized Payment Provisions For Family Farms And Businesses.

An issue on which attention has increasingly focused concerns the provisions for installment payment of estate taxes.

Inflation has had a particularly serious impact upon the family farm or business. Property values have risen dramatically with the result that owners have been faced with higher estate taxes. This has created a greater need for liquidity than is faced by many other taxpayers, because family farms or businesses generally tend to represent a significant portion of the owners' estates in terms of dollar values. Therefore, many families have found it necessary to sell the family farm or business to obtain cash to pay Federal estate taxes.

These liquidity problems will be alleviated by the adoption of the proposed increase in the estate tax exemption, but they will still exist for estates over $150,000.

To meet the specific liquidity problems of family farms and small businesses, the Administration has proposed a change in the present provisions for 10-year installment payments of estate tax to make it easier to continue the family ownership of a small farm or business following a substantial owner's death. In summary fashion, the details are as follows:

-- At the estate's option, a 5-year moratorium will apply to payment of that portion of the tax liability attributable to an ownership interest in a family farm or other closely-held business qualifying for 10-year installment payments under present section 6166 of the Internal Revenue Code. No interest will accrue during the 5-year moratorium period and no principal or interest payments will be required during that period.

-- At the end of the 5-year period, the deferred tax will, at the estate's option, be payable in equal annual installments over the next 20 years.

-- Interest on the installments will be reduced to 4 percent per annum from the 7 percent rate generally applicable to deferred tax payments.

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-- The 5-year moratorium and 20-year extended payment provisions will apply only to the estate tax liability attributable to the first $300,000 in value of the family farm or business. Between $300,000 and $600,000 there will be a dollar-for-dollar reduction in the value of the farm or business qualifying for the moratorium and extended payment provisions. That portion of the tax not qualifying will continue to be subject to 10-year installment payments with the 7 percent interest rate.

We believe that enactment of the Administration's proposals would be a positive and essential step toward ensuring the survival of small farms and businesses for future generations.

Marital Deduction

Let me turn now to the question of liberalizing the estate and gift tax marital deduction provisions.

The marital deduction was introduced in 1948 to equalize the estate and gift tax treatment of couples in common law property States with that of couples in community property States. The property of community property couples is, in general, split 50-50 between the spouses by operation of law without imposition of estate or gift taxes; and the objective of the marital deduction provisions was to provide equivalent tax treatment for common law property couples.

Under the gift tax, a marital deduction may be claimed for one-half the amount transferred to a spouse. Under the estate tax, a marital deduction may be claimed for up to one-half of the adjusted gross estate (gross estate less administrative expenses of the estate, debts of the decedent, and the value of any community property included in the estate). Under both the estate tax and the gift tax, transfers of certain "terminable interests" are nondeductible; the deduction is generally limited to gifts of outright ownership and gifts that will result in the transferred property being included in the estate of the surviving spouse.

The present marital deduction provisions are subject to criticism on several grounds.

First, under the existing provisions it is still not possible for couples in common law property States to obtain a tax-free division of their property in all cases. Whereas the community property laws operate automatically to split the spouses' property between two estates, the estate tax marital deduction may be utilized to split a family's wealth accumulation only in the event the wealthier spouse dies first. And the division of property may not be accomplished free of tax during life, since the gift tax marital deduction equals only one-half of the property transferred.

Secondly, many families rightfully regard their property as being generated by their combined efforts and, thus, "ours" rather than "his" and "hers" (this is likely to be particularly true of checking and savings accounts, stocks registered in joint names, and the family residence). As a result, they often transfer property from separate ownership, to joint ownership or community ownership without paying much attention to the legal change in ownership. There is a serious question whether it is appropriate to tax such transfers that are basically just incidents in the common management of the family's pooled resources.

Finally, the present 50 percent deduction has created complicated administrative problems for many estates. In some estates, tax savings may be achieved through use of a marital gift provision precisely limited to exactly 50 percent of the adjusted gross estate. Since the exact amount of the adjusted gross estate cannot be predicted when a will is drawn, will draftsmen have resorted to formula provisions which have increased the administrative problems of executors and have required fiduciary accounting which is a mystery to widows and children.

We recommend the adoption of a free interspousal transfer rule, or unlimited marital deduction, under which all transfers between spouses would be completely excluded from the estate and gift taxes. Such a rule best comports with the way most couples manage their property and would substantailly simplify the estate tax law and the administration of estates.

We estimate that this unlimited marital deduction, when fully effective, will reduce Federal estate and gift tax revenues by $500 million annually, if adopted in combination with the proposed $150,000 estate tax exemption, and $700 million annually if combined with the present $60,000 estate tax exemption. This is obviously a major sum in terms of the total Federal budget, and the loss ought ideally to be phased-in gradually over a period of years. In practice, however, such a phase-in is not feasible because the initial steps in liberalizing the deduction produce the greatest portion of the total revenue loss. For example, a minimum marital deduction of $100,000 plus one-half of the adjusted gross estate in excess of $100,000 would reduce revenues about $350 million if adopted together with the $78,000 exemption proposed for the first year under the 5-year phase-in period for the proposed $150,000 exemption. Moreover, a phase-in of the increased marital deduction would create a veritable nightmare for will draftsmen who would have to consider contingent provisions to match each increase in the allowable deduction. We are accordingly recommending that the effective date for the unlimited marital deduction be postponed, so that it would be effective for estates of persons dying after December 31, 1976. The first estate tax returns to which the provision would apply would, thus, not be due until October 1, 1977; and there would be no significant revenue impact until fiscal year 1978.

Tax on Unrealized Appreciation

Another major issue before your Committee concerns the treatment of unrealized appreciation in property transferred at death. Under present law, the heirs receive a new fair market basis in such property, so that any unrealized gain or loss permanently escapes income tax. This rule is sometimes called the stepped-up basis rule. In contrast, if appreciated property is given away during life, the donor's tax basis is carried over to the recipients and any unrealized gain will be taxed on their later sale of the property.

The fact that present law does not tax unrealized appreciation in property transferred at death is said by some critics of the system to create an inequity between taxpayers who accumulate wealth mainly from previously taxed income (e.g., wages and realized appreciation) and those whose accumulated wealth consists largely of unrealized appreciation in the value of their property. Both groups are subject to the estate and gift taxes, but it is argued that the latter group escapes payment of its fair share of income taxes because the unrealized appreciation had not been taxed before death. Moreover, present law is thought to create a "lock-in" effect--a tendency of taxpayers (particularly older taxpayers) to retain highly appreciated property so that they may avoid payment of capital gains tax and pass on a larger estate to their families.

These concerns have led to recurrent, serious proposals to change the rules. The main alternatives that have been suggested at various times are: (1) to impose a capital gains tax on unrealized appreciation in an estate; (2) to extend to property transferred at death the carryover basis provision now applicable to gifts; and (3) an additional estate tax on the amount of unrealized appreciation in an estate.

1. Capital gains tax. Proposals to impose a capital gains tax on unrealized appreciation in an estate would, in effect, treat the estate as if it had been sold at death. If the property in the estate had in fact been sold immediately before death, tax would have been paid by the executor with the decedent's final income tax return, and that tax would have been deductible from the gross estate subject to estate tax. Accordingly, proposals to impose a capital gains tax similarly provide for the deduction of such tax from the gross estate.

The basic assumption of the capital gains tax, which treats the estate as if it was all sold at death, is obviously unrealistic. The concept of a capital gains tax has been to tax realized gains. The event of death hardly qualifies as a tax realization transaction. During his lifetime, a taxpayer has a choice of realizing gain on sale of an asset, paying the tax, and keeping the net proceeds, or of retaining the asset and not realizing a gain on it. The occurence of his death is hardly a voluntarily chosen event upon which to base the realization of gain. Moreover, the tax will really fall on the heirs in any event. We cannot tax a dead man for a sale he did not make no matter now hard we try. Proposals to impose a capital gains tax at death can, thus, be viewed as proposals to tax some individuals who inherit property differently from others who also inherit property solely because of the decedent's investment decisions during his lifetime. It is by no means self-evident that such a system would be more equitable than present law.

Moreover, because of the deductibility of the capital gains tax against the gross estate, the net effect of a capital gains tax would be more severe for smaller estates than for larger estates. As an example, consider two estates that both have $1,000 of appreciation taxed at a 25 percent capital gains rate but with marginal estate tax rates of 30 percent and 70 percent. For both estates the initial capital gains tax would be $250. But the reduction in estate taxes resulting from the deductibility of that $250 would be $75 for the smaller estate with the 30 percent marginal rate and $175 for the larger estate with the 70 percent marginal rate. The net tax on appreciation would be 17.5 percent for the smaller estate and 7.5 percent for the larger estate. Certainly many people would instinctively question the justice of a proposal that would tax small estates more heavily than large ones.

2. Carryover basis. The second approach that has sometimes been suggested as an alternative to present law is the carryover basis approach, under which the decedent's basis in property transferred at death would be carried over to his heirs. The unrealized appreciation would be taxed when and if the property is sold by the heirs. Your Committee tentatively approved the carryover basis provisions in 1963 but deleted that provision from the bill reported to the House.

The carryover basis approach is consistent with the tax treatment that would have resulted had the decedent not died but had continued to retain the property. However, the carryover basis approach suffers from a number of major disadvantages.

The first is administrative complexity for both taxpayers and the Internal Revenue Service in determining the decedent's basis in the property, particularly for property that passes to several successive generations. In many cases, records concerning the original basis of the property will have been lost by the time the property is sold. Many of us have undoubtedly had the experience of selling stock or a house and then, at tax return time, having to search through various files, receipts, and check stubs to determine the original cost of the property and the amount of any required adjustments to basis. Often the key to reconstructing the tax basis of property is one's personal recollection of the transactions in question. The carryover basis approach, and to a lesser degree any tax on appreciation transferred at death, will put an even greater premium on careful records, and a greater penalty for carelessness, than normally exists.

Further administrative complexity would be created by carryover basis adjustments. Thus, most carryover basis proposals, such as your Committee's tentative decision in 1963 and section 106 of H.R. 1040 (introduced by Mr. Corman), provide for increasing the decedent's basis by the amount of State and Federal death taxes attributable to the unrealized appreciation in an estate. Such a basis adjustment tends to equalize the treatment of estates of persons who realize their gains during life and estates of persons with large unrealized gains. When property is sold and tax paid on the gain, the tax is deductible from that person's estate (or if not formally deducted, is excluded as a practical matter from the estate); and the estate tax is thereby reduced. The basis adjustment for death taxes allocable to unrealized appreciation in an estate has the effect of deducting such taxes from the gain that ultimately will be subject to income tax, with a consequent reduction in income tax liability. While never exactly equivalent, the income tax reduction provided by the basis adjustment for estates with unrealized appreciation roughly corresponds to the estate tax reduction provided to estates with taxed appreciation.

Allowance of an increase in the carryover basis for a portion of death taxes means that the exact amount of gain realized on sales made during administration of the estate can not be computed until final determination of State inheritance and Federal estate tax liability, including the final calculation of the total value of the estate and the amount of unrealized appreciation. As a result, income tax returns filed prior to such final determination of death tax liability may have to be reopened and the tax recomputed.

Under the carryover basis approach, there would also be a number of thorny questions regarding the allocation among specific assets of the total appreciation in the estate and the increase in basis for a portion of death taxes. For example, the tax basis of property transferred to a charity is ordinarily of little moment, since the charity will be exempt from tax on any gain it realizes upon disposition of the property. Thus, taxes could be minimized by directing highly appreciated property to charity and less highly appreciated property to others. In your Committee's 1963 tentative decision, this problem was resolved by requiring a pro rata allocation of the total unrealized appreciation in an estate among all the assets in the estate, obviously a complicating provision. Similarly, questions will be raised concerning whether the increased basis on account of death taxes should be allocated ratably among all estate assets (by value or by amount of unrealized appreciation) or only among assets included in the taxable estate (excluding, that is, deductible marital and charitable transfers). Or it might be questioned whether the basis increase should be allocated to those persons who, because of a specific direction in the will or because of State law, are actually held liable to pay the tax.

Finally, the carryover basis approach does little to eliminate the lock-in of investment resulting from the present law stepped-up basis rule. Rather, it perpetuates that lock-in effect even after a property owner's death.

3. Additional estate tax. The American Bankers Association has developed a third approach, which it calls an Additional Estate Tax, or AET. This would be a flat rate tax, the ABA suggests a 14 percent rate, on the unrealized appreciation in an estate. Unlike a capital gains tax, it would not be deductible from the estate tax base--hence the name Additional Estate Tax.

The rationale for imposition of a flat rate, nondeductible tax is the phenomenon I discussed earlier, that a capital gains tax falls more heavily on small estates than on large ones. That phenomenon, which is asserted to demonstrate that the capital gains approach is "regressive," is simply a natural consequence of the deductibility of income taxes against the estate. It is equally true of all income taxes paid during life, a fact that can most clearly be observed with respect to the income taxes paid on the decedent's final return. For example, suppose two individuals pay income tax at an average rate of 40 percent in their final returns and that the marginal estate bracket for one is 30 percent and for the other is 70 percent. Allowing for the reduced estate tax due to the deductibility of income taxes, the net tax on the income of the first individual with the smaller estate will be 28 percent and the net tax for the second individual with the larger estate will be 12 percent. This obviously does not mean that either the income tax or the estate tax is regressive. Nor does it mean that we should deny the estate tax deduction; the funds used to pay the decedent's income taxes are not available for transfer to his heirs and should not be subjected to estate tax.

Nevertheless, the AET proposal is far simpler than either of the other two approaches. Moreover, when viewed in isolation as most changes are viewed by taxpayers, it will not increase effective taxes more for small estates than for large ones. Also, it is a direct excise tax on transfer of unrealized appreciation in an estate and is not an attempt to use income tax concepts in an inappropriate setting. To that extent, therefore, it does not answer the objective of some critics of the present system, namely redressing the income tax inequity alleged to be created by the stepped-up basis rule.

In short, when the rhetoric is cut away, the AET proposal gives credence to what many of us have long suspected: proposals to tax capital gains at death are not fundamentally grounded in income tax concerns but are essentially an effort to increase death tax burdens.

That being the case, the threshold question is whether those burdens should be increased. In our view they should not be increased. Indeed, the extent of the present burden has become so severe that the Administration has recommended measures to alleviate the burden by increasing the exemption and providing for a deferral of payment of tax in certain situations.

4. Exemptions. Under all three approaches for taxing unrealized appreciation in an estate, there would be a number of difficult questions respecting the allowance of exemptions and exclusions. For example, most proposals for changing the present stepped-up basis rule would exempt estates that are not required to file an estate tax return (estates of $60,000 or less under present law). We quite agree that such an exemption would be a requisite of any such change. It would be inappropriate to impose on those smaller estates a substantial tax burden (under the capital gains or AET approaches) or the great complexity inherent in the carryover basis approach.

Many proposals to impose a capital gains tax at death would also exempt marital deduction and charitable deduction transfers. Such an attempt to harmonize the principle of taxing unrealized gains with the estate tax policies underlying the estate tax marital and charitable deductions is quite understandable, but it would combine the disadvantages of the capital gains and carryover basis approaches, and would cause the greatest of complexity for the tax system and family estate planning.

5. Administration recommendation. We oppose these proposals to change the present tax treatment of unrealized appreciation in property transferred at death. We are unable to discern any consistent rationale underlying such proposals other than a desire to increase death taxes; and we believe that decisions regarding the proper level of death taxes should be made through a review of estate and gift tax rates and exemptions, rather than through the device of a tax on appreciation in an estate. Moreover, the pressing need today is for estate tax relief rather than an increase in death tax burdens. It would be wholly inappropriate to hold forth the promise of such relief through an increased estate tax exemption and then to make that promise illusory through a tax on unrealized appreciation that will fall particularly heavily on the owners of farms and small businesses.

Miscellaneous Changes

In my testimony, I have addressed only the major issues of estate and gift tax reform. There are a number of other issues your Committee may want to examine. If so, and if time permits, I will be glad to discuss them with you. I would, however, like to mention one problem in particular because remedial action concerning it could significantly simplify the administration and application of the present gift tax law.

In the Excise, Estate, and Gift Tax Adjustment Act of 1970, Congress accelerated the collection of estate and gift taxes by requiring earlier filing of returns. The principal objective of the legislation was to accelerate the collection of estate taxes. Because the timing of gifts, unlike deathtime transfers, is subject to the volition of the donor, shortening the return period for gifts would not necessarily accelerate collections. Nevertheless, the most recent statistics (1966 returns for 1965 gifts) indicate that $100 million (or more than one-quarter of total gift tax collections in 1966) was collected from 10 donors who each made more than $10 million in gifts. In the expectation that shortening the return period would accelerate collections from such large donors, it was decided to require earlier filing of returns for both gift and estate taxes.

The annual filing system for gift tax returns was therefore changed to a quarterly filing system (under which a return is required for the first calendar quarter in which total gifts for the year exceed $3,000, and for each succeeding calendar quarter of the year).

Two problems have arisen under the quarterly gift tax return provisions. First, although Congress did not intend any changes in the rules regarding the computation of the gift tax, because of the structure of the gift tax provisions a taxpayer may now lose a portion of the gift tax marital deduction. It is clear that this effect of the 1970 changes was unintended. Second, the number of gift tax returns filed annually has increased dramatically, imposing additional administrative burdens on taxpayers and the Interal Revenue Service. During Fiscal Years 1968-70, the number of gift tax returns filed annually ranged from 139,000 to 151,000; in Fiscal 1974, 260,000 gift tax returns were filed.

We recommend that the quarterly gift tax return requirement be amended by adding a $100,000 threshold, so that a quarterly return would be required only when, by the end of a calendar quarter, total gifts for the year exceed $100,000. In other cases, an annual return would be filed, as under prior law. The suggested change would remedy the technical difficulty created under the marital deduction provisions by the 1970 changes, and also would eliminate the quarterly return requirement for most taxpayers, while retaining the intended effect of the 1970 changes of putting donors of very large gifts on a more current basis respecting payment of gift tax.

Thank you for this opportunity to address your Committee on these very important estate and gift tax issues.

ne Department of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR IMMEDIATE RELEASE March 22, 1976

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2.4 billion of 13-week Treasury bills and for $3.1 billion of 26-week Treasury bills, both series to be issued on March 25, 1976, were opened at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS: 13-week bills maturing June 24, 1976 : 26-week bills maturing September 23, 1976

	Price	Discount Rate	Investment Rate 1/
High	98.767	4.878%	5.01%
Low	98.762	4.898%	5.03%
Average	98.764	4.890%	5.02%

a/ Excepting 3 tenders totaling $3,600,000

Tenders at the low price for the 13-week bills [illegible]
Tenders at the low price for the 26-week bills [illegible]

13-wk. 26-wk

4.991 Last week 5.459

4.890 To-day 5.283

4.870 For same 2/23/76 5.204

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESER[illegible]

District	Received	Accepted	Recei[illegible]	
Boston	$ 79,045,000	$ 19,545,000	$ 7[illegible]	
New York	5,072,775,000	2,100,470,000	3,92[illegible]	
Philadelphia	25,865,000	24,040,000	12[illegible]	
Cleveland	108,775,000	31,255,000	6[illegible]	
Richmond	29,225,000	15,275,000	3[illegible]	
Atlanta	27,500,000	24,015,000	3[illegible]	
Chicago	367,065,000	38,095,000	31[illegible]	
St. Louis	59,485,000	28,630,000	4[illegible]	
Minneapolis	33,250,000	10,530,000	3.[illegible]	
Kansas City	37,360,000	28,830,000	2[illegible]	[illegible]
Dallas	21,410,000	16,410,000	18,000,000	11,000,000
San Francisco	366,820,000	64,775,000	274,275,000	140,775,000
TOTALS	$6,228,575,000	$2,401,870,000 b/	$4,987,430,000	$3,100,795,000 c/

b/ Includes $342,835,000 noncompetitive tenders from the public.
c/ Includes $179,110,000 noncompetitive tenders from the public.
1/ Equivalent coupon-issue yield.

WS-731

he Department of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 964-2041

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Contact: L.F. Potts
Extension 2951
March 23, 1976

FOR IMMEDIATE RELEASE

TREASURY ANNOUNCES CLEAR POLYMETHYL METHACRYLATE OF PELLET, POWDER, FLAKE, GRANULAR OR SIMILAR FORMS, FROM JAPAN, IS BEING SOLD AT LESS THAN FAIR VALUE

Assistant Secretary of the Treasury David R. Macdonald announced today that clear polymethyl methacrylate of pellet, powder, flake, granular or similar forms, from Japan, is being, or is likely to be, sold at less than fair value within the meaning of the Antidumping Act of 1921, as amended. Notice of the determination will be published in the Federal Register of March 24, 1976.

The case will now be referred to the U.S. International Trade Commission for a determination as to whether an American industry is being, or is likely to be, injured. In the event of an affirmative determination, dumping duties will be assessed on all entries of the subject merchandise from Japan which have not been appraised and on which dumping margins exist.

A "Withholding of Appraisement Notice", published in the Federal Register of December 18, 1975, stated that there was reasonable cause to believe or suspect that there were sales at less than fair value. Pursuant to this notice, interested persons were afforded the opportunity to present oral and written views prior to the final determination in this case.

During the period January 1, 1974, through March 31, 1975, imports of the subject merchandise from Japan were valued at approximately $2,677,000.

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WS-733

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR RELEASE AT 4:00 P.M. March 23, 1976

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $6,000,000,000 , or thereabouts, to be issued April 1, 1976, as follows:

91-day bills (to maturity date) in the amount of $ 2,600,000,000, or thereabouts, representing an additional amount of bills dated January 2, 1976, and to mature July 1, 1976 (CUSIP No. 912793 ZW 9), originally issued in the amount of $ 3,301,200,000, the additional and original bills to be freely interchangeable.

182-day bills, for $ 3,400,000,000, or thereabouts, to be dated April 1, 1976, and to mature September 30, 1976 (CUSIP No. 912793 B3 9).

The bills will be issued for cash and in exchange for Treasury bills maturing April 1, 1976, outstanding in the amount of $6,004,085,000, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,906,570,000. 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 non-competitive 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 Standard time, Monday, March 29, 1976. 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 April 1, 1976, in cash or other immediately available funds or in a like face amount of Treasury bills maturing April 1, 1976. 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.

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The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR RELEASE AT 4:00 P.M. March 23, 1976

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for $3,200 million, or thereabouts, of 364-day Treasury bills to be dated April 6, 1976, and to mature April 5, 1977 (CUSIP No. 912793 D3 7). The bills will be issued for cash and in exchange for Treasury bills maturing April 6, 1976.

This issue will provide $1.0 billion of new money for the Treasury as the maturing issue is outstanding in the amount of $2,205 million, of which $916 million is held by the public and $1,289 million is held by Government accounts and the Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities. Additional amounts of the bills may be issued to Federal Reserve Banks as agents of foreign and international monetary authorities. Tenders from Government accounts and the Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities will be accepted at the average price 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 Standard time, Wednesday, March 31, 1976. 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

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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 $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. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank or Branch on April 6, 1976, in cash or other immediately available funds or in a like face amount of Treasury bills maturing April 6, 1976. 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.

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Department of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 964-2041

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NOTE TO CORRESPONDENTS March 23, 1976

The Federal Financing Bank (FFB) today entered into an agreement with the Rural Electrification Administration to purchase up to $600 million in Certificates of Beneficial Ownership in insured notes and other obligations of the Rural Electrification and Telephone Revolving Fund. The obligations in the Fund are loans made by REA pursuant to the Rural Electrification Act to entities which own or contemplate owning rural electric and telephone systems. The first CBO sale to the Bank in the amount of approximately $175 million will be on March 31, 1976, with FFB committed to buy an additional $425 million prior to October 1, 1976.

The agreement was signed by Edwin H. Yeo, President, Federal Financing Bank, and David A. Hamil, Administrator, Rural Electrification Administration.

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Department of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 964-2041

FOR RELEASE ON DELIVERY

1153

STATEMENT BY THE HONORABLE DAVID R. MACDONALD
ASSISTANT SECRETARY OF THE TREASURY
(ENFORCEMENT, OPERATIONS, AND TARIFF AFFAIRS)
BEFORE
TRADE SUBCOMMITTEE HEARINGS
ON
806, 807, TSUS
MARCH 24, 1976
10:00 AM

Mr. Chairman and Members of the Committee:

I am here today at your invitation to provide the Administration's views on a number of bills introduced to repeal or amend items 807.00 and 806.30 of the Tariff Schedules of the United States. These items have continued to be matters of controversy over the years due to the allegations that they permit the transfer of American jobs abroad.

I would like to begin with a technical discussion of how the provision works. Item 807.00 is a duty exemption for United States components of any manufactured article assembled abroad. It was incorporated in the TSUS in 1963, after having been developed over the years as a Customs administrative practice, known as the doctrine of "constructive segregation". This doctrine allowed free entry for American-made components in articles assembled abroad if such components were capable of being identified and removed without injury to themselves or to the foreign-made components with which they had been assembled. Tariff Schedule item 807 adopted this administrative practice but eliminated the requirement that the American components not be advanced in value or condition.

In order to determine the dutiable value of item 807 merchandise, the value of the domestically produced components is subtracted from the full value of the imported article. The value of the domestically produced components is determined by their cost at the time of last purchase, their value at the time of export, their constructed value or their cost of production, depending upon the information available and Customs' judgment as to which method is most appropriate. We estimate that at least 95 percent of these imports are valued by constructed value or cost of production methods.

Administration of 807 is complicated by the requirements of determining such things as "usual general expenses", "profit", and the costs of manufacture when using constructed value and cost of production methods of valuation. As a result liquidation of 807 entries is often delayed. Recently, however, Customs has adopted regulations which clarify the application of Sections 806.30 and 807 to particular fact situations. Moreover, Customs has clarified its advance ruling process through which importers can determine the applicability of 806.30-807 to proposed assembly operations.

Item 806.30 was originally enacted into law in 1956 (as para. 1615(g) of the Tariff Act of 1930) in order to facilitate the processing of U.S. metal articles in contiguous areas of Canada during breakdowns and emergencies at nearby plants in the U S . It permits duty free entry of metal products manufactured in the United States which are imported after having undergone further processing abroad. Duty is paid only on the cost or value of processing outside the United States.

Generally speaking, the administration of item 806.30 is simpler than that of 807 since it is not necessary to determine the full value of the imported article. However, it is often necessary to use the cost of production or constructed value methods in valuing the foreign processing and consequently many of the same problems in valuation exist under both 806.30 and 807.

An interesting question arises as to what would happen if these two provisions were repealed.

So far as Customs' workload is concerned we anticipate that there would be little effect, assuming the volume of imports remains constant, since this merchandise would still be appraised under constructed value or cost of production methods.

Insofar as the dutiable status of U.S. components presently duty-free under 806.30 and 807 is concerned, a determination would be necessary as to whether the doctrine of "constructive segregation" were still effective. There are judicial decisions which would need to be studied, along with the legislative history of the repeal action, before such a ruling could be made. Should the doctrine stand, there would of course continue to be some duty-free treatment for U.S. components.

The practice of permitting duty-free entry for domestically-produced components of foreign-assembled articles is quite widespread among developed countries. While we do not have precise figures, we do know that Western European countries make extensive use of foreign assembly of goods in Eastern Europe. This practice seems to be increasing. Textiles form a considerably larger proportion of such goods reimported into EC countries than into the U.S.

The European schemes are somewhat more restrictive than ours in that they generally require the domestically produced products to be exported, processed, and re-imported for the account of a specific single domestic firm. The United States permits foreign based firms to buy our components for such processing.

Since the Tariff Commission (now the United States International Trade Commission) study of 1970, statistics indicate that imports under these two items have risen relatively only slightly more than our total imports. For example, the total of such imports utilizing 806.30 or 807 amounted to 5.1 percent of our total imports in 1969, rose to around 6.2 percent in 1972 and 1973, and declined to 5.4 percent in 1974 and 1975. Related to manufactured goods alone, such imports under 807 and 806.30 amounted to about 10 percent in 1975 compared to about 8 percent in 1969. The American components of such imports have increased more than the value added abroad. The foreign components of such imports is large, primarily because of the incorporation of American parts in foreign-made automobiles entered under item 807.00. We do not have individual product data for 1975, but for 1974, autos comprised about 40 percent of the total value of imports under 807.00. A total of 74 percent of 807 imports consists of manufactures of metal, including the automobiles mentioned previously, imported under schedule 6 of the TSUS.

In 1974 806.30 imports totalled $554 million and 807, $4.83 billion. For 806.30, non-dutiable U.S. components comprised 55.7 percent of the total ($303 million). For 807 the comparable figure was 20.9 percent ($1 billion).

Given these considerations, and we can supply more statistics for the Committee if you wish, we do not consider that repeal of these two provisions is in the best interest of the United States. On the contrary, we continue to hold the views expressed to the Committee in a letter from the Special Trade Representative to the Chairman of the Committee on October 27, 1971. To quote one of the concluding paragraphs, that letter says: "In summary, the facts at hand do not, in our view, indicate a need for special action by Congress at this time on items 807.00 and 806.30. However, the Administration will continue to keep under review developments in the level and patterns of trade under items 807.00 and 806.30, with a view to appropriate inclusion in its trade legislation program of suitable safeguards for those cases in which domestic industry or labor may be injured."

We continue to hold these views and wish to note that the Administration recommended and the Congress approved legislation which would provide relief under the escape clause procedures of the Trade Act of 1974 by providing among the remedies available to the President suspension of these two provisions of the tariff in import injury cases. So far under the Trade Act of 1974 we are not aware that any of the petitions filed have claimed that either of these two items are a source of difficulty.

To the extent that provisions 806.30 and 807.00 permit components which U.S. manufacturers can produce efficiently to be included in labor-intensive imported goods, where such producers could not compete in producing these finished goods, the U.S. economy benefits.

There is doubtful validity to the assumption that repealing these provisions would result in a return of production of the finished product to the U.S. A more likely result would be that the entire manufacturing and assembly process would be driven abroad with U.S. components replaced by similar articles from other industrial suppliers, or there would be a fall in domestic demand for the product as a result of price increases, with little or no increase in U.S. production. It would appear to us, therefore, that the net result of repeal of 806.30 and 807 would probably be a loss in U.S. jobs and production, as exports of components fall off, as well as an increase in the price of the products to the American consumer. If that analysis is correct, nobody benefits, least of all American labor, which suffers both job loss and higher prices. I note that the 1970 Tariff Commission report estimated that repeal would cause a $150 - $200 million deterioration in the U.S. trade balance. While we continue to hold the belief that repeal of these items would result in a net economic loss, we think it might be desirable to update the extensive study made of these two items to determine if events since 1970 have changed the situation in any significant degree.

Thank you Mr. Chairman.

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The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

FOR IMMEDIATE RELEASE March 24, 1976 1161

ASSISTANT SECRETARY WALKER ANNOUNCES
REVISED ADR GUIDELINES

Charles M. Walker, Assistant Secretary of the Treasury for Tax Policy, today announced publication of revised asset guideline classes, depreciation periods, and repair allowance percentages applicable to the textile industry.

Addressing the Board of Directors of the American Textile Manufacturers Institute in San Francisco, Mr. Walker said the revised guidelines were derived from a recently completed study of the textile industry by Treasury's Office of Industrial Economics.

In his remarks, Mr. Walker cited the cooperative efforts of the Office of Industrial Economics, textile manufacturing companies, and the American Textile Manufacturers Institute in assembling information on historical asset replacement patterns, and the probable effects on these of emerging and technological and market conditions.

Terming completion of the study and publication of the revised guidelines a "landmark event" in tax policy, Mr. Walker said that it demonstrated that the Treasury Department is responsive to changing conditions which affect American industries. Treasury is determined to make the Class Life Asset Depreciation Range system a viable and up-to-date mechanism for attaining neutrality, practicality, simplicity and equity in the determination of depreciation charges for the purpose of measuring the tax base of economic income, he said.

Mr. Walker stated that the cooperative spirit in which the study was conducted should serve as a model for subsequent studies of other manufacturing industries for revision of depreciation guidelines.

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The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

FOR IMMEDIATE RELEASE

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ADDRESS BY THE HONORABLE CHARLES M. WALKER
ASSISTANT SECRETARY FOR TAX POLICY
BEFORE THE
AMERICAN TEXTILE MANUFACTURERS INSTITUTE
SAN FRANCISCO, CALIFORNIA
MARCH 24, 1976

It is a pleasure to meet this morning with the Board of Directors of the American Textile Manufacturers Institute. As you represent one of the Nation's basic industries, I am particularly pleased today to bring you some good news. I understand that you will be discussing such topics as prospective trends in textile markets, and the effects on them of imports, Federal energy policies, and the spread of Government regulation. Some of these subjects relate to what the Government is doing to the textile industry, and they will doubtlessly give rise to requests that something be done for the industry. Happily, I am able to announce today completion of a project the Treasury Department has done with the industry, and because the aim of the project was to do what is right under the Internal Revenue Code, I think we may all be proud of what has been accomplished.

The project I refer to is a 2-year study of conditions bearing on the guideline classes, lives, and repair allowance percentages appropriate for the textile industry under the Class Life ADR System. Individual textile firms and the Institute fully cooperated with Treasury's Office of Industrial Economics in the execution of the study; and I trust you will have found that Office was receptive to inputs your industry has provided. The result of this extensive effort has been embodied in the publication today of a Revenue Procedure (Rev. Proc. 76-17) setting forth revised asset classifications and corresponding guideline depreciation periods and repair percentages. We believe that these elements of tax policy bearing on the textile industry fairly portray the economic attributes of a modern and vigorously progressive industry capable of holding its own in world markets.

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But the importance of this study transcends the fine work it has accomplished, for it represents the first industry-wide fulfillment of Treasury Department promises that tax depreciation procedures would be continuously monitored and revised with the aim of assuring that taxable income is reasonably measured. In this respect, the Revenue Procedure published today is a landmark in the continuing evolution of income tax law administration. A brief review of the role of tax depreciation policy and its history will help in understanding the significance of the occasion we mark today.

From the beginning, the Federal income tax has included income from capital in its base, whether that income is paid out in the form of interest or accrues as profit. Measurement of the share of private income from capital paid out in the form of interest has presented a minimum of difficulty, for loan transactions carefully stipulate conditions of repayment which permit the segregation of interest income from return of principal. But, since only the income generated by the use of assets financed by debt is formally determinable, the residual, which is profits, absorbs all the error in measurement of the income flow from employment of all the assets. This has a consequence to which I will return later.

Consider the mechanics of business income measurement. Gross income from sales of product is a quantity subject to little controversy in measurement. And the current deductions from gross income, to measure the cost of labor and material services used-up in its production, is only a little more controversial, due to its involving some inventory valuation issues that are difficult to resolve. Thus, what is normally termed "operating income" is reasonably determinable by objective rules of measurement. But the part of operating income which is net income flowing from the enterprise, and which is to be divided between the creditors who receive interest as their share of the reward for financing the acquisition of assets, and the remainder which is the return to equity suppliers, can only be determined by subtracting from operating income an allowance for the value of the enterprise capital which has been used-up during the period. If this allowance is too small, the measure of net income flowing from the assets will be overstated; and since the creditors' share is contractually determined, the profit share will include all the overstatement. If the allowance for the value of capital used-up is too large, profits are perforce understated.

I know from my own experience that corporation financial managers, and investment analysts serving the capital markets devote a significant fraction of their time to agonizing over the vexatious issues of income measurement posed by the annual allowance for capital used-up--depreciation. They are aware that the measure of depreciation produced by mechanical application of arithmetic procedures is but a first approximation of actual capital consumption. It needs to be adjusted by subjective evaluation procedures to account for inflation, past investment errors--or good fortune--to arrive at a measure of net cash flow attributable to operations. Yet, they may take comfort in their use of mechanical procedures in the knowledge that those procedures will have no long-term practical consequences. An enterprise is not bound by law to pay-out currently the "profit" reported for a year: if the "profit" is overstated, less may be paid-out without unduly limiting the ability of the enterprise to finance capital maintenance and expansion programs. And if "profit" is understated by the consistent application of accounting rules, pay-outs can normally be increased. In the long-run, corporate financial policies and the market prices of equities established in capital markets adjust for aberrations introduced in financial statements by mere accounting method.

However, in the presence of income taxation, the allowance for depreciation used in computing taxable income has real financial consequences. If the tax rules for measuring depreciation result in systematically too slow a rate of capital recovery, the result is systematically to <u>reduce</u> the profitability of equity investment; taxes on the income attributable to equity are, in effect "prepaid" and the cost of this must be reflected in the equity share. Conversely, if the tax rules result in too rapid a rate of capital recovery, taxes on the equity share of income are deferred; indeed, in the extreme, a 1 year write-off of capital expenditures relieves from tax all income from depreciable capital.

Ideally, tax rules for computing annual allowances for depreciation should approximate the real underlying phenomenon of capital consumption. The degree to which this is accomplished has a profound effect on the degree to which an income tax law affects the rate of capital formation. And in the case of specific industries, it will importantly affect the strength of their claim to a share of the economy's resources. If tax rules result in prepayment of income tax, because an unrealistically low rate of depreciation is allowed, the market rate of return on equities will have to be higher--to pay the additional tax burden and still return investors a rate of return to cover the real costs of investment, including risk. Similarly, if the tax rules result in deferral of income tax by allowing too rapid depreciation, the market rate of return on equities is depressed, for the tax wedge between the investors' return and what must be obtained from operating income has been reduced. Parenthetically, this is why industry representatives continually petition for an "acceleration" of tax allowances for depreciation. They sense that if they could reduce the tax wedge their industry must bear, they would be able to attract more equity at the going rate of return.

But the purpose of tax rules for depreciation measurement is basically not to advantage or disadvantage industry generally, or particular industries. Rather, the purpose is to arrive at reasonable measures of income subject to tax and the timing of its occurrence so that the tax wedge will be uniform over all capital. We may wish that our tax system did not include this wedge, for it means that our national capital stock is probably lower than it would otherwise be; but until Congress amends the Internal Revenue Code to eliminate income from capital from its base, and so remove the bias against saving and investment, the responsibility of the Treasury Department is to help develop rules to measure that income so it may be taxed as prescribed by law.

The statutory mandate has always been clear. Taxpayers engaged in a trade or business may deduct from gross income a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property. But the development of the rules for depreciation measurement has been, and continues to be, controversial.

Evolution of the measurement techniques has included the "Depreciation Studies" published in the early 1930's which set forth thousands of "useful" lives of particular assets grouped by industry category. Significant increases in depreciaion deductions despite decline of income during the depression brought on a rule that shifted the burden of proof to the taxpayer to show that the deductions were reasonable. That policy persisted until 1962. During that long interval the familiar Bulletin F was in force, although its effect was softened by the 1954 introduction of accelerated methods of depreciation. In 1962 the "guideline depreciation" system was set forth, with the ill-fated "reserve ratio test".

All of this evolution, and the accompanying audit controversy over depreciable lives, had the effect, finally, of clarifying an important conceptual weakness that had dogged the administration of tax depreciation rules from the outset. Just as investment is forward looking--we decide whether to invest or not in terms of what we expect the results will be--so should depreciation allowances with respect to that investment be forward looking. Of course, the past is a guide to formulating our expectations, but once made, an investment decision is irrevocable. If our expectations are achieved, we earn the expected return; if our expectations are exceeded, we earn an abnormal return; and if future results fall short of our expectations, we earn a subnormal return, or suffer a loss. But, each year, as we contemplate the desirability of investment, the price we must pay for the assets should be independent of the price that we might have paid for investments in prior years. By-gones are by-gone.

Not so in the pre-1971 administration of tax depreciation rules. Under Bulletin F, and more conspicuously under the 1962 Guidelines reserve ratio test, what the taxpayer's experience was--good or bad--would determine what his depreciation allowances would be with respect to investments undertaken currently.

Therefore, in 1971, when the ADR System was announced, the principal change from what had gone before was a redirection of attention from the past toward the future. With respect to investments made today, the taxpayer electing to use this system is given assurance that, if he uses a depreciation period within the published Asset Depreciation Range, his depreciation deductions will not be subject to administrative change. At the same time, because the depreciation of each vintage of depreciable assets is independent of other vintages, it is possible to revise asset classifications and corresponding depreciation periods as expectations of future conditions warrant. And recognizing that this system of tax depreciation administration puts a heavy burden on asset classification and realistically establishing guideline depreciation periods, the Treasury established the Office of Industrial Economics to monitor the system continually and to recommend changes in its parameters as needed.

This promise to reexamine the bases for tax depreciation policy had been made many times before, but was not a promise faithfully kept. Studies tended to be made, guidelines published, not before the need for change had become manifest, only after the fact. This was true in 1931, 1942, and 1962. But today we have kept the promise, and with you, we celebrate the completion of an industry wide study and the implementation of a current revision which will bring the textile industry into line with prevailing conditions.

From its establishment in 1971, the Office of Industrial Economics has striven to carry out the mandate of its charter professionally and with dispatch. Its role is not to establish an arbitrary capital recovery rate for each industry. Rather, it must rely upon determinations based in part on past and forecast capital asset acquisitions and replacement rates, and a consideration of technologic and economic forces operating on those replacement rates.

In its studies, in the spirit of forward-looking investment policy, OIE thus emphasizes the future. In the spirit of the Class Life System, OIE examines investment policy from the perspective of an industry, not the pre-1971 perspectives of the facts and circumstances of individual taxpayer's acquiring isolated items of depreciable property. For this reason, OIE is organizationally within the Office of Tax Policy. This provides OIE an environment free of adversary confrontations and facilitates the cooperative pursuit of analytically valid conclusions derived from governmental and private sources.

While we all can rightfully take pride in the evidence we have that the system of tax depreciation administration is now working, in all candor I must acknowledge that pressures are building, in Congress and elsewhere, to legislate blanket changes in the Class Life System. Many regard the range of 20 percent above the asset guideline depreciation period as a kind of "giveaway", which they would repeal. The ceaseless stream of studies based on financial reports of corporations which purport to show that the "effective" rates of corporation income tax are low reinforces the layman's belief that tax depreciation allowances presently permitted are "phony".

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Ironically, most of the cases of artificially accelerated capital recovery allowances and related investment preferences are those which Congress has enacted and which are not a part of the Class Life System. I refer specifically to the tax treatment of real estate, minerals, timber, and investment in anti-pollution equipment, railroad rolling stock, rehabilitation of housing, and others.

So far as our studies and those of other independent researchers are able to show, tax depreciation allowances determined under the Class Life System do not depart, on the whole, from the actual depreciation which occurs. These studies imply that straight-line methods do not describe the actual path of depreciation, and they suggest that replacement periods are far shorter than accounting methods used by most business firms assume. In some instances, careful study shows that ADR depreciation allowances permit only a subnormal rate of capital recovery for income measurement purposes; in other cases, we have indications that ADR depreciation is excessively accelerated. If we are willing to revise upward depreciation rates which are too low, so should we be willing to revise downward those which are too rapid. To keep the system working, we need the support of informed opinion, both when we make the former kind of revisions, and also when we make the latter.

This brings me to my final remarks, which are intentionally sober to balance the optimism of my earlier statements. There is a practical limit of the extent to which the Treasury and the Congress can proceed in reasonably measuring taxable income. That limit is, simply stated, not too far from the practice you in industry follow in your financial accounting. The ordinary citizen simply cannot understand why depreciation for financial reporting should be substantially less than the depreciation deductions taken for tax purposes. They perceive this as one of the principal causes of low "effective" tax rates paid by business. The existence and growth of "deferred taxes" reported on financial statements of corporations is tantamount to a public declaration that tax depreciation rules do result in tax deferrals and low effective tax rates. While I should be surprised to find corporate financial managements uniformly in accord with tax depreciation rules, it must be a matter of deep concern to all of us when large resulting differences in tax and financial income persist. Hopefully, the new textile industry depreciation will help close whatever gap now exists between financial and tax accounting attributable to depreciation deductions.

Thank you.

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The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR IMMEDIATE RELEASE March 24, 1976

RESULTS OF AUCTION OF 4-YEAR 10-1/2 MONTH TREASURY NOTES

The Treasury has accepted $2.5 billion of the $5.1 billion of tenders received from the public for the 4-year 10-1/2 month notes, Series E-1981, auctioned today.

The range of accepted competitive bids was a

Lowest yield	7.35% 1
Highest yield	7.39%
Average yield	7.38%

The interest rate on the notes will be 7-3/8
the above yields result in the following prices:

Low-yield price	100.101
High-yield price	99.940
Average-yield price	99.980

The $2.5 billion of accepted tenders include
bid for at the highest yield and $0.5 billion of r
at the average yield.

In addition, $150 million of tenders were acc
price from foreign and international monetary authorities.

3/5/76 4-year 7.54
1/13/76 [illegible] 7.40
[illegible] 4-year 7.50
[illegible]/75 49 mo. 8.54
[illegible]/75 4-year 7.83
12/30/74 [illegible] mo. 7.33
12/23/74 4 1/2 year 7.89

Attention is directed to the fact that the coupon rate of 7-3/8% on the new notes (Series E-1981) is the same as that on previously issued Treasury Notes (Series C-1981) and that both notes will mature on February 15, 1981. However, interest to be paid on August 15, 1976, will be $26.74451 per thousand for the new Series E-1981 notes and $36.87500 per thousand for the existing Series C-1981 notes. After August 15, 1976, both Series C-1981 and E-1981 will have the same semi-annual interest payments, $36.87500 per thousand. Three factors will distinguish the two notes; the series designation, the issue date, and the CUSIP number. Series C-1981 was issued on February 18, 1975 (CUSIP No. 912827 ED 0), and Series E-1981 will be issued on April 5, 1976 (CUSIP No. 912827 FM 9).

1/ Excepting 5 tenders totaling $6,530,000

WS-739

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

FOR IMMEDIATE RELEASE

1170

REMARKS BY J. ROBERT VASTINE
DEPUTY ASSISTANT SECRETARY OF TREASURY
FOR TRADE AND RAW MATERIALS POLICY
AT THE
ELECTRONIC INDUSTRIES ASSOCIATION SEMINAR
MARCH 25, 1976, 2:00 P.M.

I would like to thank our Chairman, Mr. Edgington, for inviting me to be with you today and for his initiative in planning this useful seminar. It is useful, I believe, because it takes a positive, aggressive view of world markets. I am glad to contribute tc this discussion of U.S. Government efforts to expand access to those markets by competitive U.S. enterprise.

I would like to discuss two important ways in which we are trying to expand our markets. The first is the multilateral trade negotiations -- the "MTN" -- in Geneva. The second is our effort to expand trade with the non-market economy countries -- a different kind of negotiating effort.

Total free world export trade has risen dramatically in the past 10 years, expanding from about $165 billion in 1965 to more than $778 billion in 1974. Total U.S. export trade has shown comparable increases, jumping from roughly $27 billion to almost $98 billion during the same period. You, in the electronics industry, have contributed significantly to this strong U.S. performance. Last year, for example, U.S. exports of electronics products were about $5 billion while imports were about $3 billion.

We want this trend to continue. The advantages derived from growing world trade and the shared economic efficiencies it implies are obvious. It expands our economy, creates more and higher quality jobs, and helps lower consumer prices. It helps strengthen ties with

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our major free world trading partners. Expanding trade with developing countries is perhaps the best way of promoting their soundly based economic development, without resort to attempts to organize markets for important commodities.

But the recession from which the world is now emerging has created pressures which, if not contained, may seriously curtail future trade expansion. We are particularly concerned with the restrictive measures adopted by a number of foreign countries, including such practices as import deposit schemes (as in Finland and Portugal), tariff and quota restrictions (as in Australia), export inflation insurance programs (as in the U.K.), and expansion of existing export credit schemes (as in France).

Other countries, of course, have charged that the U.S. is drifting toward protectionism. Let me assure this is not the case.

As cause for their concern, these critics have cited the recent determinations by the International Trade Commission in favor of import relief for U.S. industries, and in particular, the recent decision by the President to grant import relief to the speciality steel industry. They have also expressed alarm over the increased number of anti-dumping and countervailing investigations by the United States.

I would like to put this issue into perspective by giving you the facts. Of the 14 escape clause cases which have been brought before the ITC, four findings were in the affirmative, holding that imports constituted a substantial cause of serious injury; four were negative; two were tie votes (the President found in the negative on one of the tie votes); and four are pending.

Of the 42 countervailing duty investigations initiated or activated since passage of the Trade Act, there have been 11 negative findings; 11 affirmative findings (six of these were waived under the Trade Act authority); 14 cases terminated; five preliminary affirmative findings and one pending.

Of the 36 anti-dumping investigations initiated since passage of the Trade Act, there have been: 10 affirmative findings of which five involved no injury, one involved injury and four are under ITC review. four negative findings; five preliminary affirmative findings; two discontinued; and 15 pending.

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On Sec. 301 cases, six petitions have been filed since passage of the Trade Act. One case has been concluded; one has been suspended, and four are under review.

The specialty steel decision has been controversial. The President's decision in providing limited import relief for this industry is the first affirmative action taken under the escape clause provision of the Trade Act of 1974. It is a temporary measure designed to give the industry sufficient time to recover a healthy employment and profit position. The President has made clear that the trade restraints that will result should be lifted when the industry recovers.

The increasing number of complaints by U.S. industry about unfair or disruptive import competition cannot be confused with an increase in import barriers, nor should it be interpreted as a shift in U.S. trade policy. Any complaints received by the Government must be investigated thoroughly, and correct legal proccesses must be observed. Treasury conducts these investigations openly, under well-known rules and procedures, and they will continue to be handled in such a manner.

The U.S. remains committed to a liberal trade policy. Under the sponsorship of the OECD, we and other OECD members have pledged to avoid discriminatory trading practices during this difficult period.

But an agreement not to impose additional restrictive measures will not result in trade expansion. If we are to obtain continued growth in world trade, we must seek to reduce or remove trade barriers. And this, of course, is what the multilateral trade negotiations currently underway in Geneva are all about.

Our major goals in the MTN are to obtain the removal or reduction of tariff and nontariff barriers to our exports, and to improve the international trading framework in order to minimize the potential for trade disputes escalating into major conflicts between trading partners. These goals were confirmed last November at Rambouillet where the leaders of the six principal non-Communist industrialized nations declared that the MTN should seek to "achieve the maximum possible level of trade liberalization".

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Specifically, our aims in Geneva are:

- to implement maximum reciprocal tariff reductions no less ambitious than in the Kennedy Round on as wide a range of products as possible;

- to agree on codes of conduct for product standards, government procurement, and subsidies and countervailing;

- to develop rules governing the use of export controls and to attempt to exchange commitments on supply access and market access;

- to develop an improved international safeguard mechanism governing the application of import relief actions; and

- to pursue efforts to reform the trading system, to provide a mechanism for coordination of national trade policies and the resolution of trade disputes.

As a major step in implementing these goals the United States this week in Geneva tabled its tariff negotiating formula. In designing this formula we attempted to use to the maximum feasible extent the tariff-cutting authority contained in the Trade Act. We also took the advice of our private sector advisors and incorporated in the formula an element that will have a "harmonization" effect. That is, tariffs below a certain percentage will be cut by a smaller percentage than tariffs above that level, which will be subject to a full 60 percent cut. This formula should have very positive effects on U.S. electronics exports to major foreign markets.

We believe that the U.S. formula is extremely forthcoming. For the first time, the U.S. has accepted that some degree of harmonization is a worthwhile objective in a tariff-cutting exercise.

In these negotiations the role of private sector advisers is greater than ever before. There are 26 Industry Sector Advisory Committees, and there are advisory committees for agriculture, labor, and retailers as well. The two electronic products advisory committees have provided extremely useful analyses of foreign markets and trade barriers that operate against your industry's exports to those markets. You have signaled to us loud and clear that foreign government product standards, and government procurement systems, are two problems we must solve in these negotiations. These are high on the list of achievable objectives.

We obviously have a very heavy work program in the MTN, the most comprehensive multilateral trade negotiations ever conducted. Our very able negotiators have a formidable, even unenviable job. But, we have all recognized that if we are to avoid sliding back toward protectionism, we must aggressively create a forward momentum toward greater fairness and freedom in trade. This is our business in Geneva, and we are working at it very hard.

I would like to turn now to our effort to expand trade and economic relationships with the non-market economy countries.

Trade with the Non-Market Economy Countries

U.S. trade with the East has made remarkable progress in the 70's following our decision to pursue aggressively a policy of relaxation with the Soviet Union, of which expanded economic interchange was a key part. In 1971, our total exports to the non-market economy countries amounted to less than $400 million. In 1975, exports were $3.1 billion, nearly an eight-fold increase in four years. By contrast, 1971 U.S. imports were $230 million, and in 1975 our imports were $969 million. Thus, our total trade surplus with these countries grew approximately 12 times in four years to $2.1 billion.

The expansion of trade with the Soviet Union since the conclusion of the Trade Agreement and lend-lease accord in 1972 has been particularly striking. The U.S. and the Soviet Union have exceeded the goal announced at the June 1973 Summit: a total trade turnover of $2-3 billion during the three-year period 1973-1975.

The growth in U.S. trade with the non-market economy countries continued in 1975 in spite of the Trade Act's provision imposing restrictions on U.S. Government financing of exports and on the granting of nondiscriminatory tariff treatment to most of the non-market economy countries. Nevertheless, this Administration

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believes that these provisions of the Act have both reduced our prospects for expanded trade with the Soviet Union and other non-market economy countries, and have disserved our political and humanitarian interests.

For example, while it is true that exports to the Soviet Union increased during calendar year 1975, as compared with all of 1974, a substantial part of 1975 U.S. exports was made up of agricultural commodities needed by the Soviets as a result of massive shortfalls in their crop production. In addition, U.S. exports to the Soviet Union in 1975 consisted of equipment and other manufactured goods related to contracts signed in past years and supported by Export-Import Bank financing. As a result of the recent legislation, new Eximbank financing is not available for exports to the Soviet Union and the other non-market economy countries except for Poland and Romania. This places U.S. exporters at a disadvantage in relation to their competitors in Western countries who provide government-sponsored export credits on favorable terms. The major European countries and Japan have agreements with the U.S.S.R. under which $10 billion of government-backed credits will be available to finance export sales to the Soviet Union. This total is in sharp contrast to the $469 million in credits extended by the Eximbank <u>before</u> lending to the U.S.S.R. was suspended in May 1974.

The Soviets have given us their estimate that for January through October 1975, as much as $1.6 billion in contracts which the Soviets were ready to sign with U.S. firms have gone to Western Europe and Japan. Many of these contracts were being negotiated as part of the Soviet 1976-80 plan and therefore represented business opportunities that are not likely to appear again until the next five-year plan period.

We are convinced that were we to normalize our trading relationship by providing MFN and credits, an aggressive marketing program by U.S. businessmen could result in a large increase in the present U.S. market share, of approximately only 4% of non-market economy country manufactured goods imports. A U.S. market share for non-market economy country imports of say, 10 percent by 1980 could mean 1980 manufactured goods exports to the non-market economies of over $4.5 billion, compared with only slightly over $717 million in 1974. This is a substantial difference in terms of U.S. sales and jobs.

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Consultations with the Congress were held throughout 1975 and have continued in the early part of this year in an effort to find a way to unblock the legislative impasse to normalized trading relationships with the non-market economy countries. We have undertaken this effort with the firm belief that the normalization and improvement of our commercial relations with the U.S.S.R. and other non-market economies is a necessary element in the long-term improvement of our overall relations with these countries.

Unfortunately, because of recent events in Africa, the legislative situation has become clouded, and the pace of our official relationships has slowed. Some Cabinet-level meetings have been postponed, though we very earnestly hope and expect that government-to-government contacts at the expert and working level will continue, and similarly, that U.S./U.S.S.R. business relationships will continue. We hope that conditions will soon permit a resumption of our expanding economic exchanges with the Soviet Union.

We remain convinced that the United States will not realize the full benefits of trade with non-market economy countries until the discriminatory provisions of our legislation are removed. But changing the legislation continues to be a matter of timing, based on the broad course of U.S.-Soviet relations and our continuing consultations with Congress.

Conclusion

I have concentrated my attention today on two specific areas of international trade in which our Government is actively pursuing policies which have as an objective, the strengthening and expansion of international markets for U.S. enterprise. Our work in the MTN, with its ambitious goals, presents many difficult challenges, but when completed will result in the stronger international trading framework we all seek. In East-West trade, our efforts to change the Trade Act to eliminate discriminatory restraints on our trade with the non-market economy countries will, when successful, open the way for much greater expansion of U.S. trade in those markets. I want to express my own awareness and appreciation of the role of your industry in these efforts, particularly in the MTN. The two Electronic Industry Sector Advisory Committees are making a thorough and very useful contribution to the U.S. effort in the MTN. We continue to look forward to a good working relationship with you and your industry.

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FOR IMMEDIATE RELEASE

STATEMENT OF WILLIAM M. GOLDSTEIN
DEPUTY ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY
ON H.R. 11920
BEFORE THE WAYS AND MEANS COMMITTEE
MARCH 29, 1976, 10:00 a.m.

Mr. Chairman and Members of the Committee:

Thank you for inviting me here today to discuss capital exchange funds, or swap funds. These funds enable investors who own appreciated securities to diversify their investment portfolios without paying tax on capital gain. Ten years ago Congress thought it had solved this problem by amending the Internal Revenue Code to tax transfers to swap funds organized as corporations. H.R. 11920, the bill before you today, would extend this policy to cover swap funds organized as partnerships. The Treasury supports this portion of the bill, assuming that there will be appropriate protection for those who have relied on existing law.

In addition to the provisions just described, H.R. 11920 seeks to prevent so-called two-step swap funding by denying tax-free treatment to any acquisitive reorganization involving an "investment company." By denying tax-free reorganization treatment where the assets of one of the parties consist primarily of readily marketable investment assets, this proposal would make taxable not only reorganizations intended to achieve tax-free diversification by a single investor or a small group of investors who have formed a holding company, but also reorganizations involving one or more publicly held mutual funds motivated by legitimate business purposes including survival, efficiency and growth. The Treasury thus opposes the proposed amendment of section

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368 as overly broad. We would, however, like to work with the Committee in designing legislation which would prevent the evasion of the basic ban on swap funds through corporate reorganizations.

I will first discuss the changes which H.R. 11920 would make with respect to swap funds organized as partnerships. Then I will comment on the proposed changes in the tax treatment of acquisitive reorganizations.

How swap funds work

To achieve diversification, an investor ordinarily must sell a portion of his securities and reinvest the proceeds. However, if he does so, he will realize gain which is subject to a capital gains tax. Swap funds enable investors to diversify their assets without paying this capital gains tax.

Swap funds now rely on section 721 of the Code which allows the tax-free contribution of property to a partnership in exchange for a partnership interest. The theory underlying this Code provision, in general, is that the transfer represents a change in the form, rather than the substance, of ownership. To facilitate movement into the partnership form of doing business, Congress has long permitted the tax-free formation of a partnership.

In its simplest form, a swap fund involves two investors -- one with appreciated stock in Company A and the other with appreciated stock in Company B. If these investors decide to form a partnership to manage their investments and each contributes his appreciated stock in exchange for an interest in the partnership, section 721 will prevent the recognition of gain upon the exchanges. Each of the two partners will receive an undivided interest in the partnership's holdings of stock in Companies A and B, thus diversifying his assets, and no capital gains tax will be due.

A typical syndicated swap fund involves many investors. The promoters organize a partnership, register it with the Securities and Exchange Commission, make a public offer to exchange partnership interests for investment securities, and solicit deposits of such securities on a large scale. Investors who participate in swap fund transfers generally contribute sizeable blocks of undiversified, highly appreciated stock.

After securities are transferred, the swap fund partnership operates as a diversified investment company with redeemable shares. The appreciation on the securities transferred to the fund will not be taxed until the partnership sells the securities or the partners sell or redeem their fund shares. In general, except to raise cash to pay commissions, neither such sales nor redemptions are likely to occur since the securities have the same low tax basis in the hands of the partnership as they had in the hands of the contributing partner and since the partner's carryover basis in his partnership interest is similarly low. The sale of the securities or the partnership interest would incur the very tax the partnership was created to avoid. Under present law, of course, if the partner retains his partnership interest until death, his gain will escape income tax entirely.

It would be most difficult to estimate the revenue consequences of this portion of the proposed legislation. In the past, the average cost of securities transferred to swap funds has approximated 15 percent of their fair market value. If these securities were transferred to swap funds tax-free, a relatively small amount would be sold in taxable transactions to pay sales commissions. Apart from these sales, however, it is our understanding that, as might be expected, the portfolio turnover in existing swap funds has been very limited. Moreover, the prospectus of the Vance Sanders Exchange Fund currently states: "Because of the nature of the Fund, it is expected that the portfolio turnover will be low by industry standards and, especially in the early years, should not exceed 10 percent." On the other hand, if the proposed bill is enacted and the prospective swap-fund partners retain their securities, it is most difficult to predict the extent to which an investor's objective of diversification will overcome his desire to avoid tax on the appreciation.

Past efforts to eliminate swap funds

More than 50 years ago, Congress sought to prevent tax-free exchanges of appreciated securities by specifically excluding stock and securities from the non-recognition rules provided for "like kind" exchanges. When this exclusion was enacted, the then Secretary of the Treasury Andrew Mellon called attention to "wide abuse" of the law. Writing to the Ways and Means Committee, he said, "Many brokers, investment houses, and bond houses have established exchange departments and are advertising that they will exchange securities for their customers in such a manner as to result in no taxable gain."

The similar practice of swap funding developed about 15 years ago, primarily in connection with funds organized as corporations. Like the formation of a partnership, the organization of a corporation will ordinarily be tax-free. Section 351 of the Code provides for non-recognition of gain or loss upon transfer of property to a corporation in exchange for the corporation's stock, where the transferors are in control of the corporation immediately after the exchange.

In 1959 and 1960 the Internal Revenue Service issued rulings which accorded section 351 non-recognition treatment to promoter-solicited transfers to corporate swap funds. Reconsidering its position, the Service announced in 1961 that it would no longer issue rulings on such transfers. T.I.R. 303 (Feb. 9, 1961). Later the Service extended this no-ruling policy to transfers to swap funds organized as partnerships and trusts. T.I.R. 312 (Mar. 13, 1961); Rev. Proc. 63-20, 1963-2 C.B. 754. Notwithstanding this no-ruling policy, swap funds continued to flourish on the basis of favorable opinions of private counsel.

However, in July of 1966, the Service proposed regulations to make transfers to swap fund corporations taxable. These regulations would have denied section 351 non-recognition treatment to "a transaction which is in substance a device, or the net effect of which is, to achieve an immediate or delayed market place sale or exchange of stock or securities." The regulations specifically applied to "the transfer by taxpayers of stock or securities to a corporation which is an investment company, in exchange for stock or securities (redeemable at the holder's option) in such corporation, if the transfer was solicited or arranged by a broker or similar intermediary and if the filing of a prospectus with the Securities and Exchange Commission (or any State agency performing similar functions) was required in connection with the transaction." Prop. Treas. Reg. section 1.351-1(c), 31 Fed. Reg. 9549 (1966).

In November 1966 Congress adopted the substance of the proposed regulations by amending section 351 to make it inapplicable to post-1966 transfers to "an investment company." P.L. 89-809, section 203 (Nov. 13, 1966). In some respects the legislation went further than the proposed regulations. As Senator Long pointed out at the time, the legislation denied tax-free treatment to transfers to real estate investment funds and transfers to investment companies not required to register with the SEC. The legislation also denied tax-free treatment regardless of whether or not brokers or other intermediaries participated in the organization of the investment company.

<u>Need for legislative action to curb swap funds in partnership form</u>

In 1966 Congress considered only the problem of swap funds operated in corporate form. We now face a resurgence in the use of swap funds organized as partnerships. Allowing tax-free treatment to partnership swap fund transfers would permit circumvention of the policy against tax-free diversification which Congress has incorporated into sections 1031 and 351. The same policy should apply to partnership swap funds for they operate in the same manner as the investment companies which are now dealt with in section 351.

Partnership swap funds threaten to become even more widely used than were corporate swap funds in the 1960's. Even before 1966, a corporate swap fund generally could not receive additional appreciated property after its initial closing because such a transaction would not have been tax-free under the "control" requirement of section 351. Under section 721, however, a limited partnership swap fund may accept new partners holding appreciated securities at any time without tax being imposed on the transferors.

Partnership swap funds may be more attractive to investors for an additional reason. Since section 736 arguably does not apply to distributions of property other than money, the redemption of a partner's interest is governed by section 731, under which gain is not recognized upon redemption of a partner's interest in the partnership, except to the extent that any money distributed exceeds the basis of his interest. Thus, the potential exists for a "true" swap; that is, a limited partner could transfer appreciated securities to the fund tax-free and later - perhaps after five years - have his partnership interest redeemed tax-free by a transfer of a diversified package of securities contributed by other partners. Evidencing the potential popularity of partnership swap funds, one partnership fund has already received deposits of securities of significantly higher total dollar value than most of the corporate funds received ten years ago.

The Internal Revenue Service has recognized the threat which partnership swap funds pose to the legislative policy against tax-free diversification of stock and securities. It has concluded, however, that existing law does not permit the denial of section 721 non-recognition treatment to such funds. For this reason, the Service ruled in April 1975 that transfers of appreciated securities to the Vance, Sanders Exchange Fund, in exchange for interests in the fund, would be tax-free under existing law.

After issuance of the Vance, Sanders ruling, and before February 17, 1976 (the day on which H.R. 11920 was introduced), the Service received four similar ruling requests. Rulings have not been issued in these four cases and, on February 18, 1976, the Service announced that, "pending definitive action with respect to proposed legislation," it would no longer issue advance rulings in connection with the transfer of securities in exchange for a partnership interest in an investment partnership. T.I.R. 1445.

The policy against tax-free diversification which is embodied in the 1966 amendment to section 351 should be extended to cover partnerships. H.R. 11920 would accomplish this by amending section 721 of the Code to provide for recognition of gain realized upon the transfer of property to "a partnership which would be treated as an investment company (within the meaning of section 351) if the partnership were incorporated." The bill would also amend sections 722 and 723 to provide for appropriate basis adjustments in the event that such gain is recognized; that is, the basis of the stock and securities in the hands of the partnership, as well as the basis of the partner's interest in the partnership, would be increased by the amount of the gain recognized. The Treasury supports these proposed amendments to sections 721, 722 and 723.

In addition, the Treasury suggests that the Ways and Means Committee make it clear that the policy against tax-free diversification would cover swap funds organized as trusts. Swap fund trusts do not appear to be a problem at the present time, but they have existed in the past. The 1966 amendment to section 351 and the regulations thereunder already cover real estate investment trusts and trusts taxable as corporations.

"Grandfather clause"

In amending the law to discourage swap funds, consideration must be given to persons who have relied on existing law and, in one case, on a recent private letter ruling. H.R. 11920 would make the proposed amendment to section 721 applicable to transfers made after February 17, 1976, in taxable years ending after such date. The Treasury believes that this effective date provision would be unfair to taxpayers such as the Vance, Sanders Exchange Fund which have expended considerable amounts of time and money in organizing and preparing to market partnership swap funds but have not yet effected the actual exchange of securities. Broker-dealers have also spent time and incurred expenses in connection with these funds.

The 1966 amendment to section 351 included a generous grandfather clause. Enacted on November 13, 1966, the amendment provided that transfers to investment companies would be tax-free: (1) if made on or before June 30, 1967; (2) if a registration statement was filed with the Securities and Exchange Commission before January 1, 1967; (3) if the aggregate issue price of the stock and securities of the investment company which were issued in the transaction did not exceed the aggregate amount specified in such registration statement as of December 31, 1966, and (4) if the transfer included only property deposited before May 1, 1967. As permitted, companies filed and amended registration statements after enactment of the legislation.

Although recent efforts to organize partnership swap funds have been carried out in reliance on existing law, the circumstances surrounding these efforts differ considerably from the circumstances which existed prior to 1966. Most importantly, the recent organizational activities clearly ran counter to the intent of Congress as expressed in the 1966 amendment to section 351. Moreover, partnerships had been included in the no-ruling policy which applied to swap funds prior to the 1966 legislation. Congress' 1966 action, accomplished with the unequivocal support of the Treasury and the Internal Revenue Service, stood as a strong warning that swap funds might not be allowed to operate in partnership form. The ruling issued to Vance, Sanders in 1975 merely interpreted existing law - it provided no assurance that the law would or should remain the same.

Nevertheless, because of the reliance noted above, the Treasury suggests that H.R. 11920's proposed change in section 721 not apply to transfers made to a partnership within 90 days after enactment of the legislation: (1) if a ruling request pertaining to such transfers was filed with the Internal Revenue Service on or before February 17, 1976; (2) if a registration statement, if one is required, was filed with the Securities and Exchange Commission on or before February 17, 1976; and (3) if the aggregate value of the securities transferred to such partnership does not exceed the greater of (a) $100,000,000 or (b) the value of securities actually deposited pursuant to the registration statement prior to February 29, 1976. We believe that such a rule will satisfy the legitimate reliance interest of the funds and investors in question, without being overly generous.

In suggesting the foregoing grandfather clause, we have noted that the law on its face - that is, section 721 - clearly supported the taxpayers' requested rulings, that the Vance, Sanders ruling was issued in April 1975 and widely publicized, and that the three other funds which registered with the SEC had each received assurances from the Internal Revenue Service that a favorable ruling could be obtained so long as their transactions were substantially identical to the Vance, Sanders fact pattern. We further noted that all of the work in connection with the ruling requests and the SEC filings was completed by December 1975, well before the first date on which the February 17, 1976 cut-off was suggested. Indeed, similar legislation introduced by Congressman Corman on February 5, 1976, provided that the legislation would be effective on the date of enactment. Finally, we would like to point out that the $100,000,000 per fund limitation and the 90 day closing period will effectively limit the sales activities and size of even those few funds which will obtain the benefit of this grandfather clause.

<u>Legislation to prevent use of tax-free reorganizations to achieve swap funding</u>

H.R. 11920 seeks to prevent tax-free diversification achieved not only through the use of partnership swap funds, but also through acquisitive reorganizations. Unfortunately, however, the bill's proposed changes in the tax treatment of reorganizations are overly broad and potentially harmful.

The swap fund transfers made taxable by the 1966 amendment to section 351 achieved tax-free diversification in a single transaction, or one "step." The legislation designed to curb such transfers may sometimes be circumvented by combining a tax-free section 351 transaction with a subsequent tax-free reorganization. For example, an individual holding undiversified investment securities may form a corporation under section 351 to hold those securities and later, after the incorporation is "old and cold," merge such corporation into another having diversified assets. Together, the two transactions may achieve tax-free diversification.

The Treasury regulations implementing the 1966 amendment to section 351 are intended to prevent two-step swap funding where the first step is taken with a view toward the second. In defining a taxable transfer to an investment company, the regulations list various characteristics, including the following: "The transfer results, directly or <u>indirectly</u>, in diversification of the transferors' interests." Treas. Reg. section 1.351-1(c) (1967). (Emphasis added.) In addition, the regulations provide as follows:

> If a transfer is part of a plan to achieve diversification without recognition of gain, such as a plan which contemplates a subsequent transfer, however delayed, of the corporate assets (or of the stock or securities received in the earlier exchange) to an investment company in a transaction purporting to qualify for nonrecognition treatment, the original transfer will be treated as resulting in diversification. Treas. Reg. section 1.351-1(c) (1967).

If, however, sufficient time elapses between the transfer of assets to the first corporation and the subsequent merging of that corporation into another, it becomes extremely difficult - if not impossible - to determine intent at the time of the original transfer.

Two-step swap funding may also take place in other factual situations. For example, an undiversified personal holding company organized prior to 1967 could be merged into a regulated investment company without current tax on the appreciated securities. Again, a closely held business corporation which sold its assets in a "C" reorganization in 1970 and retained the acquiring corporation's stock could now be merged tax-free into a mutual fund. Since the consequences of these transactions so closely resemble the formation of a swap fund from the investor's point of view, it would seem that similar limitations should apply.

H.R. 11920 would amend section 368 of the Code to deny tax-free treatment to all "A," "B," and "C" reorganizations involving an "investment company." Based on the regulations which define an investment company for purposes of section 351, the proposed change in section 368 would affect any such acquisitive reorganization involving a regulated investment company, a real estate investment trust, or any corporation "more than 80 percent of the value of whose assets ... are held for investment and are readily marketable stocks or securities, or interests in regulated investment companies or real estate investment trusts." Treas. Reg. section 1.351-1(c) (1967). In other words, H.R. 11920 would deny tax-free treatment to any acquisitive reorganization involving a corporation whose assets consisted primarily of readily marketable investment assets unless, perhaps, the transaction also qualified as a "D" reorganization. We believe this rule is much too broad and would create uncertainty in many reorganization transactions which bear little or no resemblance to swap funding.

Like sections 351 and 721, the reorganization provisions are intended to facilitate changes in the form of doing business and they are based, at least in part, on the assumption that reorganization transfers represent a change in the form, rather than the substance, of ownership. Carrying out this intent, section 368 of the Code carefully defines six types of reorganization which may qualify for tax-free treatment. In addition, the regulations under section 368 incorporate judicially developed tests of business purpose and continuity of interest. Reorganizations may qualify for tax-free treatment only if they "are required by business exigencies and ... effect only a readjustment of continuing interest in property under modified corporate forms." Treas. Reg. section 1.368-1(b) (1955).

The unfavorable investment climate of the past several years provided business reasons for a good number of investment companies to merge. According to the Investment Company Institute, the total net assets of mutual funds fell from $59.8 billion at the end of 1972 to $35.7 billion at the end of 1974. It is our understanding that the Securities and Exchange Commission has actively encouraged mergers between strong mutual funds and those which are weak. Further, economies of scale and the opportunity to obtain more experienced management have led to a series of apparently beneficial mergers. Because continuity of interest is also present in these transactions, most reorganizations between investment companies have come within the spirit, as well as the letter, of the tax-free reorganization provisions. Yet H.R. 11920 would deny them the benefits of those provisions.

Notwithstanding the foregoing, legislation does appear to be needed to prevent undesirable tax-free diversification. The primary elements of swap funding are the carryover of low tax basis, with its accompanying untaxed appreciation, plus the diversification of investment assets. These elements are most likely to be present where a relatively small, closely held company is merged into a considerably larger company. It appears that, among reorganizations involving investment companies, carryover of low basis and diversification of assets are most likely to be present where the investment company is a personal holding company.

In our view, even a rule which would deny reorganization treatment only to mergers between personal holding companies and regulated investment companies would be too broad. For example, if the personal holding company already possessed a diversified portfolio or had no substantial net appreciation in its assets, the swap funding rules should not apply; such mergers might very well take place due to the desire of the owners of the personal holding company to achieve more experienced asset management. Thus, further limitations pertaining to the degree of appreciation of the portfolio and the composition of the assets of the personal holding company might be appropriate. We believe these questions should be further studied in order to eliminate any potential abuses without denying customary reorganization treatment to transactions which, as noted above, comply with both the spirit and letter of the reorganization provisions.

It has also been suggested that an improper motivation for the acquisition of one investment company by another would be the desire of the acquiring company to obtain the "built-in" tax losses of the transferee. Industry representatives deny the validity of this contention on the grounds that fund managers are looking for profits and not losses and, in any event, there are already provisions in the Code which deal with the denial of tax perquisites following their transfer for improper motives. If, after further study, we conclude that there is potential abuse in this area, we would recommend that it be handled outside the context of legislation dealing with swap funds.

In conclusion, the Treasury supports H.R. 11920's proposed changes in sections 721, 722 and 723, with appropriate protection for taxpayers who have relied on existing law. We urge the Committee to take prompt action on this matter. On the other hand, the Treasury opposes the bill's proposed change in section 368 as overly broad. While we would support more narrow legislation, structured along the lines I have suggested, designed to curb avoidance of past and present swap fund legislation, any such provision would require careful study and draftsmanship. We do not believe that the proposed amendment to section 721 should be delayed pending the completion of this task.

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STATEMENT OF THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE THE COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE
REGARDING U.S. PARTICIPATION IN THE
FINANCIAL SUPPORT FUND OF THE OECD
MARCH 26, 1976, 2:00 P.M., RM 4221, NSOB

Mr. Chairman and Members of the Committee:

You have asked for an update of Administration views on U. S. Participation in the proposed OECD Financial Support Fund -- or "financial safety net." I appreciate you scheduling this hearing, for I believe that prompt ratification by the U.S., and prompt establishment of the Support Fund, are becoming increasingly urgent. I hope today's hearing will expedite action on this proposal.

The proposed Financial Support Fund is designed to provide a comprehensive framework for cooperative action by the major oil importing countries to deal with the real and financial implications of the energy crisis. It will:

-- assure that needed financing is available to participants to support sound policies;

-- enable countries to avoid recourse to damaging and ultimately self-defeating actions to protect their own financial positions;

-- require a basic commitment to cooperation in energy and economic policy as a pre-condition for participation; and

-- require specific actions in energy and economic policy by prospective borrowers.

In essence, the Support Fund will provide the financial cement for cooperation among the major oil importing countries across the broad range of economic policy issues -- and the financial independence and self-confidence essential for national commitment to that cooperation.

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I will focus my remarks today on two main questions that I know are of concern to the Committee: first, whether the Support Fund is still needed now, almost ten months after it was first proposed to the Congress; and second, whether the design of the Support Fund adequately safeguards U.S. financial and economic interest -- including our interest in assuring that any U.S. assistance is used properly and effectively.

In my judgment, the need for the Support Fund is more critical now than when it was first proposed. And I am convinced that it contains every possible safeguard of U.S. interests. Other participants are moving to ratify the Support Fund Agreement, but the prospects for its establishment are clouded by doubts abroad about our own interest and commitment. The Support Fund bill deserves the strong and unified support of the United States Government. I strongly urge that the Committee take prompt and favorable action on this legislation.

Need for the Financial Support Fund

The Agreement to Establish the Financial Support Fund originated in parallel proposals developed by the United States and by the Secretary-General of the OECD. Those proposals, first advanced in late 1974 and approved by OECD Finance Ministers in April 1975, were developed against the background of major shifts in world payments patterns and financing needs following the oil price increases. The financial problems caused by the increases in oil prices created a serious threat to individual oil importing nations and to the world economic and political order; and the Support Fund was designed to provide a solid financial underpinning for the cooperative effort needed to meet that challenge. It reflected a real concern with the need for the major nations of the world to avoid destructive reactions to unprecedented changes in their balance of payments positions; and the need not only to maintain but to strengthen cooperation among the major countries in economic and energy policy at a time of exceptional difficulty. Countries have succeeded thus far in avoiding resort to beggar-thy-neighbor and protectionist practices. But the challenge remains.

The Support Fund is a mutual insurance mechanism. The term "safety net" is apt. The proposal derived from intense worldwide concern that oil importing nations, acting independently, would not be able to manage the financial and economic consequences of the oil price increases -- that countries, unable to obtain financing on reasonable terms, could move to protect themselves through the adoption of competitive exchange rate practices, trade restrictions or other internationally destructive policies -- and that other countries would respond in kind to protect their own positions. Once started, such actions could quickly spread, with disastrous consequences for the world economy. The risk is shared by all. The Support Fund is designed to protect against this common risk, and, as in any insurance program, it is financed by all. It will provide assurance to an individual participant that if it cannot obtain needed funds elsewhere on reasonable terms -- and on the condition that it accept energy and economic policy conditions designed to correct its problems -- the needed financing will be available.

We are fortunate that widespread resort to restrictive and aggressive economic policies has been avoided so far. With very few exceptions, oil importing countries have managed their affairs in a way that has not shifted great burdens onto others. This favorable experience has lead some to conclude that the effects of the oil crisis have come and gone and that the Support Fund today is an anachronism; or that the Support Fund proposal never had a serious substantive rationale but simply represented a political ploy to generate support in negotiations with the oil exporting nations.

To the contrary. The Support Fund represented -- and represents -- the essential international framework we must have to come to grips with our problems in a comprehensive and purposeful way. Countries have been slow to adopt the policies that are needed; and the view that the financial and economic problems caused by the energy crisis are behind us reflects a serious misreading of events and of the situation we face today and in the future. The private capital markets and existing official financial arrangements have indeed worked well; and the more flexible exchange rate arrangements now in place have helped to begin the difficult adjustment to changing international circumstances. The market has done its job -- and the total financing need within the OECD area was greatly, though temporarily, reduced last year by the world recession.

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But adjustment has not proceeded rapidly enough or at an even pace within the OECD area. Some countries have been very slow in adopting corrective policies. Huge debts have been accumulated. These debts continue and are reflected in radically changed balance sheet structures of both borrowers and lenders. Moreover, extensive recourse has been made to the IMF and to other official financing arrangements, and many countries have drawn their readily available reserve holdings down by substantial amounts.

While corrective action may now be under way, there may be a lag in the market's perception of that adjustment; and in those cases, adequate financing from existing sources may not be guaranteed. Recent exchange market disturbances provide a forceful illustration that a sense of complacency is not justified.

Nor can the provision of financing alone assure the adjustment that countries must make to the new circumstances they face. What is required is a judicious combination of internal adjustment, external adjustment, and financing. The provision of financing must be accompanied by energy and economic policies that get at the source of countries' financial problems.

The job of the Support Fund -- as a vehicle for decisions by Finance Ministers in participating countries on the extension of credit to other members -- is to bring the proper balance among these three elements. It is not and cannot be regarded as a bail-out operation. Acceptance of stringent, effective policy conditions is an integral part of the Support Fund approach. Adjustment policies, and financing to help those policies along, are essential in proper doses. Responsible adjustment cannot be achieved overnight. Without a proper balance, the dangers are serious: competitive manipulation of exchange rates; resort to controls over imports and capital; restrictive domestic policies that threaten world economic recovery. Such moves -- resort to beggar-thy-neighbor policies -- cannot be in the interest of the United States or our overseas neighbors.

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The Support Fund has an important role to play in sustaining the system and in inducing countries to follow adjustment policies which are both effective and internationally responsible. It is urgent that we put it in place promptly.

Principal Features of the Financial Support Fund

The Financial Support Fund is designed to meet a special complex of problems. Its features are unique. It is singularly suited to the situation we face, and it is tightly constructed, incorporating strong and effective safeguards to U.S. economic and financial interests.

First, the Support Fund is not an automatically available lending facility. It is an insurance mechanism. Countries must demonstrate that they have made the fullest appropriate use of alternative sources of financing. They must accept energy and economic policy conditions designed to correct their internal and external problems -- conditions which will be set by Finance Ministers in the other participating countries. Such conditions are essential to dealing with the problems we face.

Second, the U.S. will have a major voice, in many cases a decisive voice, in all operations of the Support Fund. All decisions on loans, policy conditions and financing will require a two-thirds majority vote at a minimum. With a quota and voting share of 27.8 percent, the U.S., along with one or two other countries, will be able to prevent loan proposals it does not favor. Loans above a country's quota and less than twice its quota will require a ninety percent vote, and loans of larger amounts will require a unanimous vote. Thus the U.S. acting along could block any credit in excess of a country's quota. I believe these voting provisions give the U.S. ample safeguards over the Support Fund's operations, and ample opportunity to guide those operations in directions we think appropriate.

The proposed U.S. quota is SDR 5,560 million, or approximately $6-1/2 billion at current dollar rates for the SDR. Quotas in the Support Fund are intended to reflect a rough measure of countries' relative economic weight in the OECD area, and I consider the U.S. quota to be a reasonable share for us to accept and exercise.

Third, the Support Fund rests fundamentally on the sharing of risk. Its provisions are expressly designed to assure widespread participation in financing by members, and to assure an equitable distribution of risk regardless of financing technique. The burdens of financing and risk will thus not fall to the one or two countries that may be in a relatively strong position at the time financing is needed. As you are well aware, the United States has found itself in this position in the past. I have no doubt that we would respond again to an urgent need. But I consider it far better to have an appropriately designed and equitable multilateral structure in place if the need arises, than to rely on AD HOC efforts to deal with a sudden crisis. The Support Fund spreads the risk, and its rules for decisions on loans afford the United States an appropriate degree of control over its operations.

Fourth, the Support Fund is not a foreign aid gimmick, or a soft loan facility. It is not an automatic line of credit. Maturities will be medium-term, not beyond seven years. Interest charges will be based on market rates. The aim is to assure that financing will be available to countries that need it -- not that it will be available on concessional terms and, most imporantly, not that it will be available without strict policy conditions.

Fifth, the Support Fund is designed to meet a transitional problem, and it is temporary in character. Its lending operations will expire after two years -- and if a need for extension were to arise, we would seek new Congressional authorization.

Finally, countries' financial commitments will be made available on a standby and not a paid-in basis, and those commitments will be activated only if and when a need arises. Furthermore, it is likely that the Support Fund will operate by borrowing in world financial markets on the strength of guarantees issued by its members, although countries will have an option under some circumstances or providing direct loans to the the Support Fund. We intend to meet U.S. obligations to the Support Fund through the issuance of guarantees. The proposed legislation thus provides authority for the issuance of guarantees and for appropriations to be sought in the highly unlikely event of default by a borrower from the Support Fund. In no event will U.S. obligations to the Support Fund exceed our quota.

Conclusions

Mr. Chairman, I view the Financial Support Fund as an important and well-designed element of our international economic policy. The signing by OECD countries of the agreement to establish the Support Fund represented a political commitment to cooperation across the broad scope of international economic and financial issues. As such, I am convinced that the prospect of the Support Fund has, in itself, contributed greatly to an atmosphere of intensified economic and financial cooperation. That atmosphere of cooperation has not only prompted countries to avoid damaging restrictive action in the face of unprecedented difficulties, but it has also, in my judgement contributed to the satisfactory resolution of complex and difficut issues involved in amendment of the IMF Articles of Agreement, amendments which will shortly be the subject of legislation to be considered by this Committee.

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Action to establish the Financial Support Fund has become urgent in two respects. Far from having dealt in a meaningful way with the economic and financial implications of the oil crisis, we are seeing evidence of financing difficulties on the part of some countries. We can no longer afford to defer action on the basis of a hope that the need has passed. That hope is false Second, action on ratification by other OECD countries is at an advanced stage. Twelve countries, with quotas amounting to about 43 percent of the total, have already either ratified the Agreement or have completed their legislative procedures and are expected to ratify shortly. Most other are in advanced stages of their legislative processes. But all are now looking to the United States to provide concrete evidence of the leadership and concern which underlay its orginal proposals for the Support Fund nearly 16 months ago.

I have met frequently with other Finance Ministers during the past year, in the OECD, in the IMF Interim Committee, and various smaller groups. We are attempting to build a stronger structure of cooperation, and extensive cooperation has been required to deal both with the changes that have been agreed in the rules of the monetary system and with market developments that have arisen. I know from these contacts that all regard the Support Fund as an important part of the structure we are building: important for its own sake, important for the impetus it can give to broader cooperation.

Action to approve U.S. participation will provide firm evidence of the continuing U.S. commitment to cooperation and will help to ensure the preservation of a liberal, open and prosperous world economic order. I urge your strong support in this effort.

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The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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FOR IMMEDIATE RELEASE March 29, 1976

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2.6 billion of 13-week Treasury bills and for $3.4 billion of 26-week Treasury bills, both series to be issued on April 1, 1976, were opened at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 1, 1976			26-week bills maturing September 30, 1976		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	98.762 a/	4.898%	5.03%	97.336	5.269%	5.49%
Low	98.749	4.949%	5.08%	97.295	5.351%	5.58%
Average	98.754	4.929%	5.06%	97.307	5.327%	5.55%

a/ Excepting 1 tender of $50,000

Tenders at the low price for the 13-week bills were allotted 44%.
Tenders at the low price for the 26-week bills were allotted 22%.

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Received	Accepted	Received	Accepted
Boston	$ 71,440,000	$ 46,320,000	$ 65,270,000	$ 65,270,000
New York	3,959,080,000	2,086,280,000	4,183,700,000	2,625,480,000
Philadelphia	24,000,000	24,000,000	27,500,000	27,500,000
Cleveland	34,230,000	34,230,000	82,895,000	82,895,000
Richmond	27,450,000	26,650,000	59,255,000	50,255,000
Atlanta	35,655,000	35,655,000	13,890,000	13,890,000
Chicago	260,710,000	123,430,000	344,820,000	279,920,000
St. Louis	59,650,000	36,650,000	41,490,000	21,490,000
Minneapolis	30,040,000	26,680,000	23,550,000	23,550,000
Kansas City	56,990,000	54,640,000	24,725,000	21,725,000
Dallas	41,395,000	39,835,000	18,005,000	16,005,000
San Francisco	278,015,000	67,505,000	234,505,000	172,325,000
TOTALS	$4,878,655,000	$2,601,875,000 b/	$5,119,605,000	$3,400,305,000 c/

b/ Includes $370,250,000 noncompetitive tenders from the public.
c/ Includes $179,950,000 noncompetitive tenders from the public.
1/ Equivalent coupon-issue yield.

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RANGE OF ACCEPTED 13-
COMPETITIVE BIDS: maturi

	Price
High	98.762 a
Low	98.749
Average	98.754

a/ Excepting 1 tender of

Tenders at the low p
Tenders at the low p

TOTAL TENDERS RECEIVED AN

District	Received
Boston	$ 71,440,(
New York	3,959,080,(
Philadelphia	24,000,(
Cleveland	34,230,(
Richmond	27,450,(
Atlanta	35,655,(
Chicago	260,710,(
St. Louis	59,650,(
Minneapolis	30,040,(
Kansas City	56,990,(
Dallas	41,395,(
San Francisco	278,015,(
TOTALS	$4,878,655,(

b/ Includes $370,250,000
c/ Includes $179,950,000
1/ Equivalent coupon-issu

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This Wk. 4.929%
Last Wk. 4.890%
Highest since 3/15/76 4.981%

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This Wk. 5.327%
Last Wk. 5.283%
Highest since 3/15/76 5.459%

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FOR RELEASE AT 4:00 P.M. March 30, 1976

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TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $6,200,000,000, or thereabouts, to be issued April 8, 1976, as follows:

91-day bills (to maturity date) in the amount of $2,700,000,000, or thereabouts, representing an additional amount of bills dated January 8, 1976, and to mature July 8, 1976 (CUSIP No. 912793 ZX 7), originally issued in the amount of $3,500,915,000, the additional and original bills to be freely interchangeable.

182-day bills, for $3,500,000,000, or thereabouts, to be dated April 8, 1976, and to mature October 7, 1976 (CUSIP No. 912793 B4 7).

The bills will be issued for cash and in exchange for Treasury bills maturing April 8, 1976, outstanding in the amount of $6,194,140,000, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,503,210,000. 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 non-competitive 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 Standard time, Monday, April 5, 1976. 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

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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 April 8, 1976, in cash or other immediately available funds or in a like face amount of Treasury bills maturing April 8, 1976. 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.

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Remarks by the Honorable William E. Simon
Secretary of the Treasury
Before the
University Club of New York
New York City, March 30, 1976

Thank you Harold Helm, ladies and gentlemen:
It's a great pleasure for me to be back here at the University Club among so many old friends and familiar faces. I have been looking forward to the opportunity to renew acquaintances and talk about some of the economic and social concerns that we share. And I have also been looking forward to this chance to visit New York again as a friend rather than as a sparring partner in the vigorous adversary process of government.

I love this city and its people for their vitality, their diversity and the richness of their heritage. We may not all agree on the solution to New York's problems -- but we are all united in our desire to do our best to solve them. And I want to express my admiration for those New Yorkers in and out of government who are showing a willingness to make the necessary sacrifices and exercise the necessary responsibility and restraint to restore this great city to economic health and promise.

Earlier this month I paid another kind of visit to a part of the world that makes New York seem tranquil and untroubled by comparison -- I made a two-week tour of the Middle East. That turbulent area that is terribly bound up with the future of global peace has many problems and none of them is going to vanish overnight. While I did return fully aware of the grave problems that confront them, I did return with one positive impression. Today, despite old animosities and conflicts, both the Arabs and the Israelis, regardless of their differences, realize that the United States has developed the most dynamic and efficient economic system the world has ever known. And for this reason both sides look to the United States as the major source of strength and stability -- economic as well as political --

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in an unstable world. No other country is capable of playing this role for peace.

As Secretary of Treasury, I find this both encouraging and awesome. Encouraging, because I am convinced that the way to a peaceful world political order can only come through a strong, stable world economic order -- therefore, for the Middle East peace and prosperity can and must go hand in hand. And I find it awesome because it reminds me once more of how vitally important the American economy is, not only to our everyday comfort and convenience, but to the preservation of peace and freedom in the world. Economic statistics may make for pretty dull reading, but the facts behind the figures are a massive, perhaps decisive shaping force in the lives we live today, and in the future course of America and the world.

We must never lose sight of the fact that a strong non-inflationary domestic economy is an absolute necessity. The only way to be diplomatically strong abroad is to be economically strong at home.

As for the domestic reasons for sound economic policies, the events of the past few years have made them painfully obvious.

As I look around this room, I realize that among you are many whose businesses were hard-hit by the recent recession and simultaneous double-digit inflation. Perhaps some of you fear that our economy is still in trouble, our economic future uncertain. Well, as we all know, economics is an inexact science in the best of times, but we do have extensive, impressive data indicating a healthy economic recovery. Let's look at the facts:

-- 1975 opened with inflation raging at 13 percent; we have now cut that rate in half, and this month's rise in the consumer price index was the smallest since September of 1971.

-- During the spring of 1975, the unemployment rate reached nine percent; today it is 7.6 percent and the trend is clearly downward.

-- Over two million jobs lost during the recession have now been restored.

-- And during the third quarter of 1975 we registered the biggest single jump in the GNP in 25 years, and the fourth quarter's pace indicated the recovery was still gaining momentum.

Thus we made considerable headway in 1975, and we will make even more in 1976. But it's not good enough and this is certainly no time for complacency. The unemployment rate is still far higher than we can tolerate. And inflation is by no means under control. In fact inflation remains the most dangerous enemy of real economic growth. All of us, especially those with a say in federal spending, must do everything we can to prevent another inflationary spiral. Let there be no doubt about it. The ruinous inflation that crested in 1974 was the chief cause of the recession of 1975. And if we reembark on excessive fiscal and monetary policies I can guarantee you a new bout of double-digit inflation and an even worse recession than before. Let us learn from history. Let it never be said that the pain and suffering of the 1974-75 recession were in vain because the politicians in Washington once again ignored the national interest and refused to face economic reality.

But the politicians are only part of a larger problem and that is what I want to speak to you about tonight. I am deeply concerned that our country is fundamentally unaware of what our free enterprise system is all about -- what it has accomplished for our people and how critically important it is to our future. Nearly everyone takes for granted the fruits this marvelous system has created -- the abundance, the opportunity, the freedom of choice, the unprecedented opportunities for learning, travel, and general upward mobility. And too few understand the basic economic principles that make all this possible.

Are you surprised then that as soon as economic difficulties like recession hit, millions of otherwise reasonable people fall for the quack cures of politicians who will promise anything as an excuse for another wave of quick fix government spending? And, while that approach might provide some short term relief both for the economy and for politicians facing re-election, it only aggravates the basic long-term ills of inflation and stagnation in the private sector.

The reason I am here tonight is to appeal to you -- not only for your support, but also for your direct participation in a massive effort to preserve the economic freedoms that have given this country both the greatest prosperity and the greatest freedom ever known to man. For what is at stake now is not just the future of this or that industry. What really hangs in the balance is the survival of our private sector, and the individual liberties which have never long survived the collapse of a society's economic freedoms.

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Each of you in the private sector must assume responsibility for its survival and in that regard must begin -- and in some cases reinforce -- a needed moral ingredient. Recent disclosures of corporate bribery are only illustrative of this need for the private sector to exert moral leadership. I am pleased to note that the International Chamber of Commerce has formed a new commission on unethical practices. We in the government are also taking initiatives in that area.

You and I must get the facts across while there is still time, if we don't then our children and grandchildren will be doomed to a system of economic and political bondage that is the very opposite of all we hold dear.

The problem is a matter of both policy and perception. Bad perception leads inevitably to bad policy, and I am firmly convinced that, taken together, misunderstanding and misdirection of the American economy have become the central underlying problem of our times. Unfortunately the perception of what is right or wrong is too often inaccurate, because it is described inaccurately as a superficial division between those who "care" and those who are "callous."

Today's youth often views those who consistently advocate bigger government as the saviours of the modern world out to rescue the persecuted underdog. On the other hand, those who advocate less government and the strengthening of free enterprise are often dismissed out of hand as greedy exploiters out to make a fast buck for themselves or their companies. And -- because image is so all important and bad news is big news -- those who supposedly "care" are often afforded greater media exposure to expound about all our social ills and to claim they can cure them by just cranking out more currency and soaking up more credit through massive deficit spending. In reality, of course, this is no cure at all. It is this same destructive approach that is at the very root of the problems we are struggling with today. Big government isn't the solution; it's a large part of the problem.

We who insist on the superiority of the free enterprise system, emphasizing its competition, efficiency, and profitability are nevertheless losing our argument. We tend to converse in slogans and labels, while the proponents of big government speak in more appealing, seemingly more humane terms. This is unfortunate, and to me it would be difficult to imagine any greater irony. For even the most cursory glance at history shows us that the American economy is the most successful the world has ever known -- precisely because it is an essentially humane creation of the people, by the people, and for the people.

Its performance proves this. In the period since the early 1960s -- a period during which one abuse after another has been inflicted upon our private sector, it has still made remarkable human progress:

-- The real income of the American family has increased by over 40% (and that's after inflation and taxes).

-- Total production has risen by over 60% in real terms even after allowing for three recessions over this time span.

-- The percent of families below the poverty line has been cut in half to 10%.

-- Almost 20 million new jobs have been created.

-- Real farm output has risen over 25%, enabling us to feed not only ourselves, but many millions of other people all over the world.

These are impressive achievements. And they would not have been realized without our adherence to the ideal of economic freedom. Freedom really is what America is all about. Freedom of worship, speech, association and economic opportunity. These are the freedoms that motivated our little colonial army with the courage to fight and win a war of national independence against overwhelming odds. And these same freedoms have drawn millions of immigrants to our shores, many of whom sacrificed everything they had, just to be able to come here and pursue the American dream.

They knew what it was all about. They understood the vital link between economic and political freedom. But too many of our people today have forgotten it.

Success often breeds complacency and, ultimately, contempt. Some of the vital links between past performance and future promise seem to be breaking down. We have reached the point where although the free enterprise system works better than any other in the world -- and although it feeds, clothes, and houses more people more affluently and efficiently than anywhere else while serving as the underpinning of our free society -- it is somehow losing the semantic war to an alien philosophy of government domination and irresponsibility that has never worked, but has somehow managed to preserve an aura of idealism and altruism to our youth.

Those who advocate this government control never mention what it's really like to live in a state-controlled economy. What it means to a person to be told by the state how he will be educated, whether he will be allowed to travel, what kind

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of job he will have, how much he will be paid, what kind of merchandise he will be allowed to buy, where he will live, and ultimately where he will be buried.

Most of our citizens have never seen the long lines of workers and housewives who have to line up for hours outside state-owned food and department stores in order to buy a poor selection of overpriced food staples and state-manufactured clothing and merchandise.

They don't realize what a miracle of variety, economy and productive competition the average American shopping center would represent to nine tenths of the earth's people.

They have never asked themselves why a country like the Soviet Union, with some of the largest tracts of grain-land in the world, but with a government-owned and run agriculture system cannot even feed its own people without turning to our farmers who own their own land, and make their own decisions guided by the incentives of a free marketplace.

They have not studied the contrast between the freedom and prosperity of West Germany and the police state oppression and rigidly government-controlled economic system of East Germany -- a contrast which has led thousands of East Germans to challenge death by barbed wire electrocution or machine gun fire in order to live in the free West.

And they have not experienced first hand the more gradual destruction of opportunity and individual freedom of choice in countries of the democratic west where government ownership of industries and cradle-to-grave welfare spending have brought whole nations to the verge of bankruptcy and crushed the vitality and initiative of the productive middle class.

Now some people of course will protest this as an exaggeration, that no such disaster could ever happen in America. Hopefully not. But the public deserves to be warned that our government is now growing inexorably -- and that as it does, it is gradually and insidiously eroding many of the freedoms we have so long taken for granted. As Alexander Hamilton said long ago, "Power over a man's substance amounts to power over his will."

It is obvious to me that if we ever reach the point where the federal government is taxing and spending 60% of the national wealth we will no longer be an economically free people.

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Let me give you some of the facts. In 1930, government spending at all levels amounted to 10% of the GNP. Today government accounts for almost 40% of our entire national output, and if these trends continue, the government's share of the economy will reach 60% within 25 years.

-- In just 15 years time the federal budget has quadrupled.

-- We have failed to balance the budget for 16 of the past 17 years.

-- And in just ten years time, we have doubled the national debt. It took 75 years for our national debt to reach one billion dollars. Today, government spending is causing the debt to grow by one billion dollars every week.

-- And the average American is bearing a tax burden of almost 30% of his earnings -- that means working for the state instead of yourself from January to April.

The federal government today is the nation's biggest single employer, its biggest consumer, and its biggest borrower. Partly to accomodate the Federal Government's borrowning needs in the private markets, there has been a less noticed but equally significant shift in monetary practices. From 1955 to 1965, the money supply of the United States was growing at approximately 2-1/2% a year. During that period we enjoyed relative price stability. But from 1965 to the present, the average rate of growth in the money supply has almost tripled. It is no accident that during this same period we have also had spiraling inflation.

This past decade has also seen unparalleled growth in the regulatory apparatus of the government. Regulatory agencies of the government have spread their tentacles everywhere. They now exercise direct control over 10% of everything bought and sold in the United States and indirect control over almost every other sector of the private economy. The American people now spend over 130 million work hours a year just filling out federal forms. Indeed the regulatory process has become so burdensome, for all businesses big and small, that it is threatening to strangle much of free enterprise in red tape. Consider the staggering costs involved. Last year private industry spent an estimated $18 billion just to do the paper work demanded by federal bureaucrats. Of course, it is you and I and every other consumer who pay for this in the form of higher prices and higher taxes.

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Here's just part of what the bill now comes to. Our current federal budget is equivalent to about $2,000 a head for every man, woman and child in this country. Our national debt equals almost $3,000 for every citizen. And government regulation adds approximately $2,000 to the costs of purchases made by each American family every year. How can anyone make the case that the increase in government benefits has in any way kept up with the increase in government costs?

When you add up all these facts of excessive government spending, excessive expansion of the money supply, and excessive governmental regulation, one conclusion seems inescapable. If there is such a thing as truth in packaging, both our inflation and our resulting unemployment should bear a label "Made in Washington, D.C."

The fact is that governmental excesses of the past 15 years have become the strong, underlying cause of inflation during the 1960s. They remain so today. The rise in government spending has added enormously to the aggregate demand for goods and services in the economy, thus forcing up prices. And the government's heavy borrowing requirements mean that this year it will soak up 80% of all new loanable capital, leaving only 20% to the entire private sector, which nevertheless must produce virtually all our goods and services and employ 83% of our workforce.

This increasingly massive governmental presence has been an important factor in the persistent rise in interest rates and the strains we have seen in the financial markets. Moreover, it is clear that the cumbersome regulatory procedures of the government have too often stifled competition which has inevitably added billions of dollars to the price of consumer goods.

Now, I am not saying that governmental excesses are the sole cause of our inflation and the recession that followed in its wake. The recent quadrupling of oil prices and rising food prices have also played a significant part. But it is the unbridled growth in government that has reaped the greatest destruction.

The evidence is in and it proves conclusively to me that government, far from being our greatest source of prosperity and material security as some people would have us believe, has now become a direct threat to our survival as a free society. And so, as we enter our third century as a nation, I believe the

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time has come not to reappraise our dedication to a better life for all -- that dedication is clear -- but to reappraise what we can afford to pay for this goal and how we can best achieve it. The current plight of New York, the malaise affecting many other state-controlled nations, and the overwhelming size of our federal deficits are all grave warnings to us. We can pay for what we now have and provide for the future only if our great free enterprise economy is allowed to do its jobs -- produce goods in a free market at a fair price. I am sick and tired of apologizing for free enterprise. It's our profit system that has given this country a prosperity that is now the envy of the entire world. If we were to listen to some of our critics and run our business the way they run the government, there would be no profits to tax, no revenues to collect, and thus no programs to fund.

We have the ideal human material, the ideal economic material and the ideal philosophy to keep America going and growing if we will only look at the facts as they are. At the height of the energy crisis, the doom peddlers pounded away at an inventory of disasters -- depression dollar gas, dollar bread, dollar sugar, and even dollar toilet paper. The disasters never came.

During the debate of New York City's fiscal problems many of the same voices joined together in a chorus of doom promising that, unless President Ford wrote New York a blank check, there would be a collapse of the international financial system. Instead of yielding to panic, the Administration and city leaders worked out a responsible solution and, despite the rumblings of the doom brigade, there was no economic collapse.

If each of us will just act responsibly and consider the facts calmly in deciding the political and economic issues of the day, we have every reason to be optimistic about our country's future. The free enterprise ideals and principles that have guided this nation for 200 years will be true to us as long as we are true to them.

President Ford has urged that we strike a "new balance" in our national life:

-- A balance that favors greater freedom and vitality for our private enterprise system;

-- A balance that favors greater liberty and self-reliance for individual Americans;

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-- And a balance that favors greater honesty and realism dealing with the challenges of our time.

These are great goals -- goals worthy of the greatest nation on earth. We should not begin our bicentennial year by retreating into the past, but by going forward into the future with a shared sense of purpose, patience, realistic hope, courage and common sense.

If we work together, with pride in ourselves and our nation the goals we share today can become the first great achievements of America's third century.

President Ford has set a course which points us in the right direction and will permit us to get a grip on these problems, but it will take several years, not months, to bring this about. Unfortunately, the election is only a bit over seven months away. There will be calls from the opposition for "sweeping changes" and "broad new initiatives" which will really mean bigger spending, bigger deficits and ultimately bigger governmental control of the economy. We must persuade the American people that this course is wrong and that the other approach is much sounder in the long run.

The real choice is between greater government control or greater individual freedom. That is the decision before us.

Thank you.

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Contact: James C. Davenport
Ext. 8585
March 30, 1976

FOR IMMEDIATE RELEASE

ANTIDUMPING INVESTIGATION INITIATED ON FULLY AUTOMATIC DIGITAL SCALES FROM JAPAN

The Treasury Department announced today the initiation of an antidumping investigation on imports of "fully automatic digital scales" from Japan.

Notice of this action will be published in the Federal Register of March 31, 1976.

The Treasury Department's announcement followed a summary investigation conducted by the U.S. Customs Service after receipt of a petition alleging that dumping was occurring in the United States. The information received tends to indicate that the prices of the merchandise exported to the U.S. are less than prices of such or similar merchandise sold in the home market.

For the purpose of this investigation, the term "fully automatic digital scales" means such scales that display weight, unit price and total price having a weight measuring capacity of 25 pounds or less.

Imports of the subject merchandise from Japan are believed to have amounted to roughly $2.5 million in 1974.

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he Department of the TREASURY NEWS
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FOR RELEASE UPON DELIVERY

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STATEMENT BY THE HONORABLE GERALD L. PARSKY
ASSISTANT SECRETARY OF THE TREASURY
BEFORE THE
HOUSE COMMITTEE ON SCIENCE AND TECHNOLOGY
WASHINGTON, D.C.
WEDNESDAY, MARCH 31, 1976, at 9:00 A.M.

Mr. Chairman and Members of the Committee:

I am pleased to appear before you today to discuss H.R. 12112 and, in particular, the question of Federal financial incentives to encourage the commercial demonstration of various types of energy facilities. Although the proposed bill would provide Federal guarantees for synthetic fuels production, energy conservation, renewable energy resources and geothermal development, I would like to focus my remarks today on the synthetic fuels area. I will concentrate on (1) an assessment of the reasons for Federal assistance, (2) the proper structure of such assistance, and (3) the impact of Federal incentives on the capital markets.

The Administration Program

In his January 15, 1975 State of the Union Message the President proposed a number of measures designed to help achieve energy independence and reduce our vulnerability to the OPEC

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cartel. A key measure was a program accelerating the advent of synthetic fuels. In proposing this program the President specifically endorsed the use of Federal financial incentives where necessary to encourage commercialization. The President reaffirmed the importance of this activity in his February 26th Energy Message of this year.

An Interagency Task Force on Synthetic Fuels last year undertook a comprehensive study of how best to assure early initiation of the Commercial Demonstration Program. One of the major tasks of the Task Force was to identify and evaluate the need for various types of financial assistance to assure commercial development of synthetic fuels. The draft report of the Task Force concluded:

> "In the absence of Federally provided economic incentives or other policies creating a stable and favorable investment environment, significant amounts of synthetic fuels are not likely to be produced by 1985."

We believe that it is important to proceed with a significant commercial demonstration program as part of a national effort aimed at reducing our vulnerability to a cut-off in imports of oil. Further, we concur in the Task Force conclusion that incentives are needed to accomplish the basic objectives of this program.

However, in carrying out the incentives program, we believe that special care should be taken to (1) keep the use of Federal assistance for commercial demonstration facilities to a minimum level necessary, (2) ensure that the impact of Federal incentives on the capital markets is minimized, and (3) ensure that the adoption of a Federal incentives program does not impede movement toward the fundamental actions needed to improve the climate for private investment in the energy sector--that is, regulatory reform, continued emphasis on research and development, and decontrol of energy prices. We believe that these more basic actions are the most cost effective long-run solutions to the problem of attracting private capital to develop synthetic fuels. In order to understand how a proper balance can be achieved between providing needed incentives now and ensuring that longer-term actions are taken, I would like to explore each of those areas.

Type of Federal Assistance Needed

First, let's look at the type of Federal assistance that is needed. The exact type of financial incentive needed to achieve the President's goals will vary from situation to situation depending on the technology, the regulatory environment, the nature of the companies involved, and competitive market considerations. For example, in the case of projects which would provide fuel to a nonregulated sector of the energy industry, the major uncertainty is the future course of prices of competitive fuels. In such cases, some form of price guarantee may be needed to protect the large capital investment should market prices of competitive fuels fall to a low level. In contrast, for projects which will operate in a regulated environment, price guarantees may not be needed but loan guarantees may be necessary to secure financing for the first commercial size plants to overcome the technological risk, concerns over the large size of the projects in relation to the net worth of the participating companies, and the regulatory uncertainties involved. ERDA should, therefore, have a number of incentives available to it and should also have administrative flexibility to choose the appropriate incentive based on specific situations. Different technologies or industries might require different incentives at different times, and it cannot now be predicted with certainty which form of incentive will be best. Accordingly, a range of incentives, including loan guarantees, are necessary to achieve the early commercialization of synthetic fuels.

We continue to believe, however, that every effort must be made to minimize the cost of such a program to the American people. Therefore, it is important that whatever financial incentives are deemed necessary be granted by competitive bidding to the extent possible. By using competitively bid loan and price guarantees wherever possible, the government will be able to minimize the amount of Federal subsidy involved.

Minimizing the Impact on Capital Markets

Furthermore, as the proposed program is implemented, we must minimize the impact on our capital markets. Any type of Federal financial assistance resulting in the undertaking of energy projects which would not otherwise have been undertaken will lead to some redirection of resources in our capital markets. Such incentives increase the demand for capital while having little or no effect on the overall supply of capital. They tend to cause interest rates to rise and channel capital away from more economic to less economic uses. In short, the proposed program of Federal incentives will direct capital from other areas of our economy into synthetic fuels production.

This diversion, however, is the intended objective of the incentives program which is specifically designed to attract capital into projects for the commercial demonstration of synthetic fuel technologies. The magnitude of the impact of such diversion, will, of course, depend on the amount of money involved and the length of time over which such money is raised. Between $8 and 9 billion in investment may be needed to develop the President's recommended 350,000 barrel-per-day oil equivalent synthetic fuels capacity. This amount would be on a phased basis over 5 to 10 years as plants are constructed. The incentives program designed to induce such investment should, therefore, not cause a great disruption in the capital markets.

Given the fact that the annual U.S. investment rate in 1975 was over $200 billion, the program is not likely to have a major impact on the general cost or availability of capital. In addition, FEA estimates that as much as $600 to 800 billion will be invested in the energy sector over the next ten years. When viewed in relation to this amount, the capital investment expected to be induced into the initial phase of the synfuels program is not large.

However, almost 50 percent of the $200 billion net flow of funds in U.S. credit markets is already being taken to finance existing Federal, state and local programs. These heavy government borrowing pressures will continue. Therefore, in order to help minimize the impact of ERDA guarantees and price supports in our capital markets, we believe that it is essential that the Secretary of the Treasury have the authority to approve the timing and substantial terms and conditions of each loan and price guarantee and any other financial incentive that would have a similar impact. Loan and price guarantees result in new issues of bonds, notes or other government backed obligations in the capital markets which impinge upon Treasury and other Federal agency financings and which can have significant market impact. Prior approval of the timing and terms by the Treasury will ensure effective coordination with the management of the Federal debt and will help minimize the impact of such incentives on the capital markets. H.R. 12112 contains the necessary authority with respect to guarantees for synthetic fuels, conservation equipment and impact assistance. However, H.R. 12112 is incomplete in its treatment of the Treasury role with respect to geothermal energy projects. We strongly urge an amendment making the geothermal loan program conform to the remainder of the loan guarantee programs by requiring Treasury approval of the issuance of guarantees and by making the interest on guaranteed obligations of public bodies taxable. The amendment was submitted last year by ERDA but evidently not adopted during your final conference deliberations.

Treatment of Foreign Investors

In addition, we are concerned by the fact that, with some exceptions, the legislation prevents non-U.S. citizens from obtaining guarantees under the program. This prohibition is contrary to our traditional policy of nondiscrimination against foreign investors. We follow an open door policy towards foreign investment and once foreign investors are established here they are afforded national treatment--that is, treated equally with domestic investors. This policy is based on the premise that the benefits of investments are not dependent on the nationality of investors. We should maximize our opportunity for obtaining capital and technology from whatever source rather than making discriminations on the basis of nationality which serve no economic purpose.

This is especially true in the present case where the purpose is to encourage the development of plants to demonstrate the commercial viability of new energy technologies at the least cost to the U.S. taxpayers. It follows that we should seek the most promising technology from those firms most capable of undertaking such projects. To completely prohibit foreign investors from taking advantage of the program would deny the U.S. the benefits of their technologies without obtaining any compensating benefits and with possible additional costs for American taxpayers.

We do recognize that the legislation gives the Administrator of ERDA the discretion to grant guarantees for investments by citizens from countries who are participants in the International Energy Agreement. While this is an improvement over a blanket prohibition on foreign investment, it is still contrary to our basic policy of national treatment for foreign investors. Therefore, we suggest that the restrictions with respect to the nationality of program participants be eliminated and that all foreign investors who otherwise meet the qualifications established by ERDA be eligible for guarantees under the program.

Necessity for Regulatory Reform

The proposed incentives program, Mr. Chairman, is important but should not be seen as a substitute for needed regulatory reform. The level of Federal financial assistance that will be required to bring about certain types of first generation synthetic fuels plants and, more importantly, the ability of the synthetic fuels industry to free itself from Federal financial assistance, will be determined to a great extent by how rapidly we develop a more favorable regulatory climate. Energy prices should reflect the real costs of producing energy if we are to achieve the needed increases in supplies of energy and to discourage the wasteful uses of energy. With respect to synthetic fuels in particular, the difficult problem of arranging private financing for high BTU coal gasification plants has been handicapped because of regulatory commission policies which refuse to allow an all-events full cost of service tariff for first generation synthetic fuels plants. I would hope this barrier will be removed so that once demonstration plants are proven to operate satisfactorily, the financing of future plants can be handled completely by the private markets.

Likewise, the Interagency Synthetic Fuels Task Force Report indicated that a major barrier to electric utilities undertaking medium BTU coal gasification projects is the inability of these companies to attract capital due to their low level of profitability resulting from regulatory policies. Again, the best long-run answer is regulatory reform. In addition, expediting various environmental and other regulatory procedures would significantly assist the private capital market in responding to our Nation's energy needs. The faster we can move on these needed improvements in the regulatory environment, the less will be the need for Federal Government financial assistance. We do, however, recognize that these improvements will take time and that there is currently a clear need for carefully chosen and implemented incentives in order to assure the private financing of demonstration facilities in the interim. Therefore, we urge enactment of H.R. 12112 so ERDA can proceed in this important effort.

Mr. Chairman, that concludes my prepared statement, and I will be glad to respond to any questions you might have.

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THE DEPARTMENT OF THE TREASURY 1789

FOR IMMEDIATE RELEASE 1220

REMARKS BY THE HONORABLE EDWIN H. YEO, III
UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS
BEFORE THE INSTITUTIONAL BOND CLUB OF NEW YORK
AT THE CITY MIDDAY CLUB, NEW YORK, NEW YORK
TUESDAY, MARCH 30, 1976

INTERNATIONAL LIQUIDITY

DISCUSSIONS OF FINANCIAL AFFAIRS TURN FREQUENTLY TO THE ROLE INTERNATIONAL LIQUIDITY DEVELOPMENTS HAVE PLAYED IN CAUSING THE WORLD'S ECONOMIC ILLS, PARTICULARLY THE VIRULENT INFLATION OF RECENT YEARS. AN INEVITABLE COROLLARY IS THAT COLLECTIVE MANAGEMENT OR CONTROL OF INTERNATIONAL LIQUIDITY IS NECESSARY IF WE ARE TO ALLEVIATE THOSE ILLS. THE POPULARITY OF THESE THEMES LEADS ME TO DEVOTE MY REMARKS THIS EVENING TO THE SUBJECT OF INTERNATIONAL LIQUIDITY.

SPECIFICALLY, I WOULD LIKE TO RESPOND TO THREE COMMON LINES OF THOUGHT ON THE SUBJECT:

-- THAT THE RECENTLY AGREED INTERNATIONAL MONETARY REFORMS ARE SOMEHOW INCOMPLETE BECAUSE THEY DO NOT BRING CONTROL OVER INTERNATIONAL LIQUIDITY;

-- THAT EXCESSIVE INTERNATIONAL LIQUIDITY HAS BEEN LARGELY RESPONSIBLE FOR THE SEVERE WORLD-WIDE SURGE OF INFLATION; AND

-- THAT EXCESSIVE INTERNATIONAL LIQUIDITY IS PERMITTING COUNTRIES TO AVOID ADJUSTING TO PAYMENTS IMBALANCES AS RAPIDLY AS THEY SHOULD.

THESE ARE IMPORTANT ISSUES. BUT THERE IS A SERIOUS

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DANGER THAT EXCESSIVE ATTENTION TO THE PROBLEMS OF INTERNATIONAL LIQUIDITY WILL DIVERT OUR ATTENTION FROM THE BASIC CAUSES OF OUR ECONOMIC PROBLEMS, AND LEAD US DOWN THE WRONG PATHS IN THE SEARCH FOR THE REQUIRED SOLUTIONS. INTERNATIONAL LIQUIDITY DEVELOPMENTS DO INFLUENCE NATIONS' ECONOMIC WELFARE, BUT THEY ARE NOT MAJOR DETERMINANTS OF THAT WELFARE. EVEN IF THE TIGHTEST CONTROLS OF INTERNATIONAL LIQUIDITY COULD BE DEVISED, THEY WOULD ASSURE US NEITHER AN IDEAL MONETARY SYSTEM, NOR SUCCESS IN OUR EFFORTS AGAINST INFLATION, NOR EQUILIBRIUM IN OUR INTERNATIONAL PAYMENTS RELATIONSHIPS. I AM PARTICULARLY CONCERNED THAT OUR EFFORTS TO CONTAIN INFLATION SUCCEED. BUT TO SUCCEED WE MUST CONCENTRATE OUR EFFORTS IN THE RIGHT DIRECTION. CONTROL OF INTERNATIONAL LIQUIDITY IS NOT THE ANSWER.

THESE ISSUES MUST, IN MY JUDGMENT, BE EXAMINED AGAINST THE BACKGROUND OF THE PROFOUND CHANGE WHICH HAS TAKEN PLACE IN THINKING ABOUT THE WORLD'S MONETARY SYSTEM AND THE RULES GOVERNING THAT SYSTEM.

AT MEETINGS LAST JANUARY IN JAMAICA OF THE INTERNATIONAL MONETARY FUND'S INTERIM COMMITTEE, THE WORLD'S FINANCE MINISTERS AGREED ON A SERIES OF FAR-REACHING STRUCTURAL REFORMS IN THE INTERNATIONAL MONETARY SYSTEM. THAT AGREEMENT REPRESENTED THE FIRST GENERAL REVISION OF OUR INTERNATIONAL MONETARY

ARRANGEMENTS SINCE THE BASIC FRAMEWORK FOR THE POST-WAR ECONOMIC SYSTEM WAS CREATED AT THE 1944 BRETTON WOODS CONFERENCE.

THERE ARE SOME WHO CHARGE THAT, WHILE THE JAMAICA AGREEMENT HAS INTRODUCED IMPORTANT CHANGES WITH RESPECT TO PARTS OF THE MONETARY SYSTEM, REFORM IS INCOMPLETE IN THAT IT DOES NOT BRING ANY CENTRAL CONTROL OVER THE AGGREGATE OF INTERNATIONAL LIQUIDITY. SUCH CHARGES REFLECT, IN MY VIEW, A FAILURE TO PERCEIVE THE EVOLUTION WHICH HAS TAKEN PLACE IN THE INTERNATIONAL MONETARY SYSTEM AND IN THE FRAMEWORK WITHIN WHICH LIQUIDITY ISSUES SHOULD BE CONSIDERED.

WE LIVE IN A DIFFERENT WORLD FROM THAT WHICH EXISTED AT THE TIME OF BRETTON WOODS. THE JAMAICA COMPACT REFLECTS FUNDAMENTAL SHIFTS IN THINKING FROM THE IDEAS WHICH UNDERLAY THE BRETTON WOODS SYSTEM. IT IS WIDELY ACKNOWLEDGED THAT THE CHANGE IN THINKING -- WHICH FOCUSES ATTENTION ON UNDERLYING ECONOMIC FACTORS -- CALLS FOR A NEW AND DIFFERENT ATTITUDE WITH RESPECT TO EXCHANGE RATES, GOLD, AND OTHER ASPECTS OF THE MONETARY SYSTEM. IT IS LESS GENERALLY RECOGNIZED THAT IT CALLS ALSO FOR A NEW PERSPECTIVE ON THE QUESTION OF INTERNATIONAL LIQUIDITY.

THE NEW MONETARY SYSTEM AGREED AT JAMAICA DIFFERS FUNDAMENTALLY FROM THE BRETTON WOODS SYSTEM IN THE PROVISIONS SETTING FORTH EXCHANGE RATE RULES, AND IN THE PROVISIONS ON GOLD -- TWO OF THE BASIC COMPONENTS OF THE BRETTON WOODS SYSTEM. BOTH CHANGES

STEM FROM A COMMON IDEA: THE VIEW THAT MONETARY STABILITY CANNOT BE IMPOSED ON A HETEROGENEOUS WORLD BY IMPOSING A RIGID MONETARY SYSTEM -- THAT MONETARY STABILITY CAN BE ACHIEVED ONLY BY DEVELOPING UNDERLYING CONDITIONS OF STABILITY IN THE MAJOR ECONOMIES.

THE REFORM DEALING WITH EXCHANGE RATES REFLECTS THAT FOCUS. THE BRETTON WOODS SYSTEM RECOGNIZED AS LEGITIMATE ONLY ONE EXCHANGE RATE REGIME -- PAR VALUES. IT ASSUMED THAT EXCHANGE STABILITY COULD BE ACHIEVED BY REQUIRING ADHERENCE TO A MORE OR LESS FIXED STRUCTURE OF EXCHANGE RATES, USING THE THREAT OF RESERVE LOSS OR THE EVENTUAL SHAME OF A FORCED DEVALUATION AS THE LEVERAGE TO INFLUENCE DOMESTIC POLICIES. THAT ASSUMPTION PROVED WRONG -- PARTICULARLY IN THE CONDITIONS OF THE 1960'S AND 1970'S, WHEN EXTREME VARIATIONS AMONG NATIONS' ECONOMIC POLICIES, EXTERNAL SHOCKS, WIDELY DISPARATE INFLATION RATES, AND THE CAPACITY FOR MASSIVE CAPITAL FLOWS ULTIMATELY LED TO COLLAPSE OF THE SYSTEM.

THE EXCHANGE RATE ARRANGEMENTS AGREED UPON AT JAMAICA TAKE A DIFFERENT APPROACH. THE NEW PROVISIONS FOCUS ON UNDERLYING ECONOMIC AND FINANCIAL CONDITIONS AND ACKNOWLEDGE THAT EXCHANGE STABILITY CAN PREVAIL ONLY IF NATIONS ACHIEVE STABILITY IN THOSE UNDERLYING ECONOMIC CONDITIONS. THE NEW ARRANGEMENTS DO NOT INSIST ON A PARTICULAR KIND OF EXCHANGE RATE REGIME, SUCH AS PAR VALUES. THEY PROVIDE WIDE LATITUDE FOR AN INDIVIDUAL

COUNTRY TO ADOPT SPECIFIC EXCHANGE ARRANGEMENTS OF ITS CHOICE, INCLUDING FLOATING, SO LONG AS THAT COUNTRY FULFILLS CERTAIN GENERAL OBLIGATIONS TO FOLLOW INTERNATIONALLY APPROPRIATE ECONOMIC POLICIES. THIS IS THE REVERSE OF THE BRETTON WOODS FOCUS.

SIMILARLY, THE NEW PROVISIONS FOR REDUCING THE ROLE OF GOLD IN THE MONETARY SYSTEM REFLECT A SHIFT IN THINKING ABOUT THE EFFECTIVENESS OF THAT METAL IN FOSTERING INTERNATIONAL MONETARY STABILITY. IN PLACING GOLD AT THE CENTER OF THE SYSTEM, THE FOUNDERS OF BRETTON WOODS WERE MERELY REAFFIRMING GOLD'S TRADITIONAL ROLE AS A DISCIPLINARY AGENT IN A WORLD OF FIXED EXCHANGE RATES. IN PRACTICE, GOLD FAILED IN THAT ROLE. INSTEAD, IT BECAME A CONTRIBUTOR TO INSTABILITY -- ITS COMMODITY USES CONFLICTED WITH MONETARY NEEDS; ITS SUPPLY LIMITATIONS DID NOT MEET THE NEEDS OF A VIGOROUS AND EXPANDING WORLD ECONOMY; AND IT PROVED TO BE AN INHERENTLY UNSTABLE FOUNDATION FOR THE INTERNATIONAL MONETARY SYSTEM. ACCORDINGLY, NATIONS HAVE AGREED TO REDUCE THE INTERNATIONAL MONETARY ROLE OF GOLD.

IT REMAINS FOR US TO ADJUST OUR THINKING WITH RESPECT TO THE ROLE OF INTERNATIONAL LIQUDITY IN OUR ECONOMIC AND FINANCIAL SYSTEM. THOUGH THE BRETTON WOODS SYSTEM HAS BEEN REPLACED, THE QUESTION OF INTERNATIONAL LIQUIDITY IS STILL TOO OFTEN ADDRESSED IN THE TERMS OF THE PAST, AND WE CONTINUE

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TO HEAR WIDESPREAD CALLS FOR INTERNATIONAL CONTROL OVER LIQUIDITY IN THE MANNER OF THE PAST.

WHEN I HEAR A CALL FOR SOME FORM OF AGGREGATE CONTROL OVER INTERNATIONAL LIQUIDITY, I WONDER WHAT IS MEANT. IS IT PROPOSED TO SUBSTITUTE DECISIONS OF AN INTERNATIONAL BUREAUCRACY FOR MARKET MECHANISMS, AND GIVE SOME INTERNATIONAL GROUP OR INSTITUTIO THE POWER TO ALLOCATE BOTH INTERNATIONAL PUBLIC CREDIT AND PRIVATE CREDIT AMONG INDIVIDUAL COUNTRIES ON ONE BASIS OR ANOTHER? IS IT PROPOSED THAT ALL INTERNATIONAL PRIVATE CAPITAL FLOWS BE PROHIBITED, EXCEPT AS LICENSED OR AUTHORIZED BY AN INTERNATIONAL CONTROL GROUP? IS THE INTENT TO IMPOSE A SYSTEM OF PURE FLOATING AMONG ALL CURRENCIES -- WHICH WOULD MEAN NO COUNTRY'S OFFICIAL RESERVES WOULD CHANGE -- OR WOULD A SYSTEM OF RIGID EXCHANGE RATES BE ESTABLISHED, WITH STRICT RULES FOR SETTLING IMBALANCES IN PARTICULAR ASSETS? I CAN SEE MANY UNATTRACTIVE POSSIBILITIES.

ONE THING IS CERTAIN. CONTROL OVER OFFICIAL RESERVES ALONE DOES NOT ESTABLISH CONTROL OVER THE MEANS OF INTERNATIONAL PAYMENT. DURING THE 1960'S, WHEN THE PAR VALUE SYSTEM OF BRETTON WOODS BEGAN TO COME UNDER SEVERE STRAIN, MUCH OF THE DISCUSSION OF THE PROBLEMS OF THE INTERNATIONAL MONETARY SYSTEM WAS IN TERMS OF THE ISSUE OF "INTERNATIONAL LIQUIDITY." SUCH ATTENTION WAS UNDERSTANDABLE. THE STRESSES OF THE PAR VALUE SYSTEM OFTEN SHOWED UP AS LIQUIDITY OR RESERVE PRESSURES ON MONETARY AUTHORITIES. THE PROBLEM OF DEFICIT COUNTRIES WAS TO OBTAIN ADEQUATE LIQUIDITY; THE PROBLEM OF SURPLUS COUNTRIES WAS TO ABSORB EXCESSIVE AMOUNTS OF LIQUIDITY; THE PROBLEM OF

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THE RESERVE CENTER WAS TO MAINTAIN A CREDIBLE BALANCE BETWEEN LIQUID LIABILITIES AND ASSETS. AND FOR THE MONETARY SYSTEM AS A WHOLE, THERE WAS THE SERIOUS PROBLEM OF OPERATING A RAPIDLY EXPANDING WORLD ECONOMY WITH STEADILY EXPANDING LIQUIDITY NEEDS WITHIN THE CONSTRAINTS OF A MORE OR LESS FIXED MONETARY BASE -- GOLD.

EVEN IN THOSE DAYS THE CONCEPT OF INTERNATIONAL LIQUIDITY WAS AN ELUSIVE ONE. TRADITIONALLY LIQUIDITY WAS MEASURED IN TERMS OF COUNTRIES' OFFICIAL RESERVES -- GOLD, SDR, IMF RESERVE POSITIONS, AND NATIONAL CURRENCIES -- AND ATTENTION WAS FOCUSED ON THE WORLD-WIDE AGGREGATE OF THESE OFFICIAL RESERVES. IN TODAY'S WORLD, THE CONCEPT OF LIQUIDITY, AND THE MEANS OF PAYMENT FOR INTERNATIONAL TRANSACTIONS, ARE FAR BROADER. THERE IS UNPRECEDENTED CAPACITY FOR INTERNATIONAL CREDIT AND CAPITAL FLOWS. AN IMBALANCE IN WORLD PAYMENTS OF $60 BILLION CAN EMERGE OVER NIGHT AND BE FINANCED VIRTUALLY WITHOUT DECLINES IN NATIONS' OFFICIAL RESERVES. A MEANINGFUL CONCEPT OF LIQUIDITY ALMOST HAS TO INCLUDE NOT ONLY OFFICIAL RESERVES, BUT ALSO OFFICIAL BORROWING POWER, PRIVATE FINANCIAL ASSETS, AND PRIVATE BORROWING POWER. ADMITTEDLY THE BROADER CONCEPT OF LIQUIDITY NOT ONLY VASTLY INCREASES THE MAGNITUDE OF THE FIGURE TO BE CONSIDERED BUT ALSO IS VASTLY MORE DIFFICULT TO MEASURE.

IN THIS CONTEXT, THE TRADITIONAL MEASURE OF INTERNATIONAL LIQUIDITY -- GROSS OFFICIAL RESERVES -- IS OF LIMITED UTILITY. FOR SOME COUNTRIES -- AND NOT ONLY THE UNITED STATES -- THE LEVEL OF OFFICIAL RESERVES HAS LITTLE OR NO RELEVANCE IN

DETERMINING ECONOMIC POLICY. THE CONCEPT OF AN OPTIMUM LEVEL OF WORLD RESERVES WAS TENUOUS EVEN IN A WORLD OF PAR VALUES. IN THE PRESENT ENVIRONMENT OF FLEXIBLE EXCHANGE RATES, IT IS DOUBTFUL THAT THE CONCEPT OF AN APPROPRIATE AGGREGATE STOCK OF OFFICIAL LIQUIDITY IS A USEFUL GUIDE TO POLICY.

WHAT THEN IS THE PROPER APPROACH TO INTERNATIONAL LIQUIDITY QUESTIONS IN THIS REFORMED WORLD, IF IT IS NOT A FOCUS ON GOVERNING OFFICIAL RESERVES? MY ANSWER IS THAT WE MUST FOCUS ON DOING THOSE THINGS CALLED FOR BY THE JAMAICA AGREEMENTS. AND, I WOULD ARGUE THAT THESE REFORMS IN THE INTERNATIONAL MONETARY SYSTEM IN FACT GREATLY IMPROVE THE PROSPECTS FOR LESS VIOLENT FLUCTUATIONS IN INTERNATIONAL LIQUIDITY, HOWEVER ONE DEFINES IT.

CERTAINLY EACH STEP AWAY FROM A CENTRAL MONETARY ROLE FOR GOLD CONSTITUTES A STEP AWAY FROM DEPENDENCE UPON THAT MOST ERRATIC SOURCE OF LIQUIDITY CREATION. THAT PROCESS MUST BE CONTINUED.

THE JAMAICA COMMITMENTS TO PROMOTE STABILITY BY FOSTERING ORDERLY UNDERLYING ECONOMIC CONDITIONS AND TO AVOID MANIPULATING EXCHANGE RATES HAVE PERHAPS EVEN MORE IMPORTANT IMPLICATIONS FOR FUTURE PATTERNS OF LIQUIDITY CREATION. THE NEW SYSTEM DOES NOT FOCUS ON AGGREGATE INTERNATIONAL LIQUDITY. BUT, BY STRESSING MORE PROMPT AND EFFECTIVE ACTIONS TO ELIMINATE THE INTERNATIONAL PAYMENTS IMBALANCES WHICH HAVE BEEN A MAJOR SOURCE OF LIQUIDITY IN RECENT YEARS, THE JAMAICA SYSTEM WILL YIELD NOT

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ONLY GREATER STABILITY GENERALLY BUT ALSO REDUCE THE FLUCTUATIONS IN LEVELS OF INTERNATIONAL LIQUIDITY WHICH HAVE CONCERNED SOME OBSERVERS.

THOSE WHO SEEK WAYS OF RESTRAINING THE GROWTH OF INTERNATIONAL RESERVES ARE TROUBLED -- AS WE ALL ARE TROUBLED -- BY THE INFLATIONARY PRESSURES THAT STILL THREATEN ECONOMIC AND SOCIAL STABILITY IN MUCH OF THE WORLD. THEY SEE A RELATIONSHIP BETWEEN THE RELATIVELY HIGH RATE OF GROWTH IN GLOBAL RESERVES IN 1970-74, AND THE RELATIVE EASE WITH WHICH MANY COUNTRIES HAVE FINANCED THE LARGE PAYMENTS DEFICITS THAT CORRESPONDED TO THE PAYMENT SURPLUSES OF THE OIL PRODUCERS AND OF OTHER SURPLUS COUNTRIES. THEY ASK THEMSELVES WHETHER SUCH LARGE PAYMENTS DEFICITS HAVE NOT CONTRIBUTED TO WORLD INFLATION, AND WHETHER SOME SORT OF CONTROL ON INTERNATIONAL RESERVE GROWTH OR ON INTERNATIONAL CREDIT IN THE WIDER SENSE WOULD HAVE HELPED THE WORLD'S FINANCIAL AUTHORITIES TO RESTRAIN THE UNIVERSALLY UNWANTED INFLATION.

THE ISSUE IS WHETHER FINANCING THROUGH BORROWING HAS BEEN PREFERABLE TO ATTEMPTED ADJUSTMENT THROUGH POLICIES AIMED AT ELIMINATING THE DEFICIT. THE UNITED STATES HAS BEEN DEEPLY TROUBLED ABOUT INFLATION AND HAS WORKED HARD TO REDUCE THE RATE OF PRICE INCREASES FROM THE DOUBLE-DIGIT LEVEL OF 1974 TO THE PRESENT 6 PERCENT ZONE. WE FULLY AGREE THAT IT IS ESSENTIAL TO REDUCE INFLATION IN OTHER COUNTRIES. BUT THERE ARE PRACTICAL LIMITS ON THE SPEED WITH WHICH ADJUSTMENT TO DRASTIC CHANGES CAN AND SHOULD BE MADE. IN 1974 DECISIONS TO FINANCE THE

SUDDEN CARTEL-IMPOSED OIL DEFICITS ENTIRELY BY RESERVE TRANSFERS RATHER THAN BY RESERVE CREATION UNDOUBTEDLY WOULD HAVE MEANT A REDUCTION IN WORLD DEMAND AND IN WORLD INFLATIONARY PRESSURES. THE DRAWDOWN OF EXISTING RESERVES WOULD NO DOUBT HAVE CAUSED GOVERNMENTS TO TAKE MORE FORCEFUL MEASURES TO REDUCE THEIR EXTERNAL DEFICITS THAN THEY IN FACT DID. THIS WOULD JUST AS SURELY HAVE MEANT FURTHER MAJOR CUTBACKS IN WORLD PRODUCTION AND AN EVEN MORE SEVERE RECESSION THAN THE ONE WE HAVE JUST EXPERIENCED. IT WOULD PROBABLY ALSO HAVE LED TO RESTRICTIONS ON WORLD TRADE.

IN THE PERIOD AFTER THE OIL PRICE INCREASES, NATIONS HAD A CHOICE BETWEEN FINANCING THROUGH BORROWING AND ATTEMPTED ADJUSTMENT THROUGH ELIMINATION OF THE DEFICITS -- RECOGNIZING THAT COLLECTIVELY THE DEFICIT COULD NOT HAVE BEEN ELIMINATED WITHOUT A TOTALLY INFEASIBLE REDUCTION IN IMPORTS OF OIL. HAD THERE BEEN A STRICT INTERNATIONAL CONTROL OVER LIQUIDITY CREATION -- PUBLIC AND PRIVATE -- DURING THAT PERIOD, ONE WONDERS WHETHER THOSE CHARGED WITH THAT CONTROL WOULD HAVE HAD THE COURAGE AND FORESIGHT TO PROVIDE FOR EXPANSION OF OFFICIAL RESERVES IN THE MAGNITUDES NEEDED.

THE DESIRE TO FINANCE OIL DEFICITS WAS ALSO A KEY FACTOR IN THE RECENT EXPANSION OF EUROCURRENCY MARKETS. INDEED, THE BULK OF THE FUNDS REQUIRED TO FINANCE OIL DEFICITS CAME FROM THE PRIVATE FINANCIAL MARKETS -- NOT ONLY IN EUROPE BUT NOTABLY

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ALSO IN THE UNITED STATES. AND IF THERE REMAINS ANY DOUBT THAT ALLOWANCE FOR FINANCING OF THESE DEFICITS FOR A TIME WAS THE DESIRABLE THING TO DO, CONSIDER WHAT THE IMPLICATIONS OF A SHARP CUTBACK IN INTERNATIONAL CREDIT AVAILABILITY WOULD HAVE MEANT TO THE DEPTH AND BREADTH OF WHAT WAS ALREADY THE DEEPEST WORLD RECESSION IN FORTY YEARS.

CLEARLY OUR BANKING INSTITUTIONS, WHETHER OFFSHORE OR ONSHORE, REQUIRE A PROPER DEGREE OF REGULATION, TO PROTECT THE PUBLIC INTEREST AS WELL AS TO SAFEGUARD DEPOSITORS. EVENTS IN SEVERAL COUNTRIES HAVE RE-EMPHASIZED THE IMPORTANCE OF BANK REGULATION. BUT I SEE AN IMPORTANT DISTINCTION BETWEEN REGULATION BY INDIVIDUAL GOVERNMENTS OF THE NATIONAL AND INTERNATIONAL BANKING ACTIVITIES OF INSTITUTIONS UNDER THEIR JURISDICTION AND CLOSE INTERNATIONAL CONTROL OVER THE AGGREGATE OF NATIONS' OFFICIAL RESERVES AND PRIVATE FINANCIAL FLOWS FROM ONE NATION TO ANOTHER.

WHILE IT IS WORTHWHILE TO TRY TO PLACE INTERNATIONAL LIQUIDITY DEVELOPMENTS IN PERSPECTIVE, I THINK IT IS EVEN MORE IMPORTANT TO STEP BACK AND REFLECT ABOUT THE COMMON SENSE CAUSES OF THE INFLATION WE HAVE EXPERIENCED. IT IS, FOR EXAMPLE, DIFFICULT TO EXAGGERATE THE IMPACT ON INFLATION OF THE MASSIVE OIL PRICE INCREASES OVER THE PAST TWO YEARS. ANOTHER UNCOMFORTABLY OBVIOUS SHOCK WAS DELIVERED AT ABOUT THE SAME JUNCTURE BY CROP

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SHORTFALLS AROUND THE WORLD WHICH RESULTED IN SHARP INCREASES IN FOOD PRICES. THERE HAVE BEEN ALSO HIGHLY SYNCHRONIZED SWINGS IN ECONOMIC ACTIVITY AMONG THE INDUSTRIAL COUNTRIES, WHICH SOME TIMES CONTRIBUTED TO TOO RAPID EXPANSION, AND AT OTHERS TO A DEEP AND WIDESPREAD RECESSION. BUT MOST FUNDAMENTALLY, FOR A DECADE OR MORE, TOO MANY NATIONS HAVE ERRED ON THE SIDE OF EXCESSIVE STIMULUS IN THEIR FISCAL AND MONETARY POLICIES. I KNOW THAT IS TRUE OF THE UNITED STATES; I SUSPECT OTHERS AROUND THE WORLD WOULD ALSO CONSIDER IT TRUE OF THEIR COUNTRIES.

WE WOULD BE ILL-ADVISED TO EXPEND OUR EFFORTS IN A MISGUIDED AND UNFRUITFUL ATTEMPT TO MANIPULATE THE AGGREGATE OF OFFICIAL RESERVES -- OR SOME BROADER LIQUIDITY CONCEPT -- AS THE SOLUTION TO THE PROBLEMS OF WORLD-WIDE INFLATION. THAT INFLATION HAD ITS ROOTS IN UNWISE NATIONAL FISCAL AND MONETARY POLICIES. IT WILL YIELD ONLY TO SOUND, DETERMINED DOMESTIC FISCAL AND MONETARY POLICIES. THESE POLICIES ARE THE MOST POWERFUL AND EFFECTIVE TOOLS GOVERNMENTS HAVE TO MANAGE THEIR ECONOMIC AFFAIRS. THE BASIC KEY TO CONTAINMENT OF INFLATION IS FOR INDIVIDUAL GOVERNMENTS, BY CONSISTENT ADHERENCE TO SOUND DOMESTIC POLICIES, TO DEMONSTRATE TO THEIR PEOPLE THAT THEY DO NOT HAVE TO ACCEPT INFLATION AS A WAY OF LIFE.

IN EXPRESSING DOUBTS ABOUT UNDUE ATTENTION TO AGGREGATE WORLD LIQUIDITY, AND IN QUESTIONING THE WISDOM OF ATTEMPTS TO IMPSOE INTERNATIONAL ADMINISTRATIVE CONTROL OVER THAT AGGREGATE, I DO NOT WISH TO SUGGEST THAT LIQUIDITY GROWTH AND DISCIPLINES

ON LIQUIDITY GROWTH ARE NOT IMPORTANT. THEY ARE VERY IMPORTANT. WHAT I AM CHALLENGING IS THE MISTAKEN PRESUMPTION THAT A MARKET NOT SUBJECT TO EXTERNAL ADMINISTRATIVE CONTROL IS UNDISCIPLINED. INTERNATIONAL LIQUIDITY, IN THE PRESENT MARKET ORIENTED WORLD ECONOMY, IS MAINLY CREATED IN THE MARKET, AND IS MAINLY DISCIPLINED BY THE MARKET.

IT CAN BE ARGUED THAT IN A FREE WORLD ECONOMY, CERTAIN COUNTRIES WILL NOT MAKE AN ADEQUATE EFFORT TO ADJUST TO THEIR EXTERNAL IMBALANCES. INDEED, IT CAN BE ARGUED THAT SOME COUNTRIES HAVE IN RECENT PERIODS NOT MADE SUCH AN EFFORT -- THOUGH THIS JUDGMENT CANNOT REST SIMPLY ON THE OBSERVATION THAT OFFICIAL BORROWING HAS BEEN HIGH, BUT MUST REFLECT PERSISTENT MAINTENANCE OF EXCHANGE RATES NOT IN LINE WITH UNDERLYING ECONOMIC AND FINANCIAL CONDITIONS. IN SUCH CASES, WHEN A COUNTRY IS FAILING TO ADJUST ADEQUATELY TO ITS EXTERNAL CIRCUMSTANCES, THE REMEDY IS NOT TO IMPOSE ADMINISTRATIVE BARRIERS TO THAT COUNTRY'S OFFICIAL AND PRIVATE BORROWING. IT IS TO SEEK A PROMPT IMPLEMENTATION OF THE ARRANGEMENTS FOR IMF SURVEILLANCE AND COLLABORATION THAT ARE AN IMPORTANT PART OF THE MONETARY REFORM AGREED IN JAMAICA, AND TO ENCOURAGE THE ADOPTION OF THE PROPER POLICIES.

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THE FINANCIAL MARKETS IMPOSE THEIR OWN FORM OF LIQUIDITY DISCIPLINE ON BORROWERS WHERE THOSE DISCIPLINES ARE CALLED FOR. LENDERS IN THE MARKET, THE SUPPLIERS OF LIQUIDITY, WILL IMPOSE BORROWING LIMITS ON DEFICIT COUNTRIES WHOSE DEBT PROBLEMS APPEAR DIFFICULT AND WHOSE PROSPECTS ARE UNCERTAIN. SUCH DISCIPLINE IS AN INTEGRAL AND PROPER PART OF ADJUSTMENT.

WE ARE NOW HEARING CHARGES THAT THE INTERNATIONAL CAPITAL MARKETS WILL NOT FUNCTION ADEQUATELY IN THE PERIOD IMMEDIATELY AHEAD, AND THAT PRIVATE INTERNATIONAL CREDIT WILL BE CUT OFF ABRUPTLY, PARTICULARLY FOR THE DEVELOPING COUNTRIES WHICH HAVE BORNE A LARGE SHARE OF THE WORLD PAYMENTS DEFICITS IN RECENT PERIODS. THERE ARE CALLS FOR EXPANSION OF OFFICIAL CREDIT EITHER IN NEW FORMS, SUCH AS AN ALLOCATION OF SDR'S, OR THROUGH SHARP EXPANSION OF CREDIT THROUGH THE INTERNATIONAL MONETARY FUND AND THE OTHER MULTILATERAL LENDING INSTITUTIONS.

THERE IS NO REASON TO EXPECT A WIDESPREAD, ABRUPT DECLINE IN FOREIGN PRIVATE LENDING, ALTHOUGH THE FLOW OF MARKET LIQUIDITY TO SOME MAJOR BORROWERS, INCLUDING SOME OF THE DEVELOPING COUNTRIES, CAN BE EXPECTED TO SHRINK. BUT, MORE IMPORTANTLY, THE TIME HAS COME FOR LESS EMPHASIS ON FINANCING AND MORE ON ADJUSTMENT -- MORE DOMESTIC ACTION TO CONTROL INFLATION AND LESS ACCUMULATION OF DEBT. FORTUNATELY, THERE

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ARE INDICATIONS THAT MORE ADJUSTMENT IS IN PROSPECT. THE NEED FOR CREDIT BY THE DEVELOPING COUNTRIES AS A GROUP IS BEGINNING TO DECLINE, AS THE SHARP DOWNWARD TREND IN LDC EXPORT EARNINGS ASSOCIATED WITH THE WORLD RECESSION AND INVENTORY ADJUSTMENT BEGINS TO MOVE IN THE OPPOSITE DIRECTION WITH WORLD RECOVERY. CERTAIN OF THE DEVELOPING NATIONS WILL FACE FINANCING PROBLEMS, BECAUSE OF STRUCTURAL DIFFICULTIES IN ADJUSTMENT, OR TOO WEAK AN ADJUSTMENT EFFORT. BUT A LIMITED NUMBER OF COUNTRIES FALL IN THIS CATEGORY. WE DO NOT FORESEE MAJOR LIQUIDITY PROBLEMS FOR THE DEVELOPING COUNTRIES AS A GROUP. THE MEASURES TAKEN RECENTLY IN THE IMF TO EXPAND FINANCING CAPABILITIES ARE FULLY ADEQUATE TO MEET THE NEEDS FOR OFFICIAL CREDIT OF THE DEVELOPING NATIONS. INDISCRIMINATE CREATION OF ADDITIONAL SOURCES OF OFFICIAL LIQUIDITY WOULD ONLY SERVE TO UNDERMINE THE VIABILITY OF THE INTERNATIONAL FINANCING INSTITUTIONS THEMSELVES.

FOR DEVELOPED AND DEVELOPING COUNTRIES ALIKE, CONTROLS ON GLOBAL LEVELS OF INTERNATIONAL LIQUIDITY WILL HAVE ONLY A LIMITED INFLUENCE ON THEIR PROSPECTS FOR PROSPERITY AND STABILITY. SOUND MANAGEMENT OF DOMESTIC ECONOMIES IS THE KEY.

IN THE UNITED STATES ECONOMIC DEVELOPMENTS ARE MOST ENCOURAGING. OUR DOMESTIC ECONOMY IS EXPERIENCING A STRONG AND SUSTAINABLE RECOVERY. A STRONG DOMESTIC ECONOMY IS THE GREATEST SINGLE CONTRIBUTION THE UNITED STATES CAN MAKE TO INTERNATIONAL ECONOMIC PROGRESS.

HAVE INCREASED SHARPLY. THE QUARTERLY PATTERN OF BUSINESS SPENDING IS EXPECTED TO ACCELERATE THROUGHOUT THE YEAR AS RISING CORPORATE PROFITS PROVIDE ADDITIONAL INCENTIVE AND IMPROVED CORPORATE FINANCIAL POSITIONS INCREASE BUSINESS CONFIDENCE. ADDED STRENGTH FROM INVENTORY INVESTMENT AND THE STRENGTHENING OF CONSTRUCTION ACTIVITY WILL ALSO CONTRIBUTE TO THE STRONG ECONOMIC GROWTH EXPECTED IN 1976. FINALLY, THE CYCLICAL EXPANSION IN THE UNITED STATES WILL CONTRIBUTE TO WORLD-WIDE RECOVERY AS OUR DEMANDS FOR IMPORTS ACCELERATE THROUGHOUT THE YEAR.

THE SUSTAINABILITY OF ECONOMIC RECOVERY AROUND THE WORLD DEPENDS UPON SOUND FISCAL AND MONETARY POLICIES. IT ALSO DEPENDS HEAVILY ON CORRECTION OF THE DISTORTIONS IN FINANCIAL STRUCTURES WHICH HAVE BEEN ASSOCIATED WITH THE SHARP CYCLICAL CHANGES AND THE STRONG INFLATIONARY PRESSURES THAT HAVE OCCURRED DURING THE PAST FIVE YEARS. THIS IS THE REAL LIQUIDITY PROBLEM WHICH SHOULD CONCERN US -- THE DOMESTIC LIQUIDITY PROBLEM IN INDIVIDUAL COUNTRIES ARISING FROM THE RECENT CYCLE.

IN THE EARLY PART OF THAT PERIOD, INFLATIONARY PRESSURES DEVELOPED AS A RESULT OF THE RAPID AND, BY MOST STANDARDS, UNSUSTAINABLE EXPANSION IN REAL ECONOMIC ACTIVITY TOGETHER WITH TOO RAPID AN EXPANSION OF MONEY. THESE PHENOMENA, STRENGTHENED BY THE QUADRUPLING OF OIL PRICES AND SHARP RISES IN FOOD PRICES, CULMINATED IN THE DEEPEST RECESSION IN A GENERATION. IN TURN

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THE SEVERE RECESSION LED TO A MASSIVE INVENTORY ADJUSTMENT. EXPRESSED IN NOMINAL OR MONEY TERMS, THESE SWINGS IN ECONOMIC ACTIVITY HAVE BEEN MORE PRONOUNCED.

A LARGE PORTION OF THE MONETARY EXPANSION THAT CHARACTERIZED THOSE YEARS WAS FINANCED IN SHORT-TERM FINANCIAL MARKETS. THIS LED TO A LARGE BUILD-UP IN SHORT-TERM ASSETS AND LIABILITIES, AND WAS FURTHER REFLECTED IN THE REDUCED AVAILABILITY OF FUNDS IN THE LONG-TERM MARKETS. INFLATION REDUCED THE WILLINGNESS OF SAVERS TO COMMIT THEIR FUNDS AT LONG-TERM. AS SHORT-TERM DEBTS INCREASED, BUSINESS FIRMS BECAME MORE VULNERABLE TO CYCLICAL FLUCTUATIONS BECAUSE OF THE FIXED INTEREST CHARGES AND THE FREQUENCY OF PRINCIPAL REPAYMENTS.

A PRECONDITION FOR A MORE BALANCED MARKET SITUATION IS A FULL RETURN TO CONDITIONS OF UNDERLYING ECONOMIC STABILITY WHICH WOULD FACILITATE THE FUNDING OUT OF THE MATURITIES OF A LARGE PART OF THE SHORT-TERM ASSETS AND LIABILITIES. IN THE UNITED STATES, THERE IS EVIDENCE THAT WE ARE MAKING REAL PROGRESS IN THIS EFFORT. IN 1973 AND 1974, U.S. CORPORATE FINANCING HAD SHIFTED HEAVILY TOWARD INCREASING DEPENDENCE ON SHORT-TERM DEBT, AND OUR COMMERCIAL BANKING SYSTEM, DRAWN UPON EXTENSIVELY IN MEETING CORPORATE REQUIREMENTS, DREW DOWN ITS OWN LIQUIDITY AND BORROWED EXTENSIVELY IN THE MONEY MARKET, IN THE FORM OF CERTIFICATES OF DEPOSIT. BUT LAST YEAR, A RECOVERY IN OPERATING PROFITS AND THE INVENTORY RUNOFF ALLOWED CORPORATIONS TO REDUCE

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THEIR DEPENDENCE ON OUTSIDE FINANCING AND ON SHORT-TERM INDEBTEDNESS, WHILE INCREASING LONG-TERM BORROWING. THE IMPROVED CORPORATE POSITION WAS REFLECTED IN REDUCED DEMANDS UPON THE BANKING SYSTEM, WHICH ALLOWED THE VOLUME OF ITS CERTIFICATES OF DEPOSIT TO DECLINE, WHILE REBUILDING ITS OWN LIQUIDITY. WITH THE END IN THE UNITED STATES OF AN ERA OF UNDUE DEPENDENCE UPON SHORT-TERM BORROWING, THE TASK NOW IS TO ASSURE THAT FINANCING PATTERNS AROUND THE WORLD ARE SIMILARLY HEALTHY.

LADIES AND GENTLEMEN, I WILL CONCLUDE ON AN OPTIMISTIC NOTE. THE ATTENTION OF ALL NATIONS APPEARS TO BE PROPERLY TURNING TO THE FUNDAMENTAL IMPORTANCE OF LONGER-TERM ECONOMIC STABILITY. THIS SHIFT AUGURS WELL FOR THE FUTURE MANAGEMENT OF OUR DOMESTIC AND INTERNATIONAL ECONOMIC AFFAIRS, PARTICULARLY THE CONTROL OF INFLATION. IF EACH NATION WILL INDIVIDUALLY MANAGE ITS AFFAIRS RESPONSIBLY, AND IF WE ALL REMAIN FIRM IN OUR COMMITMENT TO INTERNATIONAL COOPERATION IN MONETARY AND TRADE MATTERS, WE CAN LOOK FORWARD TO FUTURE PROGRESS WITHOUT CONCERN ABOUT EXCESSIVE INTERNATIONAL LIQUIDITY. THE JAMAICA AGREEMENT PROVIDES THE NECESSARY FRAMEWORK FOR AN IMPROVED MONETARY SYSTEM. OUR CHALLENGE IS TO MAKE IT WORK.

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ADDRESS BY THE HONORABLE WILLIAM E. SIMON

SECRETARY OF THE TREASURY

BEFORE THE ECONOMIC CLUB OF INDIANAPOLIS

March 31, 1976

Mr. Goodrich, officers and directors of the Economic Club of Indianapolis, ladies and gentlemen:

Let me begin by congratulating you all on your first place showing in our national savings bond drive for the third consecutive year. This consistently superior performance is but one indication of your strong local leadership -- leadership that makes Indianapolis a town of promise and excitement.

The Greater Indianapolis Progress Committee's successful efforts to attract new businesses have obviously created a civic spirit that is going to make Indianapolis a town to watch in the years to come. And this beautiful, new convention center is symbolic of the impressive architectural developments of this vital, thriving community.

Clearly what you have established here is a momentum that will result in an increasingly broad economic base, more jobs, and higher level of prosperity. That's the kind of commitment and leadership every community in this country needs and would be proud to have.

I'm also happy to tell you that your efforts are going to get a significant boost from our national recovery which continues to gather strength. As you will recall, 1975 opened with inflation raging at almost 13%; we have now cut in half... to roughly 6%.

-- During the Spring of 1975 the unemployment rate reached 9%; today it has fallen to 7.6%, and the trend is clearly downward.

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-- Meanwhile, over two million people have regained jobs lost during the recession.

And during the third quarter of 1975, we registered the biggest single jump in the GNP in 25 years, and the fourth quarter's pace indicated the recovery was still gaining momentum.

And other positive economic indicators include higher industrial production, strong and growing retail sales, increasing levels of new housing, rising appropriations for capital outlays and a very bullish stock market.

All in all, we made considerable headway in 1975 and 1976 is off to an excellent beginning. But this is not good enough and is certainly no time for complacency. The unemployment rate is still far higher than we can tolerate. And inflation is by no means at an acceptable level. In fact, it remains the most dangerous enemy of sustained future economic growth, and we must do nothing to unleash another inflationary spiral. Ruinous inflation was the chief cause of the severe recession. If, as some politicians urge we embark once again upon excessive fiscal and monetary policies which will result in double-digit inflation, I guarantee you that we will end up with an even worse recession than before. We must not let that happen. Let it never be said that the pain and suffering of the 1974 - 1975 recession were in vain because the politicians in Washington once again ignored the national interest and refused to face economic reality.

Nevertheless, there is already a tendency, that grows stronger as the election draws closer, to press the panic button about the current unemployment figures. Those who do so criticize the so-called indifference of the Administration for not doing more, especially for not spending more to solve our economic problems. But we must not fall prey to those who never tire of offering us instant, painless cures -- the compassionate people who have promised us everything, but have delivered us only higher inflation and worse unemployment. In choosing policies to meet our economic problems we ought to step back and ask ourselves what caused these problems in the first place:

-- How is it that the richest and most powerful country on Earth could wander into this economic quagmire?

-- How could the most dynamic economic system in the world become infected with the diseases of both inflation and unemployment at the same time?

-- Indeed, where did we lost our way as a people?

I believe it is essential to decide how we got into this mess before we can really determine the best way to get out. Otherwise, we may just become more deeply mired. Economists argue about this a good deal. Politicians often ignore the question entirely, and seek instead to capitalize on the effects of problems. But to me, there is no real mystery about how we got here, nor what we must do.

It is clear, for instance, that the economic and social problems of today do not sping from a lack of concern in Washington. In the 10 years after President Eisenhower left office, the Congress increased the number of domestic spending programs from about 100 to over 1,000.

It is also clear that we have not failed from a lack of compassion. Since 1960, this Nation has spent over one trillion dollars on social programs to support people and communities that needed help.

The compassion and generosity of the American people should not be in question.

Nor can we say that our problems stem from a lack of trying to control the business cycle. In the 1960's, it was popular to believe that the Government could fine-tune the economy and abolish the ups and downs of economic growth. And we tried to do that with the tools of fiscal and monetary policy, making one adjustment after another.

Nor do our troubles result from a lack of effort on the part of the Government to control business -- big and small. Today we have an army of more than 100,000 Government employees whose mission is to regulate and control almost every activity of the private sphere.

Nor have we had any lack of vision from our leaders. The staple of Washington life has become the politician with grand visions and even grander promises of what can be accomplished if he can spend more of our money or can be given greater authority over our lives.

So, over the past 10-15 years, the Government has tried many, many solutions. Yet the problems persist and our people grow frustrated and disillusioned.

Does this mean there are no answers? Not at all. What it means, I would suggest, is that we have been taking fundamentally the wrong approach. We suffer not from a lack of Government action, but from an <u>excess</u> of Government action.

The trouble with the Federal Government is that it is trying to do more than its resources permit, to do many things that it cannot do very well, to do some things that it should never do at all, and to do all these things at the same time. That just does not make common sense.

Excesses in the Government have been most apparent in three critical areas affecting the economy:

-- Fiscal policy;

-- Monetary policy; and

-- Regulatory policy.

No one who has followed the pattern of Federal spending in recent years can fail to be impressed by is explosive growth.

-- The Federal budget has quadrupled in 15 years;

-- We have had 16 budget deficits in 17 years;

-- And we have doubled the national debt in just 10 years time.

The Federal Government today is the Nation's biggest single employer, its biggest consumer, and its biggest borrower. And if present trends continue until the end of the century, Government at all levels will account for almost 60% of our gross national product. Let there be no doubt that if Government ever becomes such a dominant part of our society, our economic freedons will disappear, and when we lose them, our political freedoms will not be far behind.

Partly to accommodate the Federal Government's borrowing needs in the private markets, there has also been a less noticed but equally significant shift in monetary practices. From 1955 to 1965, the money supply of the United States was growing at approximately 2-1/2 percent a year, and we enjoyed relative price stability. From 1965 to the present, however, the average rate of growth has more than doubled, and it is no accident that during this most recent decade we have also had spiraling inflation.

This past decade has also seen unparalleled growth in the regulatory apparatus of the Government. Regulatory agencies of the Government now exercise direct control over 10 percent of everything bought and sold in the United States and indirect control over almost every other sector of the private economy.

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Whenever I start talking about the bureaucracy in Washington, I am reminded of a remark by Pope John. The Pope was entertaining a visitor once who asked him: How many people work in the Vatican? The Pope thought for a second and said -- "About half." Well, that's usually true in the bureaucracy too. But the Federal regulators are a different breed of cat -- they seem to work harder than anybody else in Washington, they're even more creative, and the results certainly show. I'm told that American people now spend over 130 million work hours a year filling out Federal forms. That, too, just doesn't make good common sense.

The regulatory process has now become so burdensome, for all businesses big and small, that it is threatening to strangle much of free enterprise in red tape. Consider also the staggering costs involved. One major firm estimates that in 1974 it spent $1.3 billion dollars complying with or in anticipation of government regulation at all levels. It has been estimated that the American people paid the equivalent of $2,000 per family in increased costs for all the goods and services they purchased because of regulation.

When you add up all these factors of excessive government spending, excessive expansion of the money supply, and excessive governmental regulation, one conclusion seems inescapable: Both our inflation and our unemployment should bear a label "Made in Washington, D. C."

The fact is that governmental excesses of the past 15 years became a strong, underlying cause of inflation during the 1960s, and they remain so today. The rise in government spending has added enormously to the aggregate demand for goods and services in the economy, thus forcing up prices. The heavy need for Governmental borrowing means it must now have 80% of all new long term loanable capital, leaving only 20% to the private sector, which nevertheless produces virtually all our goods and services and employs 83% of all our workers. This increasingly massive governmental presence has been an important factor in the persistent rise in interest rates and the strains we have seen in the financial markets. An even worse result is that continuing deficits undermine the confidence of the public in the capacity of Government to deal with inflation. Moreover, it is clear that the cumbersome regulatory procedures of the Government have too often stifled competition and have added untold billions of dollars to the price of consumer goods.

I grant that governmental excesses are not the sole cause of recent inflation -- and the recession that was brought in its wake. The quadrupling of oil prices and rising food prices have also played a significant part. But there is no doubt that the fundamental cause of inflation can be traced directly to the excesses of the Government.

It is also clear that as the forces of Big Government have been fed and nourished, our private enterprise system -- the system that provides five out of every six jobs in the country and is the driving force of our society -- has become sadly undernourished. We have gradually channeled a higher and higher percentage of our resources into consumption and Government spending and less and less into savings and investment. As a result, the United States since 1960 has had the lowest rate of capital investment of any major industrialized country and one of the lowest rates of productivity growth. There can be no doubt that higher productivity is the secret to a higher standard of living. Thus, it is clear, as President Ford said, that we must strike a new balance in our economy -- a balance that favors a much stronger and healthier free enterprise system.

If the country could grasp these central truths -- and I believe people are beginning to understand and appreciate them -- then it would be much easier for all of us to agree upon the solutions. As I have said, I believe the solutions are relatively straightforward -- and, I might add, they are the basic policies of this Administration.

The centerpiece of our economic policies is the President's proposal to cut the growth in Federal spending and to return the savings to the American taxpaper in the form of a major tax cut.

This policy is based on a simple, commonsense observation: That each individual can spend his or her money more efficiently and productively than the government can. It is also based on the realization that our federal budget has taken on a dangerous life of its own, swelling and spreading out of control.

As the President said in his State of the Union address: The only way to hold down the cost of living is to hold down the cost of Government. No government can spend more than it makes, year-in, year-out, without reaching a point of financial collapse. None of us want the tragic experience of New York City this past year to become a preview of our future as a Nation. Yet it could happen if we fail to heed the warning signals.

The Government has many other ways to curb inflation. We are seeking greater competition in private industry through antitrust laws and we are trying to lower barriers to international trade. But the key is to restrain Federal spending, reduce the horrendous Federal deficits, and strengthen the free enterprise system.

If we are to fulfill our promise as a Nation, it is equally vital that there be enough jobs. The President's tax and spending cuts are a major part of that effort. But we can and must do more. We must offer the American people and American industry much greater incentives to invest in the future -- to expand our supply of housing, to build new plants and equipment, to modernize industry, to expand our energy resources, and of greatest importance, to accommodate a growing labor force. The capital investment needs of the future are huge: about $4-1/2 trillion in the next decade -- or three times as much as we spent in the last decade.

Most of the responsibility for raising new capital must lie with the private sector -- a private sector that is invigorated by getting the government out of the marketplace, invigorated by a reduction in taxes, and invigorated by striking the new balance that favors less consumption and government spending and more savings and investment.

Last summer, on behalf of the Administration, I proposed a plan that would eliminate the double taxation of corporate dividends and would thus encourage greater private investment. Most of our European competitors have already adopted this tax approach, and I firmly believe it is time for the United States to catch up. That tax plan remains a central part of our economic strategy within the Administration.

Furthermore, the administration is advocating a broadened stock ownership plan to encourage more Americans to invest in American-owned companies. Under this plan, middle and lower-income taxpayers would be eligible to deduct a portion of their income for money invested in the common stock of an American-owned company. I am particularly attracted to this program because it will give more Americans a greater stake in the private enterprise system.

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Another major aspect of the President's economic program is in the regulatory field. It is even more difficult to achieve reform of Federal regulations than to fill out the Federal forms that go with them, but we are determined to try. Specifically, we are now seeking to lighten the regulatory burden in four key areas - banking, airlines, trucking and railroads -- and we are currently investigating what can be done in others. It is no accident we believe that three of the industries in greatest difficulty today -- airlines, railroads and utilities -- are also among the most highly regulated industries in the country.

If time permitted, I would like to talk about many of the other aspects of policies - what we are seeking to do in energy, what we are trying to achieve in our international policies, the cushions that we are placing beneath the unemployed, etc.

But let me conclude with these few observations:

As we enter our third century as a nation, I believe the time has come not to reappraise our dedication to a better life for all -- that dedication is clear -- but to reappraise what we can afford to pay for this goal and how we can best achieve it. The current plight of New York, the malaise affecting many other state-controlled nations, and the overwhelming size of our Federal deficits are all grave warnings to us. We can pay for what we now have and provide for the future only is our great free enterprise economy is allowed to do its job -- produce goods in a free market at a fair price.

I am sick and tired of apologizing for free enterprise. It's our profit system that has given this country a prosperity that is now the envy of the entire world. If we were to listen to some of our critics and run our business the way they run the government, there would be no profits to tax, no revenues to collect, and thus no programs to fund.

Right here in Indianapolis, you have shown that when business is encouraged it is the people who benefit the most. I have a special request to ask of you today, it is that you send this message clear across our country. For what we need are not fewer but more capitalists in the United States -- more people with a real and direct stake in the profits generated by a productive economy. We cannot continue to have more and more of our citizens shifting exclusively to the receiving end of government benefits, and fewer and fewer people contributing to the costs of those benefits. We must add to the ranks of those who produce and subtract from the ranks of those who are able to work but prefer to stay on the dole.

If each of us will just act responsibly and consider the facts calmly in deciding the political and economic issues of the day, we have every reason to be optimistic about our country's future. The free enterprise ideals and principles that have guided this nation for 200 years will ~~be true to~~ us as long as we are true to them.

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President Ford has urged that we strike a "new balance" in our national life:

--A balance that favors greater freedom and vitality for our private enterprise system;

--A balance that favors greater liberty and self reliance for individual Americans;

--And a balance that favors greater honesty and realism in dealing with the challenges of our time.

These are great goals -- goals worthy of the greatest nation on earth. We should not begin our Bicentennial year by retreating into the past, but by going forward into the future with a shared sense of purpose, patience, realistic hope, courage, and common sense.

If we work together, with pride in ourselves and our Nation, the goals we share today can become the first great achievements of America's third century.

President Ford has set a course which points us in the right direction and will permit us to get a grip on these problems, but it will take several years, not months, to bring this about. Unfortunately, the election is only a bit over seven months away. There will be calls from the opposition for "sweeping changes" and "broad new initiatives" which will really mean bigger spending, bigger deficits and ultimately bigger governmental control of the economy. We must persuade the American people that this course is wrong and that the other approach is much sounder in the long run.

The real choice is between greater government control or greater individual freedom. That is the decision before us.

Thank you

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

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REMARKS BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE THE
AD COUNCIL, WASHINGTON, D.C.
April 1, 1976

Chairman Adams, President Keim and members of the Ad Council.

It is a pleasure for me to address this luncheon session of your 32nd Annual Conference. In looking over your agenda I see that you have taken great pains to hear from a broad spectrum of people in government, including an impressive list of senior spokesmen from the executive, legislative and judicial branches. And I notice that you have already received one extensive economic briefing at the able hands of my esteemed colleagues, Bill Seidman, Jim Lynn and Fred Dent.

Under the circumstances, there probably isn't much left for me to say about the current state of the economy that you haven't already heard. So, in my remarks today, I would like to give you a brief account of my recent visit to the Middle East, and some of the impressions I brought back with me, and then go on to consider both our nation's economic future and the role that people like you -- some of the most talented communicators in the country -- can play in making that future a bright one.

There isn't a more diverse, fascinating part of the world than the Middle East. That turbulent area that is terribly bound up with the future of global peace has many problems and none of them is going to vanish overnight. While I did return fully aware of the grave problems that confront them, I did return with one positive impression. Today, despite old animosities and differences, both the Arabs and the Israelis, regardless of their other conflicts, realize that the United States has developed the most dynamic and efficent economic system the world has ever known. They see the United States as the major source of strength and stability -- economic as well as political -- in an unstable world.

As Secretary of the Treasury, I find this both encouraging and awesome. Encouraging, because I am convinced that the way to a peaceful world political order can only come through a strong, stable world economic order -- because, for the Middle East, peace and prosperity can and must go hand in hand. And I find it awesome because if reminds me once more of how vitally important the American economy is, not only to our everyday comfort and convenience, but to the preservation of peace and freedom in the world.

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Economic statistics may make for pretty dull reading, but the facts behind the figures are a massive, perhaps decisive shaping force in the lives we live today, and in the future course of America and the world.

We must never lose sight of the fact that a strong, non-inflationary domestic economy is an absolute necessity. The only way to be strong abroad is to be strong at home.

Now you would be perfectly right to ask how in the world I can reasonably expect the general public to understand economics when even the experts disagree among themselves. And, up to a point, you would be right. The same objection could be made in almost any specialized field, from horse-racing to psychiatry. There is no single, exhaustively all-embracing economic formula that can answer all the questions and solve all the problems.

But there are a number of economic basics -- fundamental, common-sense guidelines and warning signals -- that can help all of us -- from Milton Friedman to Archie Bunker -- to understand where our country is heading economically and what we can and should do about it.

There is where advertising and communication skills come in. You, as skilled communicators, individually and collectively, can make an enormous contribution by helping to educate the public. For if my three years in Washington have taught me anything at all, it is the vital importance of your specialty -- getting an often complicated message across in simple, lucid terms. Getting to the essence of things clearly and forcefully.

The success of public policy, even more than the success of a commercial product, is directly dependent on the communications ability of those who advocate it. In fact, one of the biggest problems we face today in government is the paradox of too many good communicators selling bad policies and too many bad communicators selling good policies. A rhetorical spellbinder could sell ice cubes to Eskimos, but some of the advocates of fiscal responsibility and the free enterprise system are so unimaginative that they'd have trouble peddling Alka-Selzer on New Year's morning.

Perhaps the most significant -- and distressing -- fact confronting this country today is closely related to your field. I refer to the decline in public confidence in our institutions. Instead of observing our Bicentennial on the upbeat, we find our nation in a mood of deep and widespread distrust of many of the very elements that made our society great. No group -- business, government, the press, education, labor -- enjoys the credibility and trust it once did.

Many people sensed this decline in public confidence long before the pollsters confirmed it. George Shultz, a former Secretary of the Treasury, has summed up the problem pretty well: "We need moorings in our society," he points out, but "We have let go of many old moorings and we do not have new ones to replace them."

This decline in public confidence has been building for a long time. Many different things have contributed to it: Vietnam, Watergate, and the overpromising and underperformance of government. It now seems to pervade every facet of our social structure and poses a threat to the system that has enabled this country to achieve the greatest prosperity and the highest standard of living every known.

One of the institutions whose credibility has lost the most ground is business -- or what I prefer to call free enterprise. Today the American private sector is reexamining itself to determine not only what has caused this loss of confidence but also what it can do to regain it.

One opinion researcher says the major concern facing business is to overcome the public's alienation and cynicism. I'm not sure I agree. I certainly don't agree with those who allege there is something basically wrong with the American enterprise system itself.

Part of the problem, I believe, is that many people are misinformed and misled on the economic issues. Most people simply do not have time to read the fine print behind the headlines, and most detailed economic coverage is written for the specialist rather than the general public. The result is often serious misunderstanding of the private sector. According to a recent study by the Opinion Research Corporation, the key issues on which the public is most misinformed are the level and trend of corporate profits and their interrelationships with prices, wages, unemployment and inflation -- a major part of the system of economic causes and effects that influence their daily lives. They also found that people were misinformed about antitrust problems, monopolistic practices and competition and the relations between corporations and governmental regulatory agencies.

If that worries you, there's more. Some of you may recall that report last year by the Commerce Department and your own Advertising Council, which portrayed the average American as a virtual economic illiterate who perceives our economic system almost solely in terms of his or her own personal situation rather than in its broad functional aspects.

This is only human -- but it is also dangerous.

People usually fear what they don't understand. And people tend to reject what they fear. So we shouldn't be surprised if they're tempted to unknowingly embrace programs -- and quack economic remedies -- that are destructive to our system. Let's take a look at that system and ask ourselves whether or not it is worth preserving. Even the most cursory glance at recent history shows us that is has outperformed all others, both in terms of the material benefits it has produced and the free way of life it has protected. Here are some measurable standards of performance:

-- Since the late 1950's alone, real purchasing power of Americans has jumped by 40 percent, average family income has risen to over $13,000 a year, 20 million new jobs have been created, and we have cut the number of people below the poverty line in half.

-- Our farmers harvest more than twice as much grain with fewer workers compared to a generation ago.

-- Medical science has added 10 years to our lives over this period.

-- Our economic abundance has made it possible for us to give $110 billion in food and economic aid to less fortunate nations since the end of World War II.

-- And Americans today have more leisure time for study, recreation and self-improvement than any society in recorded history. We continue to spend about 90 percent of our personal disposable income on ourselves.

No other country -- no other system -- has achieved so much for its people. Yet these tremendous achievements are the product of the same free-market system that now finds itself under attack.

The Free Enterprise System, where does it stand today? For all the talk about excessive profits, it's a system that, on the average, offers a profit incentive of less than five cents on the dollar, a small reward for all the effort and risk-taking that goes into developing and operating a successful business.

Nevertheless, it remains the real productive source of our nation's wealth, as well as that of each individual American.

Despite the growing influence of government over our lives, this system produces the food we eat, the goods we use, the clothes we wear, the homes we live in.

It is the source of five out of every six jobs in America, and it pays the taxes to provide most of the rest of the jobs in our all-too-rapidly expanding public sector.

It is the foundation for defense security for ourselves and most of the Free World.

It is the productive base that pays for government spending to aid the elderly, the jobless, the poor, the dependent and the disabled. Indeed, far from being the anti-human caricature painted by political demagogues, the American private sector is in reality the mightiest engine for social progress and individual improvement ever created.

In a nutshell, the values we live by -- all of the material and spiritual values that make our country unique and make us so proud to be Americans -- could not exist without the free enterprise system. Yet many people still fail to understand the crucial link between our economic and our political freedom. Destroy one, and the other will soon disappear.

If the prospect of seeing a system like ours go down the drain doesn't worry you, let me call you attention to a recent syndicated column by Charles Bartlett: "More than 10 years ago," Mr. Bartlett said, "Arthur Koestler wrote that a loss of incentive was ailing Britain far more than its loss of empire, and the glummest aspect of today's scene is the bowed spirit of a creative, courageous, ebullient people."

If that can happen to a nation that once was one of the proudest bastions of free enterprise, we are in no position to assume that it can't happen here.

Every generation hopes it will leave its children a better world. But there is no guarantee of endless prosperity in the United States any more than in any other country. Properity doesn't happen by accident. Tamper with its source and the shock is felt throughout our entire society.

And I am convinced that, today, the private sector -- indeed, our very society -- is enduring the greatest series of shocks and challenges since the 1930s. In my opinion the threat can be traced directly to the explosive growth in government and the ominous concentration of power on the Potomac. Today government spending at all levels accounts for some 38 percent of our gross national product.

If recent growth patterns continue, it will reach 60 percent before the end of this century.

It is my firm belief that any government that taxes away more than half of what people earn has robbed them of their economic freedom. And can there be any doubt that when our economic freedoms are destroyed, our personal and political freedoms will not long survive them?

The head of one of our major corporations says it's no longer just a challenge. In the New York Times' annual economic roundup last January, Richard Riley, the President of Firestone Tire and Rubber Company, was reported to have pronounced free enterprise already dead. I shudder to think how many other business leaders share in that counsel of despair. If they give up, who is left to uphold economic freedom?

Yet the same article quoted another executive as saying that unless something is done to halt "the systematic destruction by federal and state government of the ability to make profits, the word 'corporation' will be something to be studied... along with the buggy whip."

Now no one would seriously question the role of government in such areas as health and education. But the layer upon layer of regulations that government has piled on all aspects of the private sector, and its proliferation of programs and administrative devices has seriously hobbled the American businessman -- especially the small businessman, the very backbone of our free enterprise system. Every business in America, from the little shop around the corner to General Motors is being buried under a growing load of federal paperwork and requirements to the tune of $20 billion a year.

The men and women who run this country's businesses turn to many of you in your individual professional capacities. You work with them daily. Both you and they know there is justification for some of the charges lodged against their industries. Most of them recognize that they must put their own houses in order by correcting these faults. And most realize that failure to do so would surely contribute to the further underming of the system they profess to cherish.

But survival requires more than internal reform, and that is where you become so important.

Even the misinformed consumers who were studied in that survey by Opinion Research Corporation said they had no wish to destroy our free enterprise system. They said they still consider business a progressive force, but they would like to see it "cleaned up."

According to the same pollsters -- and here I quote: "The pressure is on coporations to overcome misconceptions about their activities while correcting abuses for which they are responsible."

Advertising, it seems to me, has its work cut out. It's a big job and a critical one. There is an urgent need for leadership in helping to restore the faith of the American people in their economic system, as well as in government, and I don't know of any group of professionals better qualified to do it than you.

It's been said that communications is the web holding civilization together -- the central nervous system of any organized society. It's also the only means of perpetuating the traditional values handed down by our forefathers which give our civilization stability and continuity.

Never has that function been more important than today. It is largely up to you to communicate the great story of freedom -- to dispel the confusion that has made free enterprise a dirty word; to let our lawmakers and leaders in government know they cannot let the system that generates our wealth, our strength, and our freedom be destroyed. If ever communication of the highest professional caliber was desperately needed, it is NOW; if ever there was an assignment that challenged your profession to the core, it is this one.

Too many in government have too long acted on its assumption that good economics is not good politics. We must show them the error of their way. We must make it politically attractive to support responsible economic policies. Our lawmakers must be convinced that this is what the public wants. For they know better than anyone that the public attitude of today is the public statute of tomorrow.

Given the facts about the very real threats to our economic system, I for one have no doubt about what the public's reaction will be. But the public must know them in order to act on them.

The people have a right to know how government restrictions are undermining individual and industry initiative. They must learn how our Government's tax and spending policies are sopping up capital needed for investment and the creation of jobs.

They must understand that runaway spending and unending deficits fuel inflation -- a silent thief that picks every American's pocket, undermines public confidence in the future and turns the desperate to government for still more illusory help.

In short, the job before you -- if you hope to preserve this system of ours -- is to convince both the public and its leaders in Washington that government just can't go on wringing the neck of that marvelous goose that lays those golden eggs.

The Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 964-2041

MEMORANDUM TO EDITORS April 2, 1976

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FROM: William F. Rhatican
Special Assistant to the Secretary
Public Affairs

The Department of the Treasury will reissue the two-dollar Federal Reserve Note this April 13. The new bill will be available at all savings and loans banks and Federal Reserve Banks on that date.

The front of the bill will feature an engraving of Thomas Jefferson, while the reverse of the bill will carry an engraving of "The Signing of the Declaration of Independence." By April 13, 225,000,000 of the new notes will be printed.

Public acceptance and frequent use is the key to success of any currency or coin issuance. While the issuance of the new two-dollar bill is connected with the nation's bicentennial, it is intended to be a permanent and practical part of our currency system and is not intended simply as a commemorative or special issue.

Following are suggestions, for your use, of how the reissuance of the two-dollar bill may be utilized in the creation of feature stories or photo features on the subject. Also enclosed is a press kit containing information on the new note, as released by the Treasury Department on November 3, 1975, at a press conference announcing the reissuance.

(1) Photo feature of local Federal Reserve Bank disbursing bills on first day of issue.

(2) Photo feature of local banks disbursing bills on first day of issue.

(3) Photo feature of citizens using the new bill in grocery stores, retail stores, etc.

(4) Story on cash-handlers in banks, stores, fast-food chains, etc. and their reactions to the new bill.

(5) Story on consumer reactions to new bill.

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(6) Story on local banks one week after release date on numbers of two-dollar bills moved.

(7) Story on local businesses one week after release date on numbers of new bills received.

(8) Story on history of new bill.

(9) Photo feature on bills being unloaded from armored trucks into banks.

(10) Story on currency distribution process.

(11) Photo feature with local bank officials and new bill day before issuance.

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FOR IMMEDIATE RELEASE March 31, 1976

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $3,200 million of 52-week Treasury bills to be dated April 6, 1976, and to mature April 5, 1977, were opened at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Price	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)
High -	94.196	5.740%	6.09%
Low -	94.143	5.793%	6.14%
Average -	94.155	5.781%	6.13%

Tenders at the low price were allotted 90%.

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Received	Accepted
Boston	$ 27,590,000	$ 17,090,000
New York	4,740,620,000	2,484,505,000
Philadelphia	49,440,000	28,940,000
Cleveland	131,130,000	99,630,000
Richmond	64,775,000	35,075,000
Atlanta	39,465,000	27,670,000
Chicago	419,270,000	169,420,000
St. Louis	41,055,000	16,055,000
Minneapolis	92,770,000	66,770,000
Kansas City	20,145,000	11,135,000
Dallas	24,845,000	21,645,000
San Francisco	393,455,000	223,840,000
TOTAL	$6,044,560,000	$3,201,775,000

The $3,201,775,000 of accepted tenders includes $ 114,920,000 of noncompetitive tenders from the public and $ 920,330,000 of tenders from Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities accepted at the average price.

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The Department of the TREASURY NEWS
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FOR IMMEDIATE RELEASE March 31, 1976

CUSTOMS-ATF EFFORTS CUTTING CARGO THEFT LOSSES, ASSISTANT SECRETARY DAVID MACDONALD REPORTS

Inroads against cargo thefts are being made by the U.S. Customs Service and the Bureau of Alcohol, Tobacco and Firearms, David Macdonald, Assistant Secretary of the Treasury for Enforcement, Operations, and Tariffs, disclosed today.

Both agencies, branches of the Treasury Department, participate in the National Cargo Security Program to reduce theft and pilferage from U.S. piers, terminals, and carriers.

Speaking at the National Cargo Security Conference in Washington, Macdonald reported progress both in ATF's Interstate Firearms Theft Project, initiated in 1973, and Customs' ongoing Cargo Security Program.

Through the voluntary cooperation of the U.S. trucking industry, ATF has received, to date, 1,794 reports of thefts or losses of firearms from interstate shipments involving approximately 12,250 firearms, Macdonald said.

Criminal action has been brought against 66 defendants, 29 of whom were trucking company employees.

The Customs Program Against Cargo Crime (C-PACC) made 247 seizures and 66 arrests during calendar year 1975, according to Macdonald.

Macdonald described Imported Merchandise Quality Control (IMQC), a second facet of Customs' three-part program, which determines the amount of cargo manifested, unladen, and delivered, and develops statistics to pinpoint specific piers, terminals or warehouses, and types of merchandise involved in thefts of cargo being imported into the country under U.S. Customs control.

The IMQC program accounted for 64 seizures for manifesting violations between July and November 1975, he said. These violations led to the assessment of nearly $3 million in penalties against carriers. Discrepancies detected between invoiced quantities entered and quantities actually landed subjected $14,132,830 worth of merchandise to seizure during calendar 1975.

Customs' program to educate and inform the cargo industry on crime prevention, Macdonald continued, has conducted more than 500 cargo security surveys of airport and marine terminals, warehouses, foreign-trade zones, and container stations since its inception in 1972.

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Department of the TREASURY
OFFICE OF REVENUE SHARING
WASHINGTON, D.C. 20226
NEWS
TELEPHONE 634-5248

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FOR IMMEDIATE RELEASE
FRIDAY, APRIL 2, 1976
CONTACT: PRISCILLA CRANE (202) 634-5248

The U.S. Treasury Department's Office of Revenue Sharing mailed 37,490 checks for $1.6 billion to units of State and local government today, in the 15th regular payment of general revenue sharing funds made since the program was authorized, in 1972.

Today's payment represents the third quarterly payment of funds allocated for Federal fiscal year 1976 (entitlement period six). The fourth and final quarterly checks for the current period will be issued at the end of the first week of July.

Including the amount distributed today, the Office of Revenue Sharing has returned $25.1 billion to nearly 39,000 States, counties, cities, towns, townships, Indian tribes and Alaskan native villages since the first checks were mailed in December 1972. A total of $30.2 billion will have been paid these governments when the currently authorized five-year program expires at the end of calendar year 1976.

The City of Chicago's revenue sharing payment was withheld today by the Office of Revenue Sharing, as required by Court order, due to a finding of discriminatory employment practices in Chicago's Police Department. Since January 1975, a total of

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$113.7 million has been withheld from the City of Chicago.

Approximately one million dollars also is being held for 514 local governments which have not reported their planned and actual uses of revenue sharing funds to the Office of Revenue Sharing. Use reports are required by section 121 of Title I of the State and Local Fiscal Assistance Act of 1972 (P.L. 92-512, revenue sharing law). The funds to which these governments are entitled will be paid when the reports have been received and accepted by the Office of Revenue Sharing.

The General Revenue Sharing Act will expire December 31, 1976, and final payments under the presently authorized program will be issued during the first week of January 1977. Legislation to continue the program is now being considered by the U. S. Congress.

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Contact: Richard B. Self
Extension 8256
March 31, 1976

FOR IMMEDIATE RELEASE

TREASURY ANNOUNCES
PRELIMINARY COUNTERVAILING DUTY
DECISION ON BONELESS BEEF
IMPORTS FROM EC COUNTRIES

Assistant Secretary of the Treasury David R. Macdonald announced today the initiation of investigation and preliminary determination under the Countervailing Duty Law (19 U.S.C. 1303) that bounties or grants are being paid or bestowed on imports of frozen boneless beef from Denmark, The Netherlands, West Germany, Italy, Belgium, Luxembourg, France, United Kingdom and Ireland. Notice to this effect will be published in the Federal Register of April 1, 1976. Interested parties will be given a period of seven days to present views regarding this action.

Information before the Treasury indicates that boneless beef is receiving bounties or grants in the form of export restitution payments under Common Agricultural Policy of the European Economic Community.

During 1975 imports of frozen boneless beef from EC countries were $3,635,000.

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The Department of the TREASURY NEWS
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FOR IMMEDIATE RELEASE

Contact: H. J. Hintgen
Extension 2427
March 31, 1976

FORMATION OF A TREASURY-FEDERAL RESERVE TASK FORCE
ESTABLISHED TO EXPAND THE BOOK-ENTRY PROGRAM
OF ISSUING GOVERNMENT SECURITIES

Secretary of the Treasury William E. Simon today announced the formation of a Treasury-Federal Reserve Task Force, established to expand the book-entry program of issuing Government securities. The Secretary commented that the expansion of the book-entry program over the past eight years has been most gratifying. At the end of February 1976, the amount of United States Treasury bills, notes and bonds in book-entry form reached a level of $299.1 billion or 79% of the total marketable debt.

Initiated in 1968, the book-entry procedure eliminates the issuance of engraved Treasury securities in favor of book-entries maintained at Federal Reserve Banks for the accounts of commercial banks which are members of the Federal Reserve System. The book-entry procedure is currently available to both individuals and institutions acting through such member banks. The book-entry procedure offers substantial benefits to investors, the financial community, and the Treasury. It reduces the burden of paperwork created by the mounting volume of public debt transactions; it protects against loss, theft, and counterfeiting; and it substantially reduces the cost of issuing, storing and delivering Treasury securities.

The Treasury-Federal Reserve Task Force will design and adopt an expanded book-entry system with the ultimate objective of completely eliminating the use of definitive securities in new public debt borrowings. During the course of this effort, the views and comments of the financial community and other interested parties will be solicited.

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